

LEVEL 3 COMMUNICATIONS INC

FORM 10-K (Annual Report)

Filed 02/27/09 for the Period Ending 12/31/08

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period from _____ to _____

Commission file number: 0-15658

Level 3 Communications, Inc.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

1025 Eldorado Boulevard, Broomfield, Colorado

(Address of principal executive offices)

80021-8869
(Zip code)

(720) 888-1000

(Registrant's telephone number including area code)

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

Common Stock, par value \$.01 per share

The NASDAQ Stock Market LLC

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

None

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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 Act). Yes No

As of June 30, 2008 the aggregate market value of common stock held by non-affiliates of the registrant approximated \$3.1 billion based upon the closing price of the common stock as reported on the NASDAQ Global Select Market as of the close of business on that date. Shares of common stock held by each executive officer and director and by each entity that owns 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

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

| <u>Title</u> | <u>Outstanding</u> |
|---|---------------------------------------|
| Common Stock, par value \$.01 per share | 1,621,291,204 as of February 25, 2009 |

DOCUMENTS INCORPORATED BY REFERENCE

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

Portions of the Company's Definitive Proxy Statement for the 2009 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K

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Unless the context otherwise requires, when we use the words "Level 3," "we," "us" or "our company" in this Form 10-K, we are referring to Level 3 Communications, Inc., a Delaware corporation, and its subsidiaries, unless it is clear from the context or expressly stated that these references are only to Level 3 Communications, Inc. In this Form 10-K, we may refer to our former subsidiary Software Spectrum, Inc. and its subsidiaries as "Software Spectrum."

The Level 3 logo and Level 3 are registered service marks of our wholly owned subsidiary, Level 3 Communications, LLC, in the United States and other countries. All rights are reserved. This Form 10-K refers to trade names and trademarks of other companies. The mention of these trade names and trademarks in this Form 10-K is made with due recognition of the rights of these companies and without any intent to misappropriate those names or marks. All other trade names and trademarks appearing in this Form 10-K are the property of their respective owners.

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

This Form 10-K contains forward-looking statements and information that are based on the beliefs of our management as well as assumptions made by and information currently available to us. When we use the words "anticipate", "believe", "plan", "estimate" and "expect" and similar expressions in this Form 10-K, as they relate to us or our management, we are intending to identify forward-looking statements. These statements reflect our current views 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, our actual results may vary materially from those described in this document. These forward-looking statements include, among others, statements concerning:

- our communications business, its advantages and our strategy for continuing to pursue our business;
- anticipated development and launch of new services in our business;
- anticipated dates on which we will begin providing certain services or reach specific milestones in the development and implementation of our business strategy;
- growth of the communications industry;
- expectations as to our future revenue, margins, expenses, cash flows and capital requirements; and
- other statements of expectations, beliefs, future plans and strategies, anticipated developments and other matters that are not historical facts.

These forward-looking statements are subject to risks and uncertainties, including financial, regulatory, environmental, industry growth and trend projections, that could cause actual events or results to differ materially from those expressed or implied by the statements. The most important factors that could prevent us from achieving our stated goals include, but are not limited to, the effects on our business and our customers of the current economic turmoil and the disruptions in the financial markets as well as our failure to:

- integrate acquisitions;
- increase the volume of traffic on our network;
- provide services that do not infringe the intellectual property and proprietary rights of others;
- successfully use new technology and information systems to support new and existing services;

- develop new services that meet customer demands and generate acceptable margins;
- attract and retain qualified management and other personnel; and
- meet all of the terms and conditions of our debt obligations.

Except as required by applicable law and regulations, we undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. Further disclosures that we make on related subjects in our additional filings with the SEC or Securities and Exchange Commission should be consulted. For further information regarding the risks and uncertainties that may affect our future results, please review the information set forth below under "ITEM 1A. RISK FACTORS."

Part I

ITEM 1. BUSINESS

Unless the context otherwise requires, when we use the words "Level 3," "we," "us" or "our company" in this Form 10-K, we are referring to Level 3 Communications, Inc., a Delaware corporation, and its subsidiaries, unless it is clear from the context or expressly stated that these references are only to Level 3 Communications, Inc. Throughout this Form 10-K we use various industry terms and abbreviations, which we have defined in the Glossary of Terms at the end of this description of our business.

Through our operating subsidiaries, we engage primarily in the communications business.

We are 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. We have created our communications network generally by constructing our own assets, but also through a combination of purchasing and leasing other companies and facilities. Our network is an advanced, international, facilities based communications network. We designed our network to provide communications services, which employ and take advantage of rapidly improving underlying optical, Internet Protocol, computing and storage technologies.

Market and Technology Opportunity. We believe that ongoing technology advances in both optical and Internet Protocol technologies have been revolutionizing the communications industry. We also believe that these advances have, and will continue to, facilitate decreases in unit costs for communications service providers that are able to most effectively take advantage of these technology advances. Service providers that can effectively take advantage of technology improvements and reduce unit costs will be able to offer lower prices, which, we believe, will stimulate substantial increases in the demand for communications services. We believe there are two primary factors that are continuing to drive this market dynamic:

- *Rapidly Improving Technologies.* Over the past few years, both Internet Protocol or IP and optical based networking technologies have undergone extremely rapid innovation, due, in large part, to market based development of underlying technologies. This rapid technology innovation has resulted in both an improvement in price-performance for optical and Internet Protocol systems, as well as rapid improvement in the functionality and applications supported by these technologies. For example, these improvements are enabling voice over IP services or VoIP that are challenging traditional telephone network or PSTN services. We believe that this rapid innovation will continue well into the future across a number of different aspects of the communications marketplace.
- *High Demand Elasticity.* We believe decreases in communications services costs and prices cause the development of new bandwidth-intensive applications, which, over time, result in even more significant increases in bandwidth demand. In addition, we believe that communications services are direct substitutes for other, existing modes of information distribution from sources such as

traditional broadcast entertainment as well as distribution of software, audio and video content using physical media delivered using motor transportation systems. An example of this dynamic is the use of the Internet for the distribution of video entertainment.

We believe that as communications services improve more rapidly than these alternative content distribution systems, significant demand will be generated from these sources of information. We also believe that high elasticity of demand from both these new applications and the substitution for existing distribution systems will continue for the foreseeable future. We believe that while high demand elasticity will be manifested over time, government regulation and communications supply chain inefficiencies may cause realization of demand to be delayed.

We also believe that there are significant implications that result from this market dynamic. These implications include the following:

- *Incorporating Technology Changes.* Given the rapid rate of improvement in optical and Internet Protocol technologies, communications service providers that are most effective at rapidly deploying new services that take advantage of these technologies will have an inherent cost and service advantage over companies that are less effective at deploying new services that use these technologies.
- *Controlling Local Facilities.* Given the consolidation in the number of local access providers—that is, the providers of connections from long distance and backbone networks to traffic aggregation points or end user locations—communications service providers that have ownership of local and/or metropolitan network facilities as opposed to communications service providers that obtain these facilities from others will have an inherent cost and service advantage over companies that do not have ownership over these types of assets.
- *Capital Intensity.* The rapid improvements in these technologies and the need to move to new technologies more quickly results in shortened economic lives of underlying assets. To achieve improvements in service capabilities and unit cost reductions, service providers will need to deploy new generations of technology sooner, resulting in a more capital-intensive business model. Those providers with the technical, operational and financial ability to take advantage of the rapid advancements in these technologies are expected to have higher absolute capital requirements, shortened asset lives, rapidly decreasing unit costs and prices, rapidly increasing unit demand and higher cash flows and profits.

Our Communications Business Strategy

We are seeking to capitalize on the opportunities presented by the expanded coverage of our communications network as well as the significant and rapid advancements in optical and Internet Protocol technologies. Key elements of our strategy include:

- *Offer a Comprehensive Range of Communications Services Over Our End-to-End Network.* We provide a comprehensive range of communications services designed to meet the needs of our customers over our network. Beginning in 2006, we expanded our targeted customer base to include enterprise or business customers through the acquisitions we completed during 2006 and early 2007.

Our communications service offerings include:

- Internet Protocol and data services—including (1) Internet access and IP and Ethernet Virtual Private Networks and (2) broadband transport services such as wavelengths, dark fiber and private line services (transoceanic, backhaul, intercity, metro and unprotected private line services);

- content distribution services including caching and downloading, streaming as well as video broadcast services;
- colocation services; and
- Softswitch and voice services—including wholesale VoIP component services, enterprise or business voice services, wholesale voice origination and termination services and managed modem for the dial-up access business.

The availability of these services varies by location.

For several years we have been developing services that take advantage of the investment that we have made in our network and that generally target large, existing markets for communications services. We have also expanded our existing markets for communications services through the acquisitions we completed in 2006 and early 2007 that enabled us to offer services directly to enterprise or business customers. Through these efforts we have increased significantly our addressable market by targeting new customers as well as new voice and data services that take advantage of the geographic coverage and cost advantages of our network.

With respect to our wholesale customers, we provide these customers with several options for accessing our intercity network—including our metropolitan networks and colocation facilities. Our metropolitan networks enable us to connect directly to points of high traffic aggregation. These traffic aggregation facilities are typically locations where our customers wish to interconnect with our intercity network. Our metropolitan networks allow us to extend our network services to these aggregation points at low costs. With respect to our enterprise customers, we provide these customers with access to our network either by directly connecting to their location or by serving that location with a connection from another communications services provider. As of December 31, 2008, we have:

- approximately 77,000 intercity route miles in North America and Europe, which we expect to reduce to approximately 52,000 intercity route miles after we complete the integration of acquired companies, connecting 22 countries;
- approximately 125 markets having metropolitan fiber networks containing approximately 27,000 route miles in the United States and Europe; and
- approximately 7,900 traffic aggregation points and buildings in the aggregate.

We believe that providing colocation services in facilities directly connected to our network attracts communications intensive customers by allowing us to offer those customers reduced bandwidth costs, rapid provisioning of additional bandwidth, interconnection with other third party networks and improved network performance.

Additionally, our metropolitan networks allow us to compete for certain local communications traffic, which constitutes a significant percentage of the communications market. As of December 31, 2008, we had secured approximately 6.9 million square feet of space for our Gateway and transmission facilities and other technical space and had completed the build-out of approximately 4.6 million square feet of this space.

- *Provide Low Cost Backbone Services Through An Upgradeable Backbone Network.* Many portions of our originally constructed intercity and metropolitan networks were designed to provide high quality communications services at a lower cost. As we continue to integrate our acquired operations, our network and business processes will seek to enable us to cost effectively deploy future generations of optical and IP networking components (both fiber and transmission electronics and optronics) and thereby expand capacity and reduce unit costs. In addition, our strategy is to maximize the use of open, non-proprietary interfaces in the design of our network

software and hardware. This approach is intended to provide us with the ability to purchase the most cost effective network equipment from multiple vendors and allow us to deploy new technology more rapidly and effectively.

- *Target Top Global Bandwidth Customers.* With respect to our wholesale service offerings, our primary distribution strategy is to use a national, direct sales force focused on high bandwidth usage businesses. These businesses include incumbent local exchange carriers, international carriers also known as PTTs, major internet service providers or ISPs, broadband cable television operators, wireless providers, major interexchange carriers, the U.S. government, voice service providers, system integrators and other businesses that purchase communications services in a manner that is consistent with these other customers. Providing communications services to many of these businesses is at the core of our market enabling strategy. We identify as wholesale customers those customers that purchase significant amounts of capacity to serve the needs of their customers or their internal needs.
- *Further Develop Existing Enterprise Customer Business.* With respect to our business markets customers, our primary distribution strategy is to use a locally based direct sales force to target business customers, state governments, higher education institutions and academic consortia with high demands for mission critical communications services. We also complement our direct sales force with an indirect sales channel of agent partners.
- *Develop Market Leading Content Distribution Service Offerings.* At December 31, 2008, we operated one of the largest Internet Protocol backbones in the world. In other words, we operate one of the largest networks over which Internet content is transported from content sources to third party owned access networks connected directly to end users. We continue to believe that one of the largest sources of future incremental demand for communications services will be derived from customers that are seeking to distribute their feature rich content or video online. To meet the needs of customers driving this growth, we are focused on refining our service offerings to provide a full portfolio of services to support content distribution, including high speed IP services, colocation, Content Delivery Network services and video acquisition. We believe that we are the only service provider that offers, owns and operates this portfolio of services on a broad scale, which provides a unique opportunity to offer customers flexible access, end to end solutions and/or building block services to meet their evolving needs.
- *Expand Metropolitan Network Coverage.* We expect to selectively extend the current reach of our existing metropolitan networks by opportunistically adding additional connections to buildings and other traffic aggregation points from these networks. These connections will enable us to reach additional potential customers and reduce our costs for the termination of our customers' communications traffic on other carriers' networks.
- *Pursue Acquisition Opportunities.* For a number of years, we have engaged in significant acquisition activities. In evaluating potential acquisition opportunities, among other criteria, we evaluate the potential acquisition according to the transaction's ability to generate positive cash flow from high credit quality customers. For these opportunities, we generally look for companies with recurring revenue that comes predominantly from services we already provide, in geographic areas that are already served, with customers that are consistent with our existing customer base. It is this group of acquisitions that generally also provide significant synergy opportunities as a result of overlapping network and service offerings.

As we seek to expand the addressable market for our services, we also evaluate opportunities that would expand our service capabilities. Transactions that would be included in this category would expand the geographic scope of our network or would provide capabilities for additional services or distribution channels. For these opportunities, we generally consider whether the targeted company's distribution strategy is consistent with our strategy and whether management

believes that the target's current and/or future revenues can be significantly increased and/or expenses can be significantly reduced as a result of a combination with our operations. Generally these acquisition opportunities will not provide the same level of synergy opportunity that the category of acquisitions described in the paragraph above provide to us.

- *Develop Advanced Operational Processes and Business Support Systems.* We have developed and continue to develop substantial and scalable operational processes and business support systems specifically designed to enable us to offer services efficiently to our targeted customers. We believe that over time these systems will reduce our operating costs, give our customers direct control over some of the services they buy from us and allow us to grow rapidly while minimizing redesign of our business support systems.
- *Attract and Motivate High Quality Employees.* We have developed programs designed to attract and retain employees with the technical and business skills necessary for our business. These programs include our long term incentive programs.

Our Strengths

We believe that the following strengths will assist us in implementing our strategy:

- *Experienced Management Team.* We have assembled a management team that we believe is well suited for our business objectives and strategy. Our senior management has substantial experience in leading the development, marketing and sale of communications services and in managing, designing and constructing metropolitan, intercity and international networks.
- *A Comprehensive Range of Communications Services.* We provide a comprehensive range of communications services designed to meet the needs of our customers over our network. Our communications service offerings include:
 - Internet Protocol and data services—including (1) Internet access and IP and Ethernet Virtual Private Networks and (2) broadband transport services such as wavelengths, dark fiber and private line services (transoceanic, backhaul, intercity, metro and unprotected private line services);
 - content distribution services including caching and downloading, streaming as well as video broadcast services;
 - colocation services; and
 - Softswitch and voice services—including wholesale VoIP component services, enterprise or business voice services, wholesale voice origination and termination services and managed modem for the dial-up access business.

The availability of these services varies by location.

For several years we have been developing services that take advantage of the investment that we have made in our network and that generally target large, existing markets for communications services. We have also expanded our existing markets for communications services through our acquisitions that enabled us to offer services directly to enterprise or business customers. Through these efforts we have increased significantly our addressable market by adding new targeted customers as well as new voice and data services that take advantage of the geographic coverage and cost advantages of our network.

- *Significant metropolitan network platform.* As of December 31, 2008, we have metropolitan fiber networks in approximately 125 markets in North America and Europe, which contain approximately 27,000 route miles and connect in the aggregate approximately 7,900 traffic aggregation points and buildings. Our metropolitan networks enable us to connect directly to

points of high traffic aggregation and customer locations and reduce our costs for the termination of our customers' communications traffic on other carriers' networks.

- *End-to-End Network Platform.* Our strategy has been and continues to be to deploy network infrastructure in major metropolitan areas and to link these networks with significant intercity and trans-oceanic networks in North America and Europe. We believe that the integration of our metropolitan and intercity networks with our colocation facilities will expand the scope and reach of our on-net customer coverage, facilitate the uniform deployment of technological innovations as we manage our future upgrade paths and allow us to grow or scale our service offerings rapidly. We believe that we are the only international communications service provider with the unique combination of:
 - a substantial intercity network;
 - large fiber count metropolitan networks;
 - substantial colocation facilities; and
 - innovative content distribution technology and services.
- *Advanced IP Backbone.* We operate one of the largest international IP networks or backbones. Our IP services deliver a broad range of IP transit and network interconnection solutions tailored to meet the varied needs of high bandwidth users.
- *Extensive Patent Portfolio.* Through acquisitions and through our own research and development, we have created an extensive patent portfolio, consisting of approximately 900 patents and patent applications filed in the United States and around the world. Our patent portfolio includes patents filed in each of the last three decades covering technologies ranging from data and voice services to content distribution to transmission and networking equipment. Most of our issued patents are not scheduled to expire for more than ten years. We have used our patent portfolio in a number of ways. First, developing or acquiring technologies and receiving the legal right to preclude others from using them may give us a competitive advantage. Second, the breadth and depth of our patent portfolio may deter others, particularly telecommunications operators, from bringing patent infringement claims against us for fear of counter-claim by us. We will continue to file new patent applications as we enhance and develop products and services, we will continue to seek opportunities to expand our patent portfolio through strategic acquisitions and licensing, and we will continue to appropriately enforce our patents against infringement by others.
- *Softswitch based Co-Carrier Network.* Our experience in operating our Softswitch based co-carrier network is combined with a set of infrastructure and other management experiences, which include extensive local interconnection with local exchange carriers, experience in scaling a Softswitch based platform, and an ability to provide seamless interconnection to the traditional telephone network or PSTN. We believe that our extensive co-carrier network and Softswitch infrastructure provides us with a competitive advantage in providing various voice over IP or VoIP services.
- *A More Readily Upgradeable Network Infrastructure.* With respect to a substantial portion of our network, the network was designed to take advantage of technological innovations, incorporating many of the features that are not present in older communication networks, and provide us flexibility to take advantage of future developments and innovations. We designed the transmission network to optimize aspects of fiber and optronics simultaneously as a system to deliver low unit cost to our customers. As fiber and optical transmission technology changes, we expect to realize new unit cost improvements by deploying more cost efficient technologies in our network. We believe that our network design will enable us to lower costs and prices while enjoying higher margins than our competitors.

Our Communications Services

Customer Focused Organization

We operate the customer interacting or customer facing aspects of our communications business in four groups. We believe that this structure enables us to focus more effectively on the needs of our customers. These four groups are:

- Wholesale Markets Group
- Business Markets Group
- Content Markets Group; and
- European Markets Group.

We believe this structure enables those employees in these customer facing roles to develop and deliver high quality communications services that are based on the needs of the customers that the group is seeking to serve. Each of these groups is supported by dedicated employees in sales and segment marketing. Each of the groups is also supported by centralized service or product management and development, general marketing, network services, engineering, information technology, and corporate functions including legal, finance, strategy and human resources. It is through the Wholesale Markets, Business Markets, Content Markets and European Markets groups that we offer our comprehensive range of communications services.

Wholesale Markets Group. The Wholesale Markets Group is focused on delivering communications services to meet the high bandwidth needs of many of the largest global communications services providers on a wholesale basis. The Wholesale Markets Group's customers typically integrate or package our services into their own products and services to offer voice, video and data services to their end-user customers and in some instances to satisfy their own internal needs.

The market segments that the Wholesale Markets Group addresses include:

- domestic and international carriers;
- voice service providers, which include calling card companies, conferencing providers, and contact centers that use VoIP technology to better manage costs and enable advanced applications;
- wireless providers;
- broadband cable television operators;
- system integrators; and
- the U.S. federal government.

Business Markets Group. The Business Markets Group is focused on delivering communications services to meet the telecommunications needs of: enterprises; higher education institutions and academic consortia; and state and local governments. We also focus on local and regional carriers, ISPs, enhanced service providers, application service providers, wireless providers, mobile virtual network operators, VoIP providers as well as datacenters and hosting facilities. The Business Markets Group focuses on providing its targeted customers with the full suite of Internet Protocol and data services, colocation and voice services.

Content Markets Group. As we believe that one of the largest sources of future incremental demand for communications services will be derived from customers that are seeking to distribute their feature rich content or video over the Internet, the Content Markets Group focuses on offering solutions ranging from end-to-end communications services to individual building block services to meet

the content distribution needs of its customers. Customers that the Content Markets Group serves include:

- video distribution companies;
- providers of online gaming;
- software distributors;
- portal and search providers;
- social networking providers; and
- traditional media distribution companies including broadcasters, television networks and sports leagues.

European Markets Group. The European Markets Group focuses on the communications needs of European customers and services in Europe for customers located outside of Europe. The European Markets Group's target customers are similar to the target customers of the Wholesale Markets Group and the Content Markets Group.

Service Offerings

We offer a comprehensive range of communications services, which currently include the following services. All of these services are available to customers of each of the customer facing groups, however their availability varies by location. The following is an overview description of some of the services that we offer.

- *Network and Internet Services.* We offer both wholesale-oriented communications services to enable large scale networks and high speed access to the Internet as well as similar services designed for the enterprise marketplace. We offer a portfolio of data communications services ranging from basic network infrastructure components such as dark fiber, wavelength, and private line services to higher level routed data services such as Ethernet, Internet Transit and IP VPN. Our Network and Internet Services include the following.
 - *Transport Services.* Transport services include wavelengths (Level 3 Intercity Wavelength Services and Level 3 Metro Wavelength Services) and private lines (Level 3 Intercity Private Line Services and Level 3 Metro Services). These services are available across our metropolitan and intercity fiber network. Wavelength services provide unprotected point-to-point connections of a fixed amount of bandwidth with Ethernet or SONET interfaces. Wavelength services are available at 2.5 Gbps and 10 Gbps speeds, which represent the largest capacity of dedicated transport services. This service offering targets customers that require significant amounts of bandwidth, desire more direct control and provide their own network management. Private line services are also point-to-point connections of dedicated bandwidth but usually include SONET or SDH protection to provide resiliency to fiber or equipment outages. Private line services are available in a range of speeds. Level 3 also offers Metro and Intercity Ethernet Private Line Services with Fast-E and Gig-E interfaces. Customers generally use our transport services to create their own SONET/SDH, ATM and IP networks. We typically offer transport services in annual or multi-year contracts with monthly payments, or in long-term pre-paid agreements.

Level 3 also provides transport services within our transatlantic cable system connecting North America and Europe as well as via leased bulk capacity on other transoceanic systems. "International Backhaul" transport services, interconnecting cable landing stations and the terrestrial North American and European networks, are also available.

- *High Speed Internet Protocol (IP) Service.* Level 3 operates one of the largest international Internet backbones providing connectivity among customer IP, content and application networks. Built largely on our own intercity and metropolitan networks in North America and Europe, we provide customers with high performance, reliability and scalability. Access to the Internet is enabled through interconnection among our customers across our network as well as interconnections with other Internet service provider "peers."
- *Dedicated Internet Access.* Dedicated Internet Access, or DIA, is Level 3's Enterprise focused Internet access product leveraging the same core Internet backbone as our other Internet Services. Level 3 operates one of the largest international Internet backbones in the world and is regularly considered one of the most connected Internet networks. Level 3's Dedicated Internet Access service provides Internet connectivity over a Tier One Internet backbone through a wide variety of access methods and speeds. The service also includes Domain Name services, primary, secondary and caching and is available as either a stand-alone service or as a complement to our other communications services.
- *VPN Services.* Built on our optical transport and MPLS networks, we offer customers the ability to create private point-to-point, point-to-multipoint, and full-mesh networks based on IP VPN, Virtual Private LAN Service, or VPLS, ATM and Frame Relay technologies. These services allow service providers, corporations, government entities, and distribution businesses to replace multiple networks with a single, cost-effective solution that simplifies the transmission of voice, video, and data over a single or converged network. The service allows the customer to achieve this convergence without sacrificing the quality of service or security levels of traditional dedicated transport offerings. These solutions are used for service provider and corporate data and voice networks, data center networking, disaster recovery and out-of-region or redundant customer connectivity for other service providers.
- *Dark Fiber Service.* Level 3 Intercity Dark Fiber and Level 3 Metro Dark Fiber provide carriers, service providers, government entities and large enterprises a complete infrastructure when a fiber solution is required based on unique applications, control or scale requirements. The services include fiber, colocation space in our Gateway and in our network facilities, power and physical operations and maintenance of the fiber and associated infrastructure.
- *Colocation Service.* We offer high quality, data center space where customers can locate servers, content storage devices and communications network equipment in a safe and secure technical operating environment. At our colocation sites, we offer high-speed, reliable connectivity to our network and to other networks, including metro and intercity networks, the traditional telephone network and the Internet.
- *Content Distribution.* Our primary Content Distribution products and services include the following.
 - *Content Delivery Network.* Our content delivery network services combine our IP network, gateway facilities and patented technology that directs a requestor or end user to the best location or server cluster in our network to retrieve the requested content based on location and network conditions. Our CDN services provide customers with improved performance, economics, scalability, reliability and reach for their web applications. Our Caching and Download Services provide efficient http delivery of large files such as video, software, security patches, audio and graphics to mass audiences. Our Streaming Services can be used to deliver high performance streams, either live or on-demand, to end users using leading proprietary protocols. Each service set provides a set of flexible features to enable customers to control their content delivery to ensure quality end-user experience, security, freshness and targeting. We also offer storage solutions enabling customers to upload and

store content to our network as part of an optimized delivery platform. In addition to our delivery services, our patented Intelligent Traffic Management service enables customers to set rules to dynamically route traffic to meet failover or dual vendor objectives.

- *Media Delivery Services.* We also offer media delivery services to customers seeking to manage, protect and monetize content delivered over the internet. Media Delivery Services extend support for online distribution models and operation by providing customers with means to ingest and digitize live video content and to manage the organization and presentation of both live and on demand video to end users via a content management system. Additionally, support for content monetization via paid and advertising supported models is provided. Media Delivery Services leverage our Content Delivery Network for the delivery of managed content to end users.
- *Fiber Optic and Satellite Video Transport Services.* We offer various services to provide audio and video feeds over fiber or satellite for broadcast and production customers. These services vary in capacity provided, frequency of use (that is, may be provided on an occasional or dedicated basis) and price. In 2009, Super Bowl XLIII® marked the 20th consecutive year that the NFL used these services, and the five year anniversary of the first live broadcast event ever carried using our new high definition (HD) transport service offering. We also offer encoding services to translate the broadcast video feeds we carry for our customers into formats for Internet distribution.
- *Switched Services.* We pioneered and developed the Softswitch—a distributed computer system that emulates the functions performed by traditional circuit switches—which enables us to control and process voice and data calls over an Internet Protocol network. We also offer several traditional circuit switch-based voice services. Our Switched Services include the following.
 - *Level 3 VoIP Enhanced Local.* Level 3 VoIP Enhanced Local is a VoIP solution that enables broadband cable operators, IXCs, voice over IP providers, and other companies operating their own switching infrastructure to launch IP-based local and long-distance voice to residential and business customers via any broadband connection. With the purchase of Level 3 VoIP Enhanced Local service, a customer obtains the essential building blocks required to offer residential or business voice over IP phone service such as local phone numbers, local number portability, local and long distance calling, E-911, operator assistance, directory listings, and directory assistance.
 - *Level 3 Local Inbound.* Level 3 Local Inbound service terminates traditional telephone network originated calls to Internet Protocol termination points. Customers, such as call centers, conferencing providers, and voice over IP service providers, can obtain telephone numbers from us or port-in local telephone numbers that the customer already controls. These local calls are then converted to IP and transported over our backbone to a customer's IP voice application at a customer-selected IP voice end point.
 - *Level 3 E-911 Direct.* Level 3 E-911 Direct is a portfolio of Enhanced 911 solutions, including a fixed-location solution with network connections to public safety answering points or PSAPs that serve approximately 80 percent of all U.S. households, and a solution for nomadic voice over IP providers that takes advantage of the same network connections as the fixed-location solution. A nomadic voice over IP provider is a company that permits its end user customer to use VoIP services from more than one location. When used with the services provided by a third party VoIP Positioning Center, or VPC, to collect, update and report subscriber location information, our Level 3 E-911 Direct service enables VoIP service providers to supply 911 services to their subscribers.

- *Level 3 One Plus.* Level 3 One Plus service provides non-facilities-based resellers, or carriers with regional networks, the ability to originate long distance calls from anywhere in the continental US. Level 3 then terminates the domestic, international and Operator Services calls over our network or customers may choose to have calls handed back to them over a dedicated facility. This service suite features Automatic Number Identification (ANI)-based and Carrier Identification Code (CIC)-based services.
- *Level 3 Enterprise Local and Long Distance Voice Services.* Level 3 Enterprise Local Voice Services provide PSTN connectivity for customer telephone equipment; telephone numbers, which include associated directory listings; standard services, which include operator services, directory assistance, and 911 services; and long-distance access, which provides equal access to all long-distance carriers, including Level 3. Level 3 Enterprise Long Distance services offer intrastate and interstate voice service at simple, cost-effective rates as well as access to over 290 international locations.
- *Level 3 Enterprise Toll-Free Services.* Level 3 Enterprise Toll-Free Services offer customers the ability to receive and pay for inbound calls, rather than those calls being paid for by the call originator. Additionally, a number of routing and call information features are available.
- *Level 3 Voice Termination.* Level 3 Voice Termination consists of local and long distance transport and termination services, offered over circuit switch or Softswitch technologies. These services are offered primarily to inter-exchange carriers, or IXCs, wireless providers, local phone companies, cable companies and voice over IP providers. We also offer the termination of international voice traffic over circuit switch or Softswitch technologies. Customers for these services include local phone companies, wireless providers, cable companies and voice over IP providers.
- *Level 3 Toll Free.* Level 3 Toll Free consists of wholesale services that terminate toll free calls that are originated on the traditional telephone network. These toll free calls are carried over either a circuit switch or Softswitch network and delivered to customers in Internet Protocol or traditional TDM format. Customers for these services include call centers, conferencing providers, and voice over IP providers.
- *Level 3 Managed Modem.* Level 3 Managed Modem is an outsourced, turn-key infrastructure solution for the management of dial up access to the public Internet. ISPs comprise a majority of the customer base for Level 3 Managed Modem and are provided a fully managed dial up network infrastructure. As part of this service, Level 3 arranges for the provision of local network coverage, dedicated local telephone numbers, racks and modems as well as dedicated connectivity from the customer's location to the Level 3 Gateway facility.

For a discussion of certain geographic information regarding our revenue from external customers and long-lived assets, please see the notes to our Consolidated Financial Statements appearing elsewhere in this Form 10-K. For a discussion of our communications revenue, please also see Management's Discussion and Analysis of Financial Condition and Results of Operations appearing later in this Form 10-K. Our management continues to review our existing lines of business and service offerings to determine how those lines of business and service offerings assist with our focus on the delivery of communications services and meeting our financial objectives. This exercise takes place both with respect to integration activities and in the ordinary course of our business. To the extent that certain lines of business or service offerings are not considered to be compatible with the delivery of communications services or with obtaining our financial objectives, we may exit those lines of business or stop offering those services in part or in whole.

Our communications network

Our network is an advanced, international, facilities based communications network. Today, we primarily provide services over our own facilities. At December 31, 2008, our network encompasses:

- approximately 67,000 intercity route miles in North America, which we expect to reduce to approximately 42,000 intercity route miles after we complete the integration of acquired companies;
- an intercity network covering approximately 10,000 miles across Europe;
- approximately 125 markets having metropolitan fiber networks containing approximately 27,000 route miles in the United States and Europe, connecting approximately 7,900 traffic aggregation points and buildings in the aggregate;
- approximately 145 markets in service in North American and approximately 45 markets in service in Europe;
- approximately 6.9 million square feet of Gateway and transmission facilities in North America and Europe; and
- substantial transoceanic cable system capacity, primarily across the Atlantic ocean.

Intercity Networks. Our approximately 67,000 mile fiber optic intercity network in North America, which we expect will be approximately 42,000 miles after we complete our integration of acquired companies, consists of the following:

- **Multiple conduits.** In approximately 30,000 miles of our intercity network, we have installed groups of multiple conduits. We believe that the availability of spare conduit will allow us to deploy future technological innovations in optical networking components as well as providing us with the flexibility to offer conduit to other entities.

Initial installation of optical fiber strands designed to accommodate dense wave division multiplexing transmission technology. In addition, we believe that the installation of newer optical fibers will allow a combination of greater wavelengths of light per strand, higher transmission speeds and longer physical spacing between network electronics. We also believe that each new generation of optical fiber will allow increases in the performance of these network design aspects and will therefore enable lower unit costs.

- **High speed Intercity Dense Wave Division Multiplexing, or DWDM,** equipment providing high quality, reliable and cost effective transmission across our fiber backbone. We are continually evaluating advancements in technology that will enable us to scale, lower our cost and provide higher speed services over our intercity network. We believe that the market will continue to move toward Ethernet based services and higher speed interfaces. Through our technology evaluations we believe that we have positioned ourselves to be able to deliver these capabilities for both our own IP network needs as well as those of our customers.
- A design that maximizes the use of open, non-proprietary hardware and software interfaces to allow less costly upgrades as hardware and software technology improves.

During the first quarter of 2001, we completed our initial construction activities relating to our North American intercity network. Also during 2001, we completed the migration of customer traffic from our original leased capacity network to our completed North America intercity network. Deployment of the North American intercity network was accomplished through simultaneous construction efforts in multiple locations, with different portions being completed at different times. In 2003, we added approximately 2,985 miles to our North America intercity network as part of the Genuity transaction, and in 2005, we added approximately 30,000 miles (including IRUs) to our

intercity network as part of the WilTel Communications transaction. In 2006 and January 2007, we added approximately 26,000 miles (including IRUs) to our North America intercity network as part of the various acquisitions during that period.

In Europe, we have completed construction of our fiber optic intercity network with characteristics similar to those of the North American intercity network in a multiple ring architecture. During 2000, we completed the construction of Ring 1 of our European network. Ring 1, which is approximately 1,900 miles, connects the major European cities of Paris, Frankfurt, Amsterdam, Brussels and London and was operational at December 31, 2000. Also in 2000, we acquired multiple conduits from another operator, configured in a ring in Germany which we call Ring 2. Ring 2, which is approximately 1,650 miles, connects the major German cities of Berlin, Dusseldorf, Frankfurt, Hamburg, and Munich. Ring 2 became operational during the first quarter of 2001. Subsequently, we created four additional fiber based rings generally through IRU acquisitions from other operators to connect our expanded operations in Europe that are described below and to add additional markets to the network. The first additional ring, added in 2006, is approximately 2,150 miles and connects Copenhagen, Stockholm and Oslo and the second additional ring is approximately 1,700 miles and connects Milan, Zurich and Geneva. The third additional ring, added in 2007, covers Central and Eastern Europe, and is approximately 1,500 miles connecting markets such as Prague, Vienna and Budapest. The fourth additional ring is approximately 1,900 miles and connects Barcelona, Madrid and Paris.

During 2002, we completed an expansion of our European operations to six additional cities. Our expansion to these additional locations was facilitated through the acquisition of available capacity from other carriers in the region. During 2003, we completed an expansion of our European operations to five additional cities. In addition, during 2004, we completed an expansion of our European operations to two cities. During 2005, we completed an expansion of our European operations to one city. During 2006, we obtained dark fiber primarily in those cities currently served by leased wavelength capacity and additionally in 2006 we completed an expansion of our European operations to 9 additional cities. During 2007, we obtained dark fiber in three cities that had been served by leased wavelength capacity and additionally in 2007 we completed an expansion of our European operations to 10 additional cities. The dark fiber combined with appropriate transmission equipment enables us to sell a full suite of transport and IP services in these markets. In 2008, we continued our European expansion to two additional cities using leased wavelength capacity. We expect to continue our expansion in 2009 to one or two additional cities.

Our European network is linked to our North American intercity network by leased capacity and by the Level 3 transatlantic cable system, which was completed and placed into service during 2000 and originally had a design capacity of 1.28 Tbps. The deployment of the system—which we refer to as the Yellow system—was completed pursuant to a co-build agreement announced in February 2000, whereby Global Crossing Ltd. participated in the construction of, and obtained a 50% ownership interest in the Yellow system. Under the co-build agreement, Level 3 and Global Crossing Ltd. each now separately own two of the four fiber pairs on the Yellow system. The Yellow system was recently upgraded and our two fiber pairs have a current capacity of 550 Gbps and we believe has a theoretical upgrade capacity to 1.8 Tbps assuming both fiber pairs are fully upgraded.

We also acquired additional capacity on Global Crossing Ltd.'s transatlantic cable, Atlantic Crossing 1, during 2000 to serve as redundant capacity for our fiber pairs on the Yellow system. We also own capacity in the TAT14 cable system. In connection with the WilTel acquisition, we have secured additional capacity on Atlantic Crossing 1 and on TAT-14. In 2006, we purchased 300 Gigabits of transatlantic capacity with the right to purchase 300 Gigabits of additional optional capacity from Apollo Submarine Cable System Ltd. In January 2007 we purchased 150 Gigabits of the additional optional capacity available from Apollo Submarine Cable System Ltd, 150 Gigabits in May 2007 and an additional 100 Gigabits in November 2007. We are also an owner on the Japan-US, and China-US cable systems, an IRU holder on Southern Cross cable system as well as an owner on the Americas II

cable and an IRU holder on the Arcos system. We also own capacity on the Reliance-Globacom transatlantic system Flag Atlantic-1 and capacity on the Hibernia transatlantic cable system.

Local Market Infrastructure. Our local facilities include fiber optic metropolitan networks connecting our intercity network and Gateways to buildings housing communications-intensive end users and traffic aggregation points—including ILEC and CLEC central offices, long distance carrier points-of-presence or POPs, cable head-ends, wireless providers' facilities and Internet peering and transit facilities. As of December 31, 2008, we had in the aggregate approximately 7,900 traffic aggregation points and buildings connected to our metropolitan networks. Our high fiber count metropolitan networks allow us to extend our services directly to our customers' locations at low costs, because the availability of this network infrastructure does not require extensive multiplexing equipment to reach a customer location, which is required in ordinary fiber constrained metropolitan networks.

We had secured approximately 6.9 million square feet of space for our Gateway and transmission facilities as of December 31, 2008, and had completed the buildout of approximately 4.6 million square feet of this space. Our initial Gateway facilities were designed to house local sales staff, operational staff, our transmission and Internet Protocol routing and Softswitch facilities and technical space to accommodate colocation services—that is, the colocation of equipment by high-volume Level 3 customers, in an environmentally controlled, secure site with direct access to Level 3's network generally through dual, fault tolerant connections. As a result of our acquisitions, some of our facilities are larger than our initial facilities and were designed to include a smaller percentage of total square feet for our transmission and Internet Protocol routing/Softswitch facilities and a larger percentage of total square feet to support the sale of colocation services. Availability of these services varies by location.

As of December 31, 2008, we had operational, facilities-based, local metropolitan networks in 116 U.S. markets and 9 European markets.

As of December 31, 2008, we also had approximately 145 markets in service in North America and approximately 45 markets in service in Europe.

Our Patent Portfolio

Through acquisitions and through our own research and development, we have created an extensive patent portfolio, consisting of approximately 900 patents and patent applications filed in the United States and around the world. Our patent portfolio includes patents filed in each of the last three decades covering technologies ranging from data and voice services to content distribution to transmission and networking equipment. Most of our issued patents are not scheduled to expire for more than ten years.

In addition to the patents and patent applications we own, we have received licenses to patents held by others, including through a cross-license with IBM, giving us access to technology covered by IBM's approximately 40,000 patents covering many technologies relevant to our business. While patents give us the right to prevent others, particularly competitors, from using our proprietary technologies, patent licenses give us the freedom to operate our business without the risk of interruption from the holder of the patent that has been licensed to us.

We have used our patent portfolio in a number of ways. First, developing or acquiring technologies and receiving the legal right to preclude others from using them may give us a competitive advantage. Second, the breadth and depth of our patent portfolio may deter others, particularly telecommunications operators, from bringing patent infringement claims against us for fear of counter-claim by us. There have been relatively few patent infringement suits brought against us to date. Most of those have been initiated by patent-holding companies who do not operate telecommunications

businesses and who are less likely to be subject to a counter-claim of infringement by us. Finally, the extensiveness of our patent portfolio gives us the option to cross-license with others having similarly broad portfolios on terms acceptable to us, mitigating the risk that others will wish to assert patent infringement claims against us.

We will continue to file new patent applications as we enhance and develop products and services, we will continue to seek opportunities to expand our patent portfolio through strategic acquisitions and licensing, and we will continue to appropriately enforce our patents against infringement by others.

Our Content Delivery Network

Content Delivery Network, or CDN, describes a system of computers networked together across the Internet to provide content to users in the most efficient manner to enable an optimal user experience. In a CDN, nodes or groups of computers are deployed in multiple locations closer to the end user, also known as the "edge of the network" and cooperate with each other to satisfy requests for content by end users, transparently moving content behind the scenes to optimize the delivery process. Requests for content are directed intelligently through sophisticated software applications to nodes that provide optimal performance for end users.

Our content delivery network is a unique configuration of our hosting and network assets located in approximately 17 countries, which is designed to improve the performance, reliability, and reach of web applications.

We believe that as a result of the combination of our CDN assets and our other network infrastructure, we are strongly positioned to grow our market share in the CDN business. This belief is based on several factors.

- *Network Scale.* Because we own our own network, our ability to increase capacity to meet the needs of content providers is greater than other CDN providers who do not have the flexibility to quickly increase their available network capacity.
- *Network Reach.* Our customers' content reaches global Internet destinations using an average number of "hops" that are fewer than with most other providers, enabling our customers to easily reach their audiences and provide better performance. The fewer number of hops required to reach Internet destinations serves to reduce latency and jitter.
- *Low Cost Position.* Because we own much of the underlying network infrastructure, we believe that we are positioned to offer cost advantages to our customers. By moving content at scale, our customers can take advantage of lower unit costs for bandwidth, colocation, servers and disk space.

CDN Applications

There are an increasing number of applications for CDN, across many types of customers, particularly Internet-centric businesses and businesses that desire to accommodate increasingly larger file sizes for transmission over the Internet. The media and entertainment industries use CDN services to provide on-demand streaming and live streaming. Social Networking businesses require CDN to provide their customers with fast reliable music and video downloads. Likewise, through the use of CDN, software companies are able to provide software downloads for their customers. Online retailers and advertisers use CDN services to provide images and to download advertisements. Online gaming companies provide for game downloads, applications updates and delivery of demos and trailers through CDN.

Content Distribution Services Architecture

The CDN platform uses our existing physical network and infrastructure, and is composed of the Edge server or computer, which provides caching and streaming functions and the Global server, which provides load balancing—that is, a computer that directs the traffic to the most efficient server to meet the end user's request. The Edge server enables the storage of popular content in a location that is closer to the end user and thereby reduces bandwidth requirements and improves response times for content stored in the cache. The Global server or computer load balancing components of the CDN directs end user requests to the content source that is best able to serve the request of the particular end user, such as routing to the service node that is closest to the end user or to the one with enough capacity to service the request of the end user.

We also transmit audio and video programming for our customers over our fiber-optic network and via satellite. We use our network to carry many live traditional broadcast and cable television events from the site of the event to the network control centers of the broadcasters of the event. These events include live sporting events of the major professional sports leagues. For live events where the location is not known in advance, such as breaking news stories in remote locations, we provide an integrated satellite and fiber-optic network based service to transmit the content to our customers. Most of our customers for these services contract for the service on an event-by-event basis; however, we have some customers who have purchased a dedicated point-to-point service, which enables these customers to transmit programming at any time.

Distribution Strategy

Our communications services sales strategy with respect to our Wholesale Markets Group and Europe is to utilize a direct sales force focused on companies with high bandwidth and/or voice requirements. These businesses include incumbent local exchange carriers, established next generation carriers, international carriers also known as PTTs, major ISPs, broadband cable television operators, major interexchange carriers, wireless carriers, systems integrators, governments, emerging VoIP service providers, calling card providers, conferencing providers and call centers.

With respect to our Business Markets Group, medium to large enterprises will be serviced by a field based direct sales force. Smaller business opportunities are serviced by an inside sales force generally selling pre-defined bundles of services. We also complement our direct sales force with an indirect sales channel of agent partners.

Our communications services sales strategy with respect to the Content Markets Group is also to utilize a direct sales force. Targeted customers include video distribution companies; providers of online gaming and mega-portals; software service providers; social networking providers; and traditional media distribution companies including broadcasters, television networks and sports leagues.

We have in place policies and procedures to review the financial condition of potential and existing customers. We apply these procedures to determine whether collectability of services billed is probable prior to the time that we begin delivering services to a customer. If the financial condition of an existing customer deteriorates to a point where payment for services is in doubt, we will not recognize revenue attributable to that customer until we receive cash. Based on these policies and procedures, we believe our exposure to collection risk within the communications business and the possible effect on our financial statements is limited. We may also experience the effects of the downturns in the economy and specifically the telecommunications industry; however, we believe the concentration of credit risk with respect to receivables is mitigated due to the dispersion of our customer base among geographic areas and remedies provided by terms of contracts and by law.

For the year ended December 31, 2008, our top ten customers represented approximately 31% of our consolidated total revenue. Revenue from our largest customer, AT&T Inc. and its subsidiaries,

represented approximately 12% of our consolidated total revenue for 2008. The next largest customer accounted for approximately 5% of our consolidated total revenue and most of the remaining top ten customers each account for 3% or less of our consolidated total revenue.

In connection with the acquisition of WilTel in December 2005, we acquired a large customer contract between WilTel and SBC Communications, a subsidiary of AT&T. We expect that the revenue generated under this contract will continue to decline over time as SBC Communications migrates its traffic from our network to the merged SBC and AT&T Communications network that SBC Communications acquired from the former AT&T.

Business Support Systems

In order to pursue our sales and distribution strategies, we have developed and are continuing to develop and implement a set of integrated software applications designed to automate our operational processes. These development activities also relate to the integration of the systems that were used by the companies that we have acquired. Through the development of a robust, scalable business support system, we believe that we have the opportunity to develop a competitive advantage relative to traditional telecommunications companies. In addition, we recognize that for the success of certain of our services that some of our business support systems will need to be easily accessible and usable directly by our customers.

We are currently deploying a unified set of simplified processes and systems that are streamlining and synchronizing our service, sales, and operational functions through our "Unity" platform. Unity has been designed to provide improved capability in service catalog management, sales opportunity management, customer management, quoting, order entry, order workflow, physical and logical network inventory management, service management, and financial management. We completed the foundation of our Unity platform processes and systems development objectives at the end of 2008 and we are now focused on operational efficiency improvements and data integrity and migration.

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

- integrated modular applications to allow us to upgrade specific applications as new services are available;
- a scalable architecture that allows our customers and distributors direct access to certain functions that would otherwise have to be performed by our employees;
- phased completion of software releases designed to allow us to test functionality on an incremental basis;
- "web-enabled" applications so that on-line access to order entry, network operations, billing, and customer care functions is available to all authorized users, including our customers;
- use of a tiered, client/server architecture that is designed to separate data and applications, and is expected to enable continued improvement of software functionality at minimum cost; and
- use of pre-developed or commercial "off-the-shelf" applications, where applicable, which will interface to our internally developed applications.

Our Employees

As of December 31, 2008, we had approximately 5,300 employees. We believe that our success depends in large part on our ability to attract and retain substantial numbers of qualified employees.

Competition

The communications industry is highly competitive. A number of factors in recent years have increased the number of competitors in the market. First, the Telecommunications Act of 1996 created opportunities for non-incumbent providers to enter the marketplace. Second, the capital markets responded by making funding more available to new and existing competitors. Third, enthusiasm over the opportunities created by the rapid developments of the Internet led investors and market participants in general to overestimate the rate at which demand for communications services would grow. Finally, the emergence of new IP-based services has created prospects for new entrants with non-traditional business models to compete with legacy providers.

We believe that a confluence of these factors created an unsustainable level of competition in the market. We believe that this was evidenced by both the number of competitors vying for similar business and by the amount of inventory or capacity each brought to the market for many services. The result of these actions was an oversupply of capacity and an intensely competitive environment.

While we believe the current industry structure has improved significantly, we believe that further restructuring is likely. With the growth of communications demand, excess capacity is increasingly being absorbed. Similarly, some form of industry consolidation will continue to occur based on underlying economics. Given the large ongoing fixed costs associated with operating a backbone network, we believe that the natural industry structure will continue to evolve to a more limited number of competitors with each having high traffic scale across their networks.

While we believe that the long-run industry structure will evolve toward that described above, uncertainty surrounds how the existing competitive landscape will evolve toward this new structure. For example, while a number of next-generation and incumbent providers have been consolidated, we believe there are still a number of competitors operating fundamentally poor business models, are resource constrained, and are unlikely to be long-term survivors in their current forms. In addition, while the completed acquisition transactions by AT&T and Verizon have given those companies greater scale and product breadth, the ultimate effect of these transactions on the industry structure is yet to be known.

We believe that each competitor's long-run success in the market will be driven by its available resources (for example, financial, personnel, marketing, customers) and the effectiveness of its business model (for example, service focus and mix, cost effectiveness, ability to adapt to new technologies, channel effectiveness). We recognize that many of our existing and potential competitors in the communications industry have resources significantly greater than ours.

In the short term, the current economic environment may put increased pressure on competitors that lack a strong financial position, and as a result competition may become more intense as these competitors seek to win business in a slower market.

Our primary competitors are long distance carriers, incumbent local exchange carriers, competitive local exchange carriers, PTTs, Content Delivery Network companies, and other companies that provide communications services. The following information identifies some key competitors for each of our product offerings.

Our key competitors for our voice service offerings are other providers of wholesale communications services including AT&T, Verizon, Qwest, Global Crossing and competitive local exchange carriers. Our key competitors for managed modem services are other providers of dial up Internet access including AT&T, Verizon and PAETEC Communications.

For our IP and Data services, we compete with companies that include Verizon, AT&T, Global Crossing and Cogent in North America, and TeliaSonera, Global Crossing and Cogent in Europe.

For transport services, our key competitors in the United States are other facilities based communications companies including AT&T, Verizon, Qwest, tw telecom and XO. In Europe, our key competitors are other carriers such as PTTs, Telia International, Colt, KPN, Belgacom and Global Crossing.

Our key competitors for our colocation services are other facilities based communications companies, and other colocation providers such as web hosting companies and third party colocation companies. In the United States, these companies include Equinix, Savvis, Switch & Data and Internap. In Europe, competitors include Equinix, Global Switch, InterXion, Telecitec and Telehouse Europe.

In the enterprise market, our key competitors include incumbent local exchange carriers (such as AT&T, Verizon and Qwest and competitive local exchange carriers.

For content distribution network or CDN services, our key competitors include Akamai Technologies and Limelight Networks.

The communications industry is subject to rapid and significant changes in technology. For instance, recent technological advances permit substantial increases in transmission capacity of both new and existing fiber, and the introduction of new products or emergence of new technologies may reduce the cost or increase the supply of certain services similar to those which we plan on providing. Accordingly, in the future our most significant competitors may be new entrants to the communications industry, which—unlike the traditional incumbent carriers we also compete with—are not burdened by an installed base of outmoded or legacy equipment.

Regulation

Federal Regulation

The Federal Communications Commission or the FCC has jurisdiction over interstate and international communications services, among other things. The FCC's regulation of common carriers without market power, such as us, is less stringent than its regulation of dominant incumbent local exchange carriers. We have obtained FCC approval to land our transatlantic cable in the United States. We have obtained FCC authorization to provide international services on a facilities and resale basis as well as various wireless licenses. Under the Telecommunications Act of 1996 (the "1996 Act"), any entity, including cable television companies, electric and gas utilities, may enter any telecommunications market, subject to reasonable state regulation of safety, quality and consumer protection.

The FCC has pending a Notice of Proposed Rulemaking ("NPRM") to initiate a comprehensive review of rules governing the pricing of special access service offered by ILECs subject to price cap regulation. Special access pricing by these carriers currently is subject to price cap rules, as well as pricing flexibility rules which permit these carriers to offer volume and term discounts and contract tariffs (Phase I pricing flexibility) and/or remove from price caps regulation special access service in a defined geographic area (Phase II pricing flexibility) based on showings of competition. In the NPRM the FCC tentatively concludes to continue to permit pricing flexibility where competitive market forces are sufficient to constrain special access prices, but undertakes an examination of whether the current triggers for pricing flexibility accurately assess competition and have worked as intended. The NPRM also asks for comment on whether certain aspects of ILEC special access tariff offerings (e.g., basing discounts on previous volumes of service; tying nonrecurring charges and termination penalties to term commitments; and imposing use restrictions in connection with discounts), are unreasonable. At this time, we cannot predict the impact, if any, that a ruling on the NPRM will have on our network cost structure.

Both AT&T and Verizon, in connection with large acquisitions, have agreed to abide by certain conditions that are enforceable by the FCC in connection with special access prices, terms and conditions. In December 2007, we filed a complaint against AT&T alleging, among other things, that

AT&T had violated those commitments. At this stage, the proceeding is continuing and we intend to vigorously pursue our claims. We cannot at this time predict the outcome of that proceeding.

As of August 1, 2001, our tariffs for interstate end user services were eliminated and our tariffs for international interexchange services were eliminated on January 28, 2002. Our rates must still be just and reasonable and nondiscriminatory. Our state tariffs remain in place. We have historically relied primarily on our sales force and marketing activities to provide information to our customers regarding these matters and expect to continue to do so. Further, in accordance with the FCC's orders we maintain a schedule of our rates, terms and conditions for our domestic and international private line services on our web site.

Intercarrier compensation. Telecommunications carriers compensate one another for traffic carried on each other's networks. Interexchange carriers pay access charges to local telephone companies for long distance calls that originate and terminate on local networks. Local telephone companies typically charge one another for local and Internet-bound traffic terminating on each other's networks. The entire methodology by which carriers compensate one another for exchanged traffic, whether it be for local, intrastate or interstate traffic, is under review at the FCC.

Apart from this comprehensive review of intercarrier compensation, individual compensation issues have been the subject of FCC and state commission rulings. Since 1997 the issue of compensation to be paid for calls dialed to Internet service providers or ISPs has been heavily litigated. Since 2004, the issue of compensation to be paid in connection with the exchange of Voice over Internet Protocol or VoIP calls has also been the subject of much debate.

In its decision on Nov. 5, 2008, the FCC responded to a mandamus order from the United States Circuit Court of Appeals for the District of Columbia concerning its 2001 ISP Remand Order. In that Mandamus Order, the FCC clarified that it had jurisdiction over ISP bound traffic pursuant to the reciprocal compensation provisions of the Telecommunications Act of 1996 regardless of whether the traffic was local or long distance. The FCC then decided to maintain the existing compensation regime it had established for ISP-bound traffic with a rate of \$0.0007 per minute of use. The Mandamus Order has been appealed to the Court of Appeals. In addition, a number of states have been asked to implement the Mandamus Order. The Company cannot predict the outcome of those proceedings.

Level 3 maintains approximately 233 interconnection agreements with other telecommunications carriers. These agreements set out the terms and conditions under which the parties will exchange traffic. The largest agreements are with AT&T and Verizon. Level 3's agreement with AT&T expires on January 11, 2011. Level 3's agreement with Verizon expires on March 31, 2009. Upon expiration of the agreement, Level 3 and Verizon will continue to provide services until a successor agreement has been reached.

As interconnection agreements expire, we will continue to negotiate new agreements but at this time cannot predict what the final terms will be, including compensation for ISP-bound traffic or VoIP traffic. In the event we initiate arbitration before a state commission to establish the terms of the interconnection agreement, we cannot predict what the final terms will be, including compensation for ISP-bound traffic or VoIP traffic

Given the general uncertainty surrounding the effect of the FCC and state decisions and appeals, we may have to change (1) how we treat the compensation we receive for terminating calls bound for ISPs if the agreements under which compensation is paid provided for the incorporation of changes in FCC rules and regulations; (2) the manner in which we account for the compensation and costs of intercarrier compensation for VOIP.

There is also uncertainty in respect to intercarrier compensation for VoIP traffic. As in the ISP intercarrier compensation situation, the FCC has issued a number of rulings asserting its jurisdiction over such traffic, but to date it has not issued any rulings on the scope and rate of intercarrier

compensation to be paid by carriers exchanging VoIP traffic. While carriers that serve VoIP providers such as Level 3 have typically asserted that VoIP traffic is local in nature and thereby subject to local compensation rates, the RBOCS and other incumbents have taken the position that some or all of this traffic should be subject to higher intrastate or interstate rates. A number of carriers have filed petitions with the FCC seeking a declaratory ruling on the treatment of VoIP traffic. These petitions have either been withdrawn or rejected based on procedural grounds. In those cases, the FCC did not resolve the question of the appropriate intercarrier compensation. The last petition, filed by Embarq, was withdrawn on February 11, 2009.

Until such time as the FCC acts in such a way as to either clarify its rulings on ISP compensation, VoIP compensation or rules on intercarrier compensation in its entirety, and such rules are final and non-appealable, the scope of intercarrier compensation obligations between carriers exchanging ISP or VoIP traffic is uncertain.

Universal Service. Level 3 is subject to federal and state regulations that implement universal service support for access to communications services in rural, high-cost and low-income markets at reasonable rates; and access to advanced communications services by schools, libraries and rural health care providers. Currently, the FCC assesses Level 3 a percentage of interstate and international revenue it receives from retail customers as its contribution to the Federal Universal Service Fund. The FCC is currently considering changing the method by which our contributions are assessed to a flat-fee charge, such as a per-line or per-number charge. Any change in the assessment methodology may affect Level 3's revenues but at this time, it is not possible to predict the extent we would be affected, if at all.

State Regulation

The 1996 Act is intended to increase competition in the telecommunications industry, especially in the local exchange market. With respect to local services, ILECs are required to allow interconnection to their networks and to provide unbundled access to network facilities, as well as a number of other pro-competitive measures. Because the implementation of the 1996 Act is subject to numerous state rulemaking proceedings on these issues, it is currently difficult to predict how quickly full competition for local services will be realized.

State regulatory agencies have jurisdiction when our facilities and services are used to provide intrastate telecommunications services. A portion of our traffic may be classified as intrastate telecommunications and therefore subject to state regulation. We expect that we will offer more intrastate telecommunications services (including intrastate switched services) as our business and product lines expand. To provide intrastate services, we generally must obtain a certificate of public convenience and necessity from the state regulatory agency and comply with state requirements for telecommunications utilities, including state tariffing requirements. We currently are authorized to provide telecommunications services in all fifty states and the District of Columbia. In addition, we will be required to obtain and maintain interconnection agreements with ILECs where we wish to provide service. We expect that we should be able to negotiate or otherwise obtain renewals or successor agreements through adoption of others' contracts or arbitration proceedings, although the rates, terms, and conditions applicable to interconnection and the exchange of traffic with certain ILECs could change significantly in certain cases. The degree to which the rates, terms, and conditions may change will depend not only upon the negotiation and arbitration process and availability of other interconnection agreements, but will also depend in significant part upon state commission proceedings that either uphold or modify the current regimes governing interconnection and the exchange of certain kinds of traffic between carriers.

States also often require prior approvals or notifications for certain transfers of assets, customers or ownership of certificated carriers and for issuances by certified carriers of equity or debt.

Local Regulation

Our networks are subject to numerous local regulations such as building codes and licensing. Such regulations vary on a city-by-city, county-by-county and state-by-state basis. To install our own fiber optic transmission facilities, we need to obtain rights-of-way over privately and publicly owned land. Rights-of-way that are not already secured, or which may expire and not be renewed, may not be available to us on economically reasonable or advantageous terms.

Regulation of Voice over Internet Protocol (VoIP)

Federal and State

Due to the growing acceptance and deployment of VoIP services, the FCC and state public utility commissions are conducting regulatory proceedings that could affect the regulatory duties and rights of entities such as us or our affiliates that provide IP-based voice applications. There is regulatory uncertainty as to the imposition of access charges and other taxes, fees and surcharges on VoIP services that use the public switched telephone network. There is regulatory uncertainty as to the imposition of traditional retail, common carrier regulation on VoIP products and services.

The rules respecting the payments made by carriers for the exchange of VoIP traffic have been subject to much debate. The FCC has not clarified whether VoIP traffic is to be subjected to the access charges regime that is applicable to traditional telecom service, or whether VoIP traffic is to be treated as an "information service" or "enhanced" and not subject to access charges. There are a number of petitions and proceedings pending before the FCC where this issue could be resolved. At this time, it is difficult to predict the outcome of any of these proceedings or the timing for their eventual resolution. As a result, we cannot predict the effect that any such rulings could have on our provision of VoIP services.

The FCC has classified VoIP services as "interstate" services subject to FCC regulations, and has stated that states have limited authority to regulate the offering of VoIP services. On September 22, 2003, Vonage Holdings Corporation ("Vonage") filed a petition with the FCC requesting a declaration that its offerings, which originate on a broadband network in IP format and terminate on the PSTN, are interstate information services not subject to state regulation under the 1996 Act and existing FCC rules. On November 10, 2004, the FCC adopted an order (which was subsequently upheld on appeal) ruling that Vonage's service was an interstate service not subject to state regulation.

On June 3, 2005, the FCC issued an order (which was subsequently upheld on appeal) requiring all interconnected VoIP providers to deliver enhanced 911 capabilities to their subscribers by no later than November 28, 2005. We have modified our service offerings to VoIP providers in order to assist them in complying with the FCC mandate.

In 2007, the FCC imposed some regulatory requirements on VoIP providers that had previously been applicable only to traditional telecommunications providers. Specifically, the FCC (a) imposed obligations on VoIP providers to contribute to the federal universal service fund, and (b) required VoIP carriers to comply with regulations relating to local number portability (including contributing to the costs of managing number portability requirements). In addition, a number of state public utility commissions are conducting regulatory proceedings that could impact our rights and obligations with respect to IP-based voice applications. Specifically, some states have taken the position that the "local" component of VoIP service is subject to traditional regulations applicable to local telecommunications services, such as the obligation to pay intrastate universal service fees.

We cannot predict the outcome of any of these petitions and regulatory proceedings or any similar petitions and regulatory proceedings pending before the FCC or state public utility commissions. Moreover, we cannot predict how their outcomes may affect our operations or whether the FCC or

state public utility commissions will impose additional requirements, regulations or charges upon our provision of services related to IP communications.

European Regulation

Unlike the United States which has a fractured regulatory scheme with respect to VoIP services, the European Union has adopted a more systematic approach to the convergence of networks and VoIP regulation specifically. The European Commission will oversee the implementation by its member-states of six new directives developed to regulate electronic communications in a technology and platform neutral manner. Implementation of the directives has not been uniform across the Member States of the European Union and it is difficult to predict when they will be implemented at the national level. Even with harmonization, the national regulatory agencies will continue to be responsible for issuing general authorizations and specific licenses.

The European Union's approach to the regulation of VoIP turns on whether VoIP is voice telephony. The European Commission has defined voice telephony to have four elements: (1) commercial offering as voice telephony; (2) provision to the public; (3) provision to and from the public switched telephone network termination points; and (4) direct speech transport and switching of speech in real time, particularly at the same level of reliability and speech quality as provided by the PSTN. In its "Communication from the Commission, Consultation on Voice on the Internet" in June 2000, the European Commission directed that "Member States should continue to allow Internet access providers to offer voice over Internet protocol under data transmission general authorizations, and that specific licensing conditions are not justified."

The European Commission has subsequently redefined its definitions to suggest that some VoIP offerings are voice telephony. In its December 2000 communication, the European Commission noted that increasing quality and reliability as well as marketing of voice capabilities with bundled services, made certain kinds of "voice over Internet" much more like voice services. While the current European Commission directives do not mandate the treatment of VoIP as voice telephony, the commission will continue to reevaluate the regulation of VoIP as service quality becomes the equivalent of traditional voice telephony.

In February 2003, the European Union adopted a new regulatory framework for electronic communications that is designed to address in a technologically neutral manner the convergence of communications across telecommunications, computer and broadcasting networks. The directives address: (1) framework (2) interconnection and access, (3) authorization and licensing, (4) universal service and (5) privacy. These directives and an additional decision on radio spectrum replace the existing 20 directives on electronic communications. Under the framework, voice telephony providers will face additional obligations, including specific licensing and universal service obligations. Others will likely face new regulation. One example could be VoIP. If it is classified as an electronic communications service, rather than voice telephony, it would still be subject to additional regulations to achieve regulatory parity with other electronic communications.

The United Kingdom was one of the first countries to fully implement the European Union's new framework for electronic communications, which it did by July 25, 2003. At that time, certain provisions of the United Kingdom's Telecommunications Act of 1984 were repealed. Pursuant to that framework, the licensing regime was replaced with a general authorization. Our existing licenses were canceled and replaced with a general authorization.

Under the regime, the United Kingdom regulates VoIP as an electronic communication service. The degree of regulation imposed on the service depends upon whether the service is considered to be a Publicly Available Telephone Service (PATS). A service is considered to be a PATS if the following conditions are met: it is marketed as a substitute for the traditional telephone service; the service appears to the customer to be a substitute for the traditional public telephone service over which they expect access to emergency services; or the service provides the customers sole means of access to the traditional circuit switched public telephone network.

Canadian Regulation

Pursuant to the *Telecommunications Act* ("Act"), the Canadian Radio-television and Telecommunications Commission ("CRTC"), has jurisdiction to regulate telecommunications communications and their service offerings in Canada (telecommunications is a Federal jurisdiction). Regulatory developments over the past several years have terminated the historic monopolies of the ILECs bringing significant competition to this industry for both domestic and international long distance services. On December 14, 2006, the Governor in Council (Federal Cabinet) for the first time exercised its statutory power to issue a binding Policy Direction requiring the CRTC, in regulating the telecommunications industry, to rely on market forces to the maximum extent possible, regulating only to the extent necessary and then in an efficient and a proportionate way. The provision of Canadian domestic and international transmission facilities based services remains restricted to "Canadian carriers". These carriers must have majority ownership and control in fact by Canadians. There are no such Canadian ownership and control requirements for companies that resell the services and facilities of a Canadian carrier. Level 3 operates as a reseller in Canada. If the ownership restrictions are repealed, we anticipate that we will be able to expand our operations and service offerings in Canada. The liberalization of Canadian carrier ownership and control is controversial and there are no immediate prospects for such a change.

While competition is permitted in virtually all other Canadian telecommunications market segments, we believe that the ILECs continue to retain a substantial majority of the local and calling card markets. Beginning in May 1997 and furthered by a Federal Government policy direction, the CRTC has released a number of decisions opening to competition the Canadian local telecommunications services market. As a result, networks operated by CLECs may now be interconnected with the networks of the ILECs. Transmission facilities-based CLECs are subject to the same majority Canadian ownership "Canadian carrier" requirements as transmission facilities-based long distance carriers. CLECs have the same status as ILECs, but without universal service or customer tariff filing obligations. All bundled and unbundled local services (including residential lines and other bulk services) may now be resold, but ILECs need not provide these services to resellers at wholesale prices. The CRTC has ruled that resellers cannot be classified as CLECs, and thus are not entitled to CLEC interconnection terms and conditions.

With respect to VoIP services, the CRTC ruled in Decision 2005-28 that it should forbear from regulating circuit-switched VoIP services. As a result, ILECs are not required to file tariffs for the provision of long distance VoIP services. With respect to local VoIP services, the Governor in Council varied the CRTC decision to treat VoIP services as other local exchange services by making an exception for access-independent VoIP services that do not include an ILEC-provided loop. Furthermore, the ILEC, Bell Canada, has received approval of its application to be relieved of the requirement to obtain pre-approval for price changes for its local VoIP services. Bell has been permitted to notify the CRTC two business days in advance of changes as long as the price is within an authorized range.

In a March 3, 2008 decision, the CRTC established the regulatory framework for wholesale telecommunications services with rules for the regulation and pricing provided by ILECs to competitive service providers such as alternative local and long distance carriers, resellers and ISPs. The CRTC

decision revised its definition of an "essential service", established a six-category framework for the CRTC's regulation of wholesale telecommunications services, categorized various available wholesale services within these identified categories, and established the regulatory conditions associated with each service category, notably mandated access and pricing principles, as well as the process for the phase-out of regulation for certain services found to be non-essential. In its 1997 local competition decision, the CRTC had tied essential facilities to those provided on a monopoly basis. In the 2008 decision, non-monopoly facilities will have to be provided to competitors if the CRTC makes a determination that withdrawal of mandatory access would likely result in a substantial lessening or prevention of competition. The CRTC classified wholesale services that are currently regulated into six categories: essential, conditional essential, conditional mandated non-essential, public good, interconnection, and non-essential subject to phase-out of regulation. Very few services were classified as essential. In the category of "conditional essential" wholesale services, the CRTC included wholesale services used for local telephony (primarily unbundled local loops), low-speed competitor digital network access services, DS-0 and DS-1 access facilities and ADSL access services used to provide high-speed Internet access services to residences and businesses. This essential conditional category classification will continue until it is demonstrated that wholesale alternatives functionally equivalent are sufficiently present such that withdrawing mandated access would not likely result in a substantial lessening or prevention of competition in the local exchange services market. Regarding network interconnection services, customer access facilities, and support structure services, the CRTC considers that these arrangements are technologically and competitively neutral to the greatest extent possible, enable competition from new technologies, and do not artificially favour Canadian carriers or resellers.

The CRTC has conditionally forbore from regulating the retail Internet services, but not the wholesale Internet services, of Canadian carriers preserving its regulatory powers relating to unjust discrimination and undue preference or advantage. The CRTC has ruled (Telecom Decision 2008-108) that Bell Canada's application of its traffic-shaping measures to its wholesale ADSL access service known as Gateway Access Service (GAS) were not in violation of the Act. In Public Notice 2008-19, the CRTC noted that Decision 2008-108 dealt only with Bell Canada's practice of throttling P2P traffic at certain times of the day in relation to its GAS being provided to wholesale customers. In the Public Notice, the CRTC announced it would explore the current and potential Internet traffic management practices of all ISPs operating in Canada, examining both retail and wholesale services. Following the filing of written submissions, the CRTC will hold an oral public hearing commencing July 6, 2009 to consider the issues relating to Internet traffic management practices.

Our Other Business

Our company was incorporated as Peter Kiewit Sons', Inc. in Delaware in 1941 to continue a construction business founded in Omaha, Nebraska in 1884. In subsequent years, we invested a portion of the cash flow generated by our construction activities in a variety of other businesses. We entered the coal mining business in 1943, the telecommunications business in 1988, the information services business in 1990 and the alternative energy business in 1991. We have also made investments in several development-stage ventures.

In December 1997, our stockholders ratified the decision of the Board to effect the split-off separating our historical construction business from the remainder of our operations. As a result of the split-off, which was completed on March 31, 1998, we no longer own any interest in the prior construction business. In conjunction with the split-off, we changed our name to "Level 3 Communications, Inc.," and the entity that held the prior construction business changed its name to "Peter Kiewit Sons', Inc."

On November 30, 2005, we completed the sale of our (i)Structure, LLC subsidiary to Infocrossing, Inc. Prior to the sale, (i)Structure provided computer operations outsourcing to customers located primarily in the United States. On September 7, 2006, we completed the sale of 100% of the

capital stock of our indirect, wholly owned subsidiary, Software Spectrum, Inc., to Insight Enterprises, Inc. Prior to the sale, Software Spectrum was a leading direct marketer of software and provider of software licensing services to corporations. With the completion of the sale of Software Spectrum, we exited the information services business.

Coal Mining

We are engaged in coal mining through our subsidiary, KCP, Inc. or KCP. KCP has a 50% interest in two mines, which are operated by a subsidiary of Peter Kiewit Sons', Inc. or PKS. Decker Coal Company or Decker is a joint venture with Western Minerals, Inc., which is a subsidiary of Rio Tinto Energy America Inc. Black Butte Coal Company or Black Butte is a joint venture with Bitter Creek Coal Company, a subsidiary of Anadarko Petroleum Corporation. The Decker mine is located in southeastern Montana and the Black Butte mine is in southwestern Wyoming. The coal mines use the surface mining method.

The coal produced from the KCP mines is sold primarily to electric utilities, which burn coal to produce steam to generate electricity. Essentially all of the sales were made under long-term contracts. Approximately 63%, 67% and 68% of KCP's revenue in 2008, 2007 and 2006, respectively, were derived from long-term contracts with PacifiCorp (Black Butte), Idaho Power (Black Butte), The Detroit Edison Company (with Decker), and Commonwealth Edison Company (with Decker). The mines have commitments to deliver approximately 20.7 million tons of coal through 2014 under contracts with PacifiCorp, Idaho Power and Virginia Power. The mines also have other sales commitments, including those with The Detroit Edison Company, Sierra Pacific and Minnesota Power that provide for the delivery of approximately 7.7 million tons through 2012. Under a mine management agreement, KCP pays a subsidiary of PKS an annual fee equal to 30% of KCP's adjusted operating income. The fee for 2008 was approximately \$1 million.

The coal industry is highly competitive. KCP competes not only with other domestic and foreign coal suppliers, some of whom are larger and have greater capital resources than KCP, but also with alternative methods of generating electricity and alternative energy sources. In 2007, the most recent year for which information is available, KCP's production represented less than 1% of total U.S. coal production. Demand for KCP's coal is affected by economic, political and regulatory factors. For example, recent "clean air" laws may stimulate demand for low sulfur coal. KCP's western coal reserves generally have a low sulfur content (less than one percent) and are currently useful principally as fuel for coal-fired, steam-electric generating units.

KCP's sales of its coal, like sales by other western coal producers, typically provide for delivery to customers at the mine. A significant portion of the customer's delivered cost of coal is attributable to transportation costs. Most of the coal sold from KCP's western mines is currently shipped by rail to utilities outside Montana and Wyoming. The Decker and Black Butte mines are each served by a single railroad. Many of their western coal competitors are served by two railroads and such competitors' customers often benefit from lower transportation costs because of competition between railroads for coal hauling business. Other western coal producers, particularly those in the Powder River Basin of Wyoming, have lower stripping ratios (that is, the amount of overburden that must be removed in proportion to the amount of minable coal) than the Black Butte and Decker mines, often resulting in lower comparative costs of production. As a result, KCP's production costs per ton of coal at the Black Butte and Decker mines can be as much as four and five times greater than production costs of certain competitors. Because of these cost disadvantages, there is no assurance that KCP will be able to enter into additional long-term coal purchase contracts for Black Butte and Decker production. In addition, these cost disadvantages may adversely affect KCP's ability to compete for sales in the future.

We are required to comply with various federal, state and local laws and regulations concerning protection of the environment. KCP's share of land reclamation expenses for the year ended December 31, 2008 was approximately \$3 million. KCP's share of accrued estimated reclamation costs was \$96 million at December 31, 2008. We were not required to make significant capital expenditures for environmental compliance with respect to the coal business in 2008. We believe our compliance with environmental protection and land restoration laws will not affect our competitive position since our competitors in the mining industry are similarly affected by such laws. However, failure to comply with environmental protection and land restoration laws, or actual reclamation costs in excess of our accruals, could have an adverse effect on our business, results of operations, and financial condition.

Glossary of Terms

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| access | Telecommunications services that permit long distance carriers to use local exchange facilities to originate and/or terminate long distance service. |
| access charges | The fees paid by long distance carriers to LECs for originating and terminating long distance calls on the LECs' local networks. |
| backbone | A high-speed network that interconnects smaller, independent networks. It is the through- portion of a transmission network, as opposed to spurs which branch off the through- portions. |
| ATM (asynchronous transfer mode) | An information transfer standard that is one of a general class of packet technologies that relay traffic by way of an address contained within the first five bytes of a standard fifty-three byte long packet or cell. The ATM format can be used by many different information systems, including LANs, to deliver traffic at varying rates, permitting a mix of data, voice and video. |
| CAP | Competitive Access Provider. A company that provides its customers with an alternative to the local exchange company for local transport of private line and special access telecommunications services. |
| caching | A process by which a Web storage device or cache is located between Web servers (or origin servers) and a user, and watches requests for HTML pages and objects such as images, audio, and video, then saves a copy for itself. If there is another request for the same object, the cache will use its copy, instead of asking the origin server for it again. |
| capacity | The information carrying ability of a telecommunications facility. |
| carrier | A provider of communications transmission services by fiber, wire or radio. |

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| CDN | Content Distribution Network or CDN describes a system of computers networked together across the Internet that cooperate transparently to deliver various types of content to end users. The delivery process is optimized generally for either performance or cost. When optimizing for performance, locations that can serve content quickly to the user are chosen. When optimizing for cost, locations that are less expensive to serve from may be chosen instead. |
| central office | Telephone company facility where subscribers' lines are joined to switching equipment for connecting other subscribers to each other, locally and long distance. |
| CLEC | Competitive Local Exchange Carrier. A company that competes with LECs in the local services market. |
| co-carrier | A relationship between a CLEC and an ILEC that affords each company the same access to and right on the other's network and provides access and services on an equal basis. |
| common carrier | A government-defined group of private companies offering telecommunications services or facilities to the general public on a non-discriminatory basis. |
| conduit | A pipe, usually made of metal, ceramic or plastic, that protects buried cables. |
| DS-3 | A data communications circuit capable of transmitting data at 45 Mbps. |
| dark fiber | Fiber optic strands that are not connected to transmission equipment. |
| dedicated lines | Telecommunications lines reserved for use by particular customers. |
| dialing parity | The ability of a competing local or toll service provider to provide telecommunications services in such a manner that customers have the ability to route automatically, without the use of any access code, their telecommunications to the service provider of the customers' designation. |
| equal access | The basis upon which customers of interexchange carriers are able to obtain access to their Primary Interexchange Carriers' (PIC) long distance telephone network by dialing "1", thus eliminating the need to dial additional digits and an authorization code to obtain such access. |
| facilities based carriers | Carriers that own and operate their own network and equipment. |

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| fiber optics | A technology in which light is used to transport information from one point to another. Fiber optic cables are thin filaments of glass through which light beams are transmitted over long distances carrying enormous amounts of data. Modulating light on thin strands of glass produces major benefits including high bandwidth, relatively low cost, low power consumption, small space needs and total insensitivity to electromagnetic interference. |
| Gbps | Gigabits per second. A transmission rate. One gigabit equals 1.024 billion bits of information. |
| ILEC | Incumbent Local Exchange Carrier. A company historically providing local telephone service. Often refers to one of the Regional Bell Operating Companies (RBOCs). Often referred to as "LEC" (Local Exchange Carrier). |
| Interconnection | Interconnection of facilities between or among the networks of carriers, including potential physical colocation of one carrier's equipment in the other carrier's premises to facilitate such interconnection. |
| InterLATA | Telecommunications services originating in a LATA and terminating outside of that LATA. |
| Internet | A global collection of interconnected computer networks which use a specific communications protocol. |
| IntraLATA | Telecommunications services originating and terminating in the same LATA. |
| ISDN | Integrated Services Digital Network. An information transfer standard for transmitting digital voice and data over telephone lines at speeds up to 128 Kbps. |
| ISPs | Internet Service Providers. Companies formed to provide access to the Internet to consumers and business customers via local networks. |
| IXC | Interexchange Carrier. A telecommunications company that provides telecommunications services between local exchanges on an interstate or intrastate basis. |
| Kbps | Kilobits per second. A transmission rate. One kilobit equals 1,024 bits of information. |
| LATA | Local Access and Transport Area. A geographic area composed of contiguous local exchanges, usually but not always within a single state. There are approximately 200 LATAs in the United States. |
| leased line | An amount of telecommunications capacity dedicated to a particular customer along predetermined routes. |
| LEC | Local Exchange Carrier. A telecommunications company that provides telecommunications services in a geographic area. LECs include both ILECs and CLECs. |

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| local exchange | A geographic area determined by the appropriate state regulatory authority in which calls generally are transmitted without toll charges to the calling or called party. |
| local loop | A circuit that connects an end user to the LEC central office within a LATA. |
| long distance carriers | Long distance carriers provide services between local exchanges on an interstate or intrastate basis. A long distance carrier may offer services over its own or another carrier's facilities. |
| Mbps | Megabits per second. A transmission rate. One megabit equals 1.024 million bits of information. |
| MPLS | MultiProtocol Label Switching. A standards-approved technology for speeding up network traffic flow and making it easier to manage. MPLS involves setting up a specific path for a given sequence of packets, identified by a label put in each packet, thus saving the time needed for a router or switch to look up the address to the next node to forward the packet to. |
| multiplexing | An electronic or optical process that combines a large number of lower speed transmission lines into one high speed line by splitting the total available bandwidth into narrower bands (frequency division), or by allotting a common channel to several different transmitting devices, one at a time in sequence (time division). |
| NAP | Network Access Point. A location at which ISPs exchange traffic with each other. |
| OC-3 | A data communications circuit capable of transmitting data at 155 Mbps. |
| OC-12 | A data communications circuit capable of transmitting data at 622 Mbps. |
| OC-48 | A data communications circuit capable of transmitting data at approximately 2.45 Gbps. |
| PBX | Private Branch eXchange. A PBX, sometimes known as a phone switch or phone switching device, is a device that connects office telephones in a business with the PSTN. The functions of a PBX include routing incoming calls to the appropriate extension in an office, sharing phone lines between extensions, automated greetings for callers using recorded messages, dialing menus, connections to voicemail, automatic call distribution and teleconferencing. |

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| peering | The commercial practice under which ISPs exchange traffic with each other. Although ISPs are free to make a private commercial arrangement, there are generally two types of peering. With a settlement free peering arrangement the ISPs do not need to pay each other for the exchange of traffic. With paid peering, the larger ISP receives payment from the smaller ISP to carry the traffic of that smaller ISP. Peering occurs at both public and private exchange points. |
| POP | Point of Presence. Telecommunications facility where a communications provider locates network equipment used to connect customers to its network backbone. |
| private line | A dedicated telecommunications connection between end user locations. |
| PSTN | Public Switched Telephone Network. That portion of a local exchange company's network available to all users generally on a shared basis (i.e., not dedicated to a particular user). Traffic along the public switched network is generally switched at the local exchange company's central offices. |
| Public Safety Answering Point | An answering location for 911 calls originating in a given area. PSAPs are typically a common bureau used to answer emergency calls and dispatch safety agencies such as police, fire, emergency medical, etc. |
| RBOCs | Regional Bell Operating Companies. Originally, the seven local telephone companies established as a result of the AT&T Divestiture. |
| reciprocal compensation | The compensation of a CLEC for termination of a local call by the ILEC on the CLEC's network, which is the same as the compensation that the CLEC pays the ILEC for termination of local calls on the ILEC's network. |
| resale | Resale by a provider of telecommunications services (such as a LEC) of such services to other providers or carriers on a wholesale or a retail basis. |
| router | Equipment placed between networks that relays data to those networks based upon a destination address contained in the data packets being routed. |
| selective router | Telephone switch or functional equivalent, controlled by the relevant local exchange carrier (LEC), which determines the PSAP to which a 911 call should be delivered based on the location of the 911 caller. |
| SONET | Synchronous Optical Network. An electronics and network architecture for variable bandwidth products which enables transmission of voice, data and video (multimedia) at very high speeds. SONET ring architecture provides for virtually instantaneous restoration of service in the event of a fiber cut or equipment failure by automatically rerouting traffic in the opposite direction around the ring. |

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| special access services | The lease of private, dedicated telecommunications lines or "circuits" along the network of a local exchange company or a CAP, which lines or circuits run to or from the long distance carrier POPs. Examples of special access services are telecommunications lines running between POPs of a single long distance carrier, from one long distance carrier POP to the POP of another long distance carrier or from an end user to a long distance carrier POP. |
| streaming | Streaming is the delivery of media, such as movies and live presentations, over a network in real time. A computer (a streaming server) sends the media to another computer (a client computer), which plays the media as it is delivered. |
| switch | A device that selects the paths or circuits to be used for transmission of information and establishes a connection. Switching is the process of interconnecting circuits to form a transmission path between users and it also captures information for billing purposes. |
| Tbps | Terabits per second. A transmission rate. One terabit equals 1.024 trillion bits of information. |
| T-1 | A data communications circuit capable of transmitting data at 1.544 Mbps. |
| unbundled | Services, programs, software and training sold separately from the hardware. |
| unbundled access | Access to unbundled elements of a telecommunications services provider's network including network facilities, equipment, features, functions and capabilities, at any technically feasible point within such network. |
| VoIP | Voice over Internet Protocol |
| VPC | VoIP Positioning Center. An entity that maintains an end user location database and manages the technology including query keys and routing number pools used to deliver 911 calls to the correct PSAP for emergency handling. |
| web site | A server connected to the Internet from which Internet users can obtain information. |
| wireless | A communications system that operates without wires. Cellular service is an example. |
| world wide web or web | A collection of computer systems supporting a communications protocol that permits multimedia presentation of information over the Internet. |
| xDSL | A term referring to a variety of newer Digital Subscriber Line technologies. Some of these newer varieties are asymmetric with different data rates in the downstream and upstream directions. Others are symmetric. Downstream speeds range from 384 Kbps (or "SDSL") to 1.5 to 8 Mbps ("ADSL"). |

Directors and Executive Officers

Set forth below is information as of February 27, 2009, about our directors and our executive officers. Our executive officers have been determined in accordance with the rules of the SEC.

| <u>Name</u> | <u>Age</u> | <u>Position</u> |
|--------------------------------|------------|---|
| Walter Scott, Jr. | 77 | Chairman of the Board |
| James Q. Crowe | 59 | Chief Executive Officer and Director |
| Jeffrey K. Storey | 48 | President and Chief Operating Officer |
| Charles C. Miller, III | 56 | Vice Chairman, Executive Vice President and Director |
| Sunit S. Patel | 47 | Executive Vice President and Chief Financial Officer |
| Thomas C. Stortz | 57 | Executive Vice President, Chief Legal Officer and Secretary |
| Eric J. Mortensen | 50 | Senior Vice President and Controller |
| R. Douglas Bradbury | 58 | Director |
| Douglas C. Eby(1) | 49 | Director |
| Admiral James O. Ellis, Jr.(3) | 61 | Director |
| Richard R. Jaros(2) | 57 | Director |
| Robert E. Julian(1) | 69 | Director |
| Michael J. Mahoney(2) | 58 | Director |
| Arun Netravali(2) | 62 | Director |
| John T. Reed(1)(3) | 65 | Director |
| Michael B. Yanney(3) | 75 | Director |
| Dr. Albert C. Yates(2) | 67 | Director |

- (1) Member of Audit Committee
- (2) Member of Compensation Committee
- (3) Member of Nominating and Governance Committee

Other Management

Set forth below is information as of February 27, 2009, about the following members of senior management of Level 3 Communications, LLC.

| <u>Name</u> | <u>Age</u> | <u>Position</u> |
|---------------------|------------|--|
| Sureel A. Choksi | 36 | Chief Marketing Officer |
| Andrew Crouch | 38 | President Wholesale Markets Group |
| James Heard | 46 | President European Markets Group |
| Jeffrey Tench | 36 | President Business Markets Group |
| Grant van Rooyen | 35 | President Content Markets Group |
| John F. Waters, Jr. | 43 | President Operations, Chief Technology Officer |
| Kevin T. Hart | 42 | Chief Information Officer |

Walter Scott, Jr. has been the Chairman of the Board of the Company since September 1979, and a director of the Company since April 1964. Mr. Scott has been Chairman Emeritus of Peter Kiewit Sons', Inc. ("PKS") since the split-off in 1998. Mr. Scott is also a director of PKS, Berkshire Hathaway Inc., MidAmerican Energy Holdings Company, and Valmont Industries, Inc.

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

Jeffrey K. Storey has been the President and Chief Operating Officer of the Company since December 2008. From December 2005 until May 2008, Mr. Storey, was President—Leucadia Telecommunications Group of Leucadia National Corporation, where he directed and managed Leucadia's investments in telecommunications companies. Prior to that, beginning in October 2002 Mr. Storey was President and Chief Executive Officer of WilTel Communications Group, LLC until its sale to the Company in December 2005. Prior to this position, Mr. Storey was Senior Vice President—Chief Operations Officer, Network for Williams Communications, Inc., where he had responsibility for all areas of operations for the company's communications network, including planning, engineering, field operations, service delivery and network management.

Charles C. Miller, III has been Vice Chairman and Executive Vice President of the Company since February 15, 2001. Mr. Miller has also been a director of the Company since February 19, 2009. Mr. Miller was previously a director from February 2001 until May 2004. Prior to joining the Company, Mr. Miller was President of Bellsouth International, a subsidiary of Bellsouth Corporation from 1995 until December 2000. Prior to that, Mr. Miller held various senior level officer and management position at BellSouth from 1987 until 1995.

Sunit S. Patel has been Chief Financial Officer and an Executive Vice President of the Company since March 2008. Prior to that, Mr. Patel was Chief Financial Officer from May 2003 and a Group Vice President of the Company from March 13, 2003 to March 2008. Prior to that, Mr. Patel was Chief Financial Officer of Looking Glass Networks, Inc., a provider of metropolitan fiber optic networks, from April 2000 until March 2003. Mr. Patel was Treasurer of WorldCom Inc. and MCIWorldcom Inc., each long distance telephone services providers from 1997 to March 2000. From 1994 to 1997, Mr. Patel was Treasurer of MFS Communications Company Inc., a competitive local exchange carrier.

Thomas C. Stortz has been Executive Vice President, Chief Legal Officer and Secretary since February 2004. Prior to that, Mr. Stortz was Group Vice President, General Counsel and Secretary of the Company from February 2000 to February 2004. Prior to that, Mr. Stortz served as Senior Vice President, General Counsel and Secretary of the Company from September 1998 to February 1, 2000. Prior to that, he served as Vice President and General Counsel of Peter Kiewit Sons', Inc. and Kiewit Construction Group, Inc. from April 1991 to September 1998. He has served as a director of Peter Kiewit Sons', Inc.

Eric J. Mortensen has been Senior Vice President and Controller of the Company since 2003. Prior to that, Mr. Mortensen was Vice President and Controller of the Company from 1999 to 2003 and was the Controller of the Company from 1997 to 1999. Prior to that, Mr. Mortensen was Controller and Assistant Controller of Kiewit Diversified Group for more than five years.

R. Douglas Bradbury has been a director of the Company since February 19, 2009. Mr. Bradbury is a private investor. Mr. Bradbury served as Vice Chairman of the Company from 2000 to 2003 and as Executive Vice President and Chief Financial Officer of the Company from 1997 to 2000. Mr. Bradbury was previously a member of the Company's Board from 1997 to 2003. Prior to joining Level 3, Mr. Bradbury was Executive Vice President and Chief Financial Officer of MFS Communications Company, Inc. until its purchase by WorldCom, Inc. in 1996. He currently serves on the board of directors of LodgeNet Interactive Corporation, a leading provider of media and connectivity solutions designed to meet the needs of hospitality, healthcare and other guest-based businesses.

Douglas C. Eby has been a director of the Company since August 2007. Mr. Eby is chairman and CEO of TimePartners LLC, an investment advisory firm since 2004. Prior to that from April 1997 until September 2007, Mr. Eby was President of Torray LLC, a registered investment advisory firm, having joined Torray LLC in 1992. Mr. Eby is also a member of the Board of Directors of Markel Corporation, a specialty insurance company, Realty Finance Corporation, a commercial real estate specialty finance company, and Suburban Healthcare System. Since July 2007, Mr. Eby is also a

member of the Board and past Chairman of the Boys and Girls Clubs of Greater Washington, D.C. Mr. Eby is a member of the Audit Committee.

Admiral James O. Ellis, Jr. U.S. Navy (ret.) has been a director of the Company since March 2005. Effective May 18, 2005, Admiral Ellis became the president and chief executive officer of the Institute of Nuclear Power Operations or INPO, a nonprofit corporation established by the nuclear utility industry in 1979 to promote the highest levels of safety and reliability in the operation of nuclear electric generating plants. Admiral Ellis most recently served as Commander, U.S. Strategic Command in Omaha, Nebraska, before retiring in July 2004 after 35 years of service in the U.S. Navy, as Commander of the Strategic Command. In his Naval career, he held numerous commands. A graduate of the U.S. Naval Academy, he also holds M.S. degrees in Aerospace Engineering from the Georgia Institute of Technology and in Aeronautical Systems from the University of West Florida. He served as a Naval aviator and was a graduate of the U.S. Naval Test Pilot School. Admiral Ellis is also a member of the Board of Directors of Lockheed Martin Corporation, a global security company and Inmarsat PLC, an owner and operator of geostationary satellites from which a wide range of voice and high-speed data services are provided. Admiral Ellis is the Chairman of the Nominating and Governance committee.

Richard R. Jaros has been a director of the Company since June 1993 and served as President of the Company from 1996 to 1997. Mr. Jaros has been a private investor for more than the past five years. Mr. Jaros served as Executive Vice President of the Company from 1993 to 1996 and Chief Financial Officer of the Company from 1995 to 1996. He also served as President and Chief Operating Officer of CalEnergy from 1992 to 1993. Mr. Jaros is the Chairman of the Compensation Committee.

Robert E. Julian has been a director of the Company since March 1998. Mr. Julian has been a private investor for more than the past five years. From 1992 to 1995 Mr. Julian served as Executive Vice President and Chief Financial Officer of the Company. Mr. Julian is a member of the Audit Committee.

Michael J. Mahoney has been a director of the Company since August 2007. Mr. Mahoney is a private investor since March 2007. From 2000 until March 2007, Mr. Mahoney was the president and chief executive officer of Commonwealth Telephone Enterprises. Prior to that, from 1997 until 2000, Mr. Mahoney was president and chief operating officer of RCN Corporation. Mr. Mahoney also served as president and chief operating officer of C-TEC Corporation from 1993 until 1997. Mr. Mahoney is a member of the Board of Trustees of Wilkes University. Mr. Mahoney is a member of the Compensation Committee.

Arun Netravali has been a director of the Company since April 2003. Mr. Netravali is currently the managing partner of OmniCapital Group LLC, a venture capital firm since November 2004. Mr. Netravali was a private investor from April 2003 until November 2004. Prior to that, Mr. Netravali was Chief Scientist for Lucent Technologies, working with academic and investment communities to identify and implement important new networking technologies from January 2002 to April 2003. Prior to that position, Mr. Netravali was President of Bell Labs as well as Lucent's Chief Technology Officer and Chief Network Architect from June 1999 to January 2002. Bell Labs serves as the research and development organization for Lucent Technologies. Mr. Netravali is a director of LSI Corporation, a leading provider of innovative silicon, systems and software technologies. Mr. Netravali is a member of the Compensation Committee.

John T. Reed has been a director of the Company since March 2003. Mr. Reed has been a private investor since February 2005. Mr. Reed is also a Director of and Chairman of the Audit Committee of First National Nebraska, Inc. and a Director of, and a member of the Audit, Nominating, Investment and Compensation committees of Investors Real Estate Trust, a real estate investment trust. Mr. Reed is also Chairman-Elect of Boys Town, located in Boys Town, Nebraska. Mr. Reed was Chairman of HMG Properties, the real estate investment banking joint venture of McCarthy Group, Inc. from 2000

until February 2005. Prior to that, he was Chairman of McCarthy & Co., the investment banking affiliate of McCarthy Group. Prior to joining McCarthy Group in 1997, Mr. Reed spent 32 years with Arthur Andersen LLP. Mr. Reed is the Chairman of the Audit Committee and a member of the Nominating and Governance Committee.

Michael B. Yanney has been a director of the Company since March 1998. He has served as Chairman of the Board of The Burlington Capital Group, LLC (formerly known as America First Companies L.L.C.) for more than the last five years. Mr. Yanney also served as President and Chief Executive Officer of The Burlington Capital Group, LLC. Mr. Yanney is a member of the Nominating and Governance Committee.

Dr. Albert C. Yates has been a director of the Company since March 2005. Dr. Yates retired after 13 years as president of Colorado State University in Fort Collins, Colorado in June 2003. He was also chancellor of the Colorado State University System until October 2003, and is a former member of the board of the Federal Reserve Board of Kansas City-Denver Branch and the board of directors of First Interstate Bank and Molson Coors Brewing Company. He currently serves as a director of Guaranty Bancorp, a bank holding company that operates 34 branches in Colorado through a single bank, Guaranty Bank and Trust Company, and StarTek, Inc., a leading provider of high value business process outsourcing services to the communications industry. Dr. Yates is a member of the Compensation Committee.

Sureel A. Choksi has been Chief Marketing Officer since January 2008, responsible for product management and marketing. Prior to that, Mr. Choksi was President Wholesale Markets Group from August 2006 to January 2008. Prior to that, Mr. Choksi was Executive Vice President of Switched Services from January 2006 to August 2006. Prior to this role, Mr. Choksi was Executive Vice President of Services from November 2004 to January 2006, responsible for developing and managing Level 3's communications services. Prior to that, Mr. Choksi was Executive Vice President Softswitch Services from January 2004 and Group Vice President Transport and Infrastructure from May 2003 until January 2004. Mr. Choksi was a Group Vice President and Chief Financial Officer of the Company from July 2000 to May 2003. Prior to that, Mr. Choksi was Group Vice President Corporate Development and Treasurer of the Company from February 2000 until August 2000. Prior to that, Mr. Choksi served as Vice President and Treasurer of the Company from January 1999 to February 2000. Prior to that, Mr. Choksi was a Director of Finance at the Company from 1997 to 1998, an Associate at TeleSoft Management, LLC in 1997 and an Analyst at Gleacher & Company from 1995 to 1997.

Andrew Crouch has been the President of the Wholesale Markets Group since January 2008, after serving as Group Vice President of Sales for the Wholesale Markets Group beginning in April 2006. Prior to that, Mr. Crouch served as the Senior Vice President of the Carrier Channel from January 2005 to April 2006, and Senior Vice President of the Enterprise Voice Services from January 2004 to January 2005. Mr. Crouch began his career at Level 3 in November 2001 as the Senior Vice President of Sales for the Cable and ISP Channel and held this position until December 2003. Before joining Level 3, Mr. Crouch served as the Deputy General Manager within the Corporate Clients Division at British Telecom. He also served as the Vice President of Commercial Operations for Concert Communications, a joint venture between British Telecom and AT&T from January 2000 to October 2001.

Jeffrey Tench has been the President of the Business Markets Group since November 2008, after serving as Group Vice President for Product Management beginning earlier in 2008. Prior to that, Mr. Tench served as the Senior Vice President of Product Management for Enterprise Products from March 2007 to January 2008. Mr. Tench began his career at Level 3 in 1999, and has held a range of product management positions across the entire Level 3 portfolio, including two years as Senior Vice President of Product for Level 3's European Markets Group. Before joining the Company, Mr. Tench served in a range of sales and product management positions at U S WEST Communications.

James Heard has been the President of the European Markets Group since April 2008. Prior to that, Mr. Heard was Managing Director for the European Markets Group from March 2007 to April 2008. From 1996 until 2007, Mr. Heard worked for British Telecommunications, in a number of senior management roles, including serving as the General Manager, Financial Services Group within BT Global services. He also served as the Vice President of Commercial Operations, Global accounts for Concert Communications, a joint venture between British Telecom and AT&T from January 2000 to June 2002. Prior to British Telecommunications, Mr. Heard served as Regional Sales Manager for Olivetti UK from March 1990 until June 1996.

Grant van Rooyen has been President of the Content Markets Group since April 2008. From March 2008 until April 2008, Mr. van Rooyen was the Group Vice President of the Content Markets Group with responsibility for sales, offer management, operations, research and development and a number of services including the Vyvx and CDN businesses. Mr. van Rooyen was the Senior Vice President of Marketing for the Company from February 2006 until January 2008, responsible for all Marketing activity in the Company. He has also served as the Senior Vice President of Product Management and Delivery for various services, including colocation, Internet services, Vyvx and CDN. Mr. van Rooyen was based in Europe and worked in our European business from 2004 through 2006 where he was the Vice President for Product Management, Delivery and Marketing. Mr. van Rooyen joined Level 3 in 1999 in London and held positions in International Business Development and Global Submarine Services. He joined Level 3 from the Global Satellite Services Division at British Telecom where he managed finance and commercial operations.

John F. Waters, Jr. has been President Operations, Chief Technology Officer since January 2008. Prior to that, Mr. Waters was Executive Vice President, Chief Technology Officer from January 2004 to January 2008. Prior to that, Mr. Waters was Group Vice President and Chief Technology Officer of the Company from February 2000 to January 2004. Prior to that, Mr. Waters was Vice President, Engineering of the Company from November 1997 until February 2000. Prior to that, Mr. Waters was an executive staff member of MCI Communications from 1994 to November 1997.

Kevin T. Hart has been Chief Information officer since January 2008. Prior to that, Mr. Hart was Group Vice President Global Systems Development and Chief Information Officer from January 2005 to 2008. Prior to that, Mr. Hart was Vice President of Telecommunications, Media & Entertainment at Capgemini (formerly Ernst & Young), a management consulting firm in Dallas, Texas, for over nine years. In that role, he was responsible for the overall growth and direction of the organization's Communications Operations Support Systems, Billing/Business Support Systems and the Network Management Systems service offerings and delivery. Prior to joining Capgemini's management consulting practice, he held the positions of Director of Strategic Planning at International Paper and Manager of Operations at SBC Communications.

At our 2009 Annual Meeting of Stockholders, the term of office of all of our directors will expire. At each annual meeting of stockholders, successors to the directors whose term expires at that annual meeting will be elected for a one-year term. Our officers are elected annually to serve until each successor is elected and qualified or until his or her death, resignation or removal.

We believe that the members of the Audit Committee are independent within the meaning of the listing standards of The NASDAQ Stock Market, LLC. The Board has determined that Mr. John T. Reed, Chairman of the Audit Committee, qualifies as a "financial expert" as defined by the Securities and Exchange Commission. The Board considered Mr. Reed's credentials and financial background and found that he was qualified to serve as the "financial expert."

Our website

Our website is www.level3.com . We caution you that any information that is included in our website is not part of this Form 10-K.

Code of Ethics

We have adopted a code of ethics that complies with the standards mandated by the Sarbanes-Oxley Act of 2002. The complete code of ethics is available on our website at www.level3.com. At any time that the code of ethics is not available on our website, we will provide a copy upon written request made to Investor Relations, Level 3 Communications, Inc., 1025 Eldorado Blvd., Broomfield, Colorado 80021. We caution you that any information that is included in our website is not part of this Form 10-K. If we amend the code of ethics, or grant any waiver from a provision of the code of ethics that applies to our executive officers or directors, we will publicly disclose such amendment or waiver as required by applicable law, including by posting such amendment or waiver on our website at www.level3.com or by filing a Form 8-K with the Securities and Exchange Commission or SEC.

SEC Filings

Our Form 10-K, along with all other reports and amendments filed with or furnished to the SEC are publicly available free of charge on the investor relations section of our website as soon as reasonably practicable after we file such materials with, or furnish them to, the SEC. We caution you that the information on our website is not part of this or any other report we file with, or furnish to, the SEC.

Section 16(a)—Beneficial Ownership Reporting Compliance

Except as described below, to our knowledge, no person that was a director, executive officer or beneficial owner of more than 10% of the outstanding shares of our common stock failed to timely file all reports required under Section 16(a) of the Securities Exchange Act of 1934. With respect to ten open market purchases of our 6% Convertible Subordinated Notes due 2010, our director, Robert E. Julian, did not timely file a Form 4.

Employees

As of December 31, 2008, we had approximately 5,300 total employees. We believe that our success depends in large part on our ability to attract and retain substantial numbers of qualified employees.

ITEM 1A. RISK FACTORS

Forward Looking Statements

We, or our representatives, from time to time may make or may have made certain forward-looking statements, either orally or in writing, including without limitation statements made or to be made in this Form 10-K, our Quarterly Reports on Form 10-Q, information contained in other filings with the SEC, press releases and other public documents or statements. In addition, our representatives, from time to time, participate in speeches and calls with market analysts, conferences with investors or potential investors in our securities and other meetings and conferences. Some of the information presented at these speeches, calls, meetings and conferences may include forward-looking statements. We use words like "plans," "estimates," "expects," "anticipates" or "believes" to identify forward-looking statements.

We wish to ensure that all forward-looking statements are accompanied by meaningful cautionary statements, so as to ensure to the fullest extent possible the protections of the safe harbor established in the Private Securities Litigation Reform Act of 1995. Accordingly, all forward-looking statements are qualified in their entirety by reference to, and are accompanied by, the following discussion of certain important factors that could cause actual results to differ materially from those projected in these forward-looking statements. We caution the reader that this list of important factors may not be exhaustive. We operate in a rapidly changing business, and new risk factors emerge from time to time.

We cannot predict every risk factor, nor can we assess the effect, if any, of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those projected in any forward-looking statements. Accordingly, forward-looking statements should not be relied upon as a prediction of actual results. Further, we undertake no obligation to update forward-looking statements after the date they are made to conform the statements to actual results or changes in our expectations.

Risks Related to our Business

Current uncertainty in the global financial markets and the global economy may negatively affect our financial results.

Current uncertainty in the global financial markets and economy may negatively affect our financial results. A prolonged period of economic decline could have a material adverse effect on our results of operations and financial condition and exacerbate some of the other risk factors we have described below. Our customers may defer purchases of our services in response to tighter credit and negative financial news or reduce their demand for our services. Our customers may also not be able to obtain adequate access to credit, which could affect their ability to make timely payments to us or ultimately cause the customer to file for protection from creditors under applicable insolvency or bankruptcy laws. If our customers are not able to make timely payments to us, our accounts receivable could increase.

In addition, our operating results and financial condition could be negatively affected if as a result of economic conditions:

- customers defer or forgo purchases of our services;
- customers are unable to make timely payments to us;
- the demand for, and prices of, our services are reduced as a result of actions by our competitors or otherwise;
- key suppliers upon which we rely are unable to provide us with the materials we need for our network on a timely basis; or
- our financial counterparties, insurance providers or other contractual counterparties are unable to, or do not meet, their contractual commitments to us.

For more information, please see the risk factor below under the caption, "Termination of relationships with key suppliers could cause delay and additional costs."

Recent disruptions in the financial markets could affect our ability to obtain debt or equity financing or to refinance our existing indebtedness on reasonable terms (or at all), and have other adverse effects on us.

Widely documented commercial credit market disruptions have resulted in a tightening of credit markets worldwide. Liquidity in the global credit markets have been severely contracted by these market disruptions, making it costly to obtain new lines of credit or to refinance existing debt, when debt financing is available at all. The effects of these disruptions are widespread and difficult to quantify, and it is impossible to predict when the global credit markets will improve or when the credit contraction will stop. As a result of the ongoing credit market turmoil, we may not be able to obtain debt or equity financing or to refinance our existing indebtedness on favorable terms (or at all), which could affect our strategic operations and our financial performance and force modifications to our operations.

If we were unable to refinance our debt or to raise additional capital on acceptable terms, our ability to operate our business would be impaired. As of December 31, 2008, we had an aggregate of approximately \$6.580 billion of long-term debt on a consolidated basis, including current maturities,

premiums and discounts, capital leases and our commercial mortgage, and approximately \$876 million of stockholders' equity. Of this long-term debt, approximately \$186 million is due to mature in 2009, approximately \$583 million is due to mature in 2010 and approximately \$569 million is due to mature in 2011, in each case excluding issue discounts, premiums and fair value adjustments. For more information, please see the risk factor below under the caption "We may not be able to repay our existing debt; failure to do so or refinance the debt could prevent us from implementing our strategy and realizing anticipated profits."

Communications Group

Our financial condition and growth depends upon the successful integration of our acquired businesses. We may not be able to efficiently and effectively integrate acquired operations, and thus may not fully realize the anticipated benefits from such acquisitions.

Achieving the anticipated benefits of the acquisitions that we have completed starting in December 2005 will depend in part upon whether we can integrate our businesses in an efficient and effective manner.

Since December 2005, we have acquired, in chronological order, WilTel Communications Group, LLC, Progress Telecom, LLC, ICG Communications, Inc., TelCove, Inc., Looking Glass Networks Holding Co., Inc., Broadwing Corporation, the CDN services business of SAVVIS, and Servecast Limited. In the future we may acquire additional businesses in accordance with our business strategy. The integration of our acquired businesses and any future businesses that we may acquire involves a number of risks, including, but not limited to:

- demands on management related to the significant increase in size after the acquisition;
- the disruption of ongoing business and the diversion of management's attention from the management of daily operations to the integration of operations;
- failure to fully achieve expected synergies and costs savings;
- unanticipated impediments in the integration of departments, systems, including accounting systems, technologies, books and records and procedures, as well as in maintaining uniform standards, controls, including internal control over financial reporting required by the Sarbanes-Oxley Act of 2002, procedures and policies;
- loss of customers or the failure of customers to order incremental services that we expect them to order;
- failure to provision services that are ordered by customers during the integration period;
- higher integration costs than anticipated; and
- difficulties in the assimilation and retention of highly qualified, experienced employees, many of whom are geographically dispersed.

Successful integration of these acquired businesses or operations will depend on our ability to manage these operations, realize opportunities for revenue growth presented by strengthened service offerings and expanded geographic market coverage, obtain better terms from our vendors due to increased buying power, and eliminate redundant and excess costs to fully realize the expected synergies. Because of difficulties in combining geographically distant operations and systems which may not be fully compatible, we may not be able to achieve the financial strength and growth we anticipate from the acquisitions.

We cannot be certain that we will realize our anticipated benefits from our acquisitions, or that we will be able to efficiently and effectively integrate the acquired operations as planned. If we fail to integrate the acquired businesses and operations efficiently and effectively or fail to realize the benefits we anticipate, we would be likely to experience material adverse effects on our business, financial condition, results of operations and future prospects.

We need to continue to increase the volume of traffic on our network to become and/or remain profitable.

We must continue to increase the volume of data, voice and content transmissions on our communications network at acceptable prices in order to realize our targets for anticipated revenue growth, cash flow, operating efficiencies and the cost benefits of our network. If we do not maintain or improve our current relationships with existing customers and develop new large volume and enterprise customers, we may not be able to substantially increase traffic on our network, which would adversely affect our ability to become and/or remain profitable.

Intellectual property and proprietary rights of others could prevent us from using necessary technology to provide our services or subject us to expensive intellectual property litigation.

If technology that is necessary for us to provide our services was determined by a court to infringe a patent held by another entity that is unwilling to grant us a license on terms acceptable to us, we could be precluded by a court order from using that technology and we would likely be required to pay a significant monetary damages award to the patent-holder. The successful enforcement of these patents, or our inability to negotiate a license for these patents on acceptable terms, could force us to cease using the relevant technology and offering services incorporating the technology. In the event that a claim of infringement was brought against us based on the use of our technology or against our customers based on their use of our services for which we are obligated to indemnify, we could be subject to litigation to determine whether such use or sale is, in fact, infringing. This litigation could be expensive and distracting, regardless of the outcome of the suit.

While our own patent portfolio may deter other operating companies from bringing such actions, patent infringement claims are increasingly being asserted by patent holding companies, which do not use technology and whose sole business is to enforce patents against operators, such as us, for monetary gain. Because such patent holding companies, commonly referred to as patent "trolls," do not provide services or use technology, the assertion of our own patents by way of counter-claim would be largely ineffective. We have already been the subject of time-consuming and expensive patent litigation brought by certain patent holding companies and we can reasonably expect that we will face further claims in the future, particularly if legislation now discussed in Congress is not enacted in a way that will decrease the number and frequency of claims by patent trolls.

Our business requires the continued development of effective business support systems to implement customer orders and to provide and bill for services.

Our business depends on our ability to continue to develop effective business support systems. In certain cases, the development of these business support systems is required to realize our anticipated benefits from our acquisitions. This is a complicated undertaking requiring significant resources and expertise and support from third-party vendors. Following the development of the business support systems, the data migration regarding network and circuit inventory must be completed for the full benefit of the systems to be realized. Business support systems are needed for:

- accepting and inputting customer orders for services;
- provisioning, installing and delivering these services; and
- billing for these services.

Because our business provides for continued rapid growth in the number of customers that we serve and the volume of services offered as well as requires the integration of acquired companies' business support systems, there is a need to continue to develop our business support systems on a schedule sufficient to meet proposed milestone dates. The failure to continue to develop effective unified business support systems could materially adversely affect our ability to implement our business plans, realize anticipated benefits from our acquisitions and meet our financial goals and objectives.

Our revenue is concentrated in a limited number of customers.

A significant portion of our communications revenue is concentrated among a limited number of customers. For the year ended December 31, 2008, our top ten customers represented approximately 31% of our consolidated total revenue. Revenue from our largest customer, AT&T Inc. and its subsidiaries, represented approximately 12% of our consolidated total revenue for 2008. The next largest customer accounted for approximately 5% of our consolidated total revenue and most of the remaining top ten customers each account for 3% or less of our consolidated total revenue. If we lost one or more of our top five customers, or, subject to the following, if one or more of these major customers significantly decreased orders for our services, our business would be materially and adversely affected.

In connection with the acquisition of WilTel in December 2005, we acquired a large customer contract between WilTel and SBC Communications, a subsidiary of AT&T, which we refer to as the SBC Master Services Agreement. We recognized \$201 million and \$303 million of revenue under the SBC Master Services Agreement during 2008 and 2007, respectively. The agreement provided a gross margin purchase commitment of \$335 million, which was fully satisfied in 2008. However, AT&T, Inc., continues to purchase services from us under the SBC Master Services Agreement as it continues to migrate the services provided under the agreement to its own network facilities. As a result of the satisfaction of the gross margin purchase commitment, we expect that the revenue generated under the SBC Master Services Agreement will continue to decline. For more information regarding the SBC Master Services Agreement, please see the discussion in "Management's Discussion and Analysis of Financial Condition and Results of Operations."

We may lose customers if we experience system failures that significantly disrupt the availability and quality of the services that we provide. System failures may also cause interruptions to service delivery and the completion of other corporate functions.

Our operations depend on our ability to avoid and mitigate any interruptions or degradation in service for customers. Interruptions in service or performance problems, for whatever reason, could undermine confidence in our services and cause us to lose customers or make it more difficult to attract new ones. In addition, because many of our services are critical to the businesses of many of our customers, any significant interruption or degradation in service could result in lost profits or other losses to customers. Although we generally limit our liability for service failures in our service agreements to limited service credits, generally in the form of free service for a short period of time and we generally exclude any liability for "consequential" damages such as lost profits, a court might not enforce these limitations on liability, which could expose us to financial loss. In addition, we often provide our customers with committed service levels. If we are unable to meet these service level commitments, we may be obligated to provide service credits or other compensation to our customers, which could negatively affect our operating results.

The failure of any equipment or facility on our network, including our network operations control centers and network data storage locations, could result in the interruption of customer service and other corporate functions until necessary repairs are effected or replacement equipment is installed. In addition, our business continuity plans may not be adequate to address a particular failure that we experience. Delays, errors, network equipment or network facility failures, including with respect to our

network operations control centers and network data storage locations, could also result from natural disasters, disease, accidents, terrorist acts, power losses, security breaches, vandalism or other illegal acts, computer viruses, or other causes. Our business could be significantly hurt from these delays, errors, failures or faults including as a result of:

- service interruptions;
- exposure to customer liability;
- the inability to install new service;
- the unavailability of employees necessary to provide services;
- the delay in the completion of other corporate functions such as issuing bills and the preparation of financial statements; or
- the need for expensive modifications to our systems and infrastructure.

For more information, please see the risk factor below under the caption, "Termination of relationships with key suppliers could cause delay and additional costs."

There is no guarantee that we will be successful in increasing sales of our content distribution service offering.

As we believe that one of the largest sources of future incremental demand for our communications services will be derived from customers that are seeking to distribute their video, feature rich content or applications over the Internet, we purchased the content distribution network or CDN assets of SAVVIS, Inc. in January 2007 and we purchased Servecast Limited in July 2007. Although we have sold high speed Internet access, transport and colocation services since the late 1990's, we have only been selling our CDN services since January 2007. As a result, there are many difficulties that we may encounter, including customer acceptance, customer support system development issues, intellectual property matters, technological issues, developmental constraints and other problems that we may not anticipate. There is no guarantee that we will be successful in generating significant revenues from our CDN service offering.

Failure to develop and introduce new services could affect our ability to compete in the industry.

We continuously develop, test and introduce new communications services that are delivered over our communications network. These new services are intended to allow us to address new segments of the communications marketplace and to compete for additional customers. In certain instances, the introduction of new services requires the successful development of new technology. To the extent that upgrades of existing technology are required for the introduction of new services, the success of these upgrades may be dependent on reaching mutually-acceptable terms with vendors and on vendors meeting their obligations in a timely manner. In addition, new service offerings may not be widely accepted by our customers. If our new service offerings are not widely accepted by our customers, we may terminate those service offerings and we may be required to impair any assets or technology used to develop or offer those services. If we are not able to successfully complete the development and introduction of new services in a timely manner, our business could be materially adversely affected.

Rapid technological changes can lead to further competition.

The communications industry is subject to rapid and significant changes in technology. In addition, the introduction of new services or technologies, as well as the further development of existing services and technologies may reduce the cost or increase the supply of certain services similar to those that we provide. As a result, our most significant competitors in the future may be new entrants to the communications industry. These new entrants may not be burdened by an installed base of outdated

equipment or obsolete technology. Our future success depends, in part, on our ability to anticipate and adapt in a timely manner to technological changes. Failure to do so could have a material adverse effect on our business.

During our communications business operating history we have generated substantial net operating losses, and we expect to continue to generate net operating losses.

Our expenditures combined with non-cash compensation expense as well as depreciation and amortization expense could result in substantial net losses for the near future. For the fiscal years ended December 31, 2008 and December 31, 2007, we incurred net losses of approximately \$290 million and \$1.114 billion, respectively. We expect to continue to experience net losses, and we may not be able to achieve or sustain profitability in the future. Continued net losses could limit our ability to obtain the cash needed to expand our network, make interest and principal payments on our debt, or fund other business needs.

We will need to continue to expand and adapt our network in order to remain competitive, which may require significant additional funding. Additional expansion and adaptations of our communications network's electronic and software components will be necessary in order to respond to:

- growing number of customers;
- the development and launching of new services;
- increased demands by customers to transmit larger amounts of data;
- changes in customers' service requirements;
- technological advances by competitors; and
- governmental regulations.

Future expansion or adaptation of our network will require substantial additional financial, operational and managerial resources, which may not be available at the time. If we are unable to expand or adapt our network to respond to these developments on a timely basis and at a commercially reasonable cost, our business will be materially adversely affected.

The market prices for certain of our communications services have decreased in the past and may decrease in the future, resulting in lower revenue than we anticipate.

Over the past few years, the market prices for certain of our communications services have decreased. These decreases resulted from downward market pressure and other factors including:

- technological changes and network expansions which have resulted in increased transmission capacity available for sale by us and by our competitors;
- some of our customer agreements contain volume-based pricing or other contractually agreed-upon decreases in prices during the term of the respective agreements; and
- some of our competitors have been willing to accept smaller operating margins in the short term in an attempt to increase long-term revenues.

In order to retain customers and revenue, we often must reduce prices in response to market conditions and trends. As our prices for some of our communications services decrease, our operating results may suffer unless we are unable to either reduce our operating expenses or increase traffic volume from which we can derive additional revenue.

We also expect revenue from our managed modem services to continue to decline primarily as a result of end users migrating to broadband services.

We may be liable for the information that content owners or distributors distribute over our network.

The law relating to the liability of private network operators for information carried on or disseminated through their networks is still unsettled. We may become subject to legal claims relating to the content disseminated on our network, even though such content is owned or distributed by our customers or a customer of our customers. For example, lawsuits may be brought against us claiming that material distributed using our network was inaccurate, offensive, or violated the law or the rights of others. Claims could also involve matters such as defamation, invasion of privacy and copyright infringement. In addition, the law remains unclear over whether content may be distributed from one jurisdiction, where the content is legal, into another jurisdiction, where it is not. Companies operating private networks have been sued in the past, sometimes successfully, based on the nature of material distributed, even if the content is not owned by the network operator and the network operator has no knowledge of the content or its legality. It is not practical for us to monitor all of the content which is distributed using our network. If we need to take costly measures to reduce our exposure to these risks, or are required to defend ourselves against such claims, our financial results could be negatively affected.

The need to obtain additional capacity for our network from other providers increases our costs.

We use network resources owned by other companies for portions of our network in North America, in Europe and elsewhere. We obtain the right to use such network portions, including both telecommunications capacity and rights to use dark fiber, through operating leases and IRU agreements. In several of those agreements, the counter party is responsible for network maintenance and repair. If a counter party to a lease or IRU suffers financial distress or bankruptcy, we may not be able to enforce our rights to use these network assets or, even if we could continue to use these network assets, we could incur material expenses related to maintenance and repair. We could also incur material expenses if we were required to locate alternative network assets. We may not be successful in obtaining reasonable alternative network assets if needed. Failure to obtain usage of alternative network assets, if necessary, could have a material adverse effect on our ability to carry on business operations. In addition, some of our agreements with other providers require the payment of amounts for services whether or not those services are used.

In the normal course of business, we need to enter into interconnection agreements with many domestic and foreign local telephone companies, but we are not always able to do so on favorable terms. Costs of obtaining local service from other carriers comprise a significant proportion of the operating expenses of long distance carriers. Similarly, a large proportion of the costs of providing international service consists of payments to other carriers. Changes in regulation, particularly the regulation of local and international telecommunication carriers, could indirectly, but significantly, affect our competitive position. These changes could increase or decrease the costs of providing our services.

We may be unable to hire and retain sufficient qualified personnel; the loss of any of our key executive officers could adversely affect our business.

We believe that our future success will depend in large part on our ability to attract and retain highly skilled, knowledgeable, sophisticated and qualified managerial, professional and technical personnel. We have experienced significant competition in attracting and retaining personnel who possess the skills that we are seeking. As a result of this significant competition, we may experience a shortage of qualified personnel.

Our businesses are managed by a small number of key executive officers, including James Q. Crowe, Chief Executive Officer. The loss of any of these key executive officers could have a material adverse effect on our business.

We must obtain and maintain permits and rights-of-way to operate our network.

If we are unable, on acceptable terms and on a timely basis, to obtain and maintain the franchises, permits and rights-of-way needed to expand and operate our network, our business could be materially adversely affected. In addition, the cancellation or non-renewal of the franchises, permits or rights-of-way that are obtained could materially adversely affect our business. Our communications operating subsidiaries are defendants in several lawsuits that, among other things, challenge the subsidiaries' use of rights-of-way. The plaintiffs have sought to have these lawsuits certified as class actions. It is possible that additional suits challenging use of our rights-of-way will be filed and that those plaintiffs also may seek class certification. The outcome of such litigation may increase our costs and adversely affect our operating results.

Termination of relationships with key suppliers could cause delay and additional costs.

Our business is dependent on third-party suppliers for fiber, computers, software, optronics, transmission electronics and related components that are integrated into our network, some of which are critical to the operation of our business. If any of these critical relationships is terminated, a supplier either exits or curtails its business as a result of the current economic conditions, a supplier fails to provide critical services or equipment, or the supplier is forced to stop providing services due to legal constraints, such as patent infringement, and we are unable to reach suitable alternative arrangements quickly, we may experience significant additional costs or we may not be able to provide certain services to customers. If that happens, our business could be materially adversely affected.

AT&T and Verizon may not provide us local access services at prices which allow us to effectively compete.

We acquire a significant portion of our local access services, the connection between our owned network and the customer premises, from incumbent local exchange carriers or ILECs. With the recent acquisitions by AT&T and Verizon, the ILECs now compete directly with our business and may have a tendency to favor themselves and their affiliates to our detriment. Network access represents a very large portion of our total costs and if we face less favorable pricing and provisioning, we may be at a competitive disadvantage to the ILECs.

We are subject to significant regulation that could change in an adverse manner.

Communications services are subject to significant regulation at the federal, state, local and international levels. These regulations affect our business and our existing and potential competitors. Delays in receiving required regulatory approvals (including approvals relating to acquisitions or financing activities), completing interconnection agreements with other carriers, or the enactment of new and adverse regulations or regulatory requirements may have a material adverse effect on our business. In addition, future legislative, judicial and regulatory agency actions could have a material adverse effect on our business.

Federal legislation provides for a significant deregulation of the U.S. telecommunications industry, including the local exchange, long distance and cable television industries. This legislation remains subject to judicial review and additional Federal Communications Commission, or FCC, rulemaking. As a result, we cannot predict the legislation's effect on our future operations. Many regulatory actions are under way or are being contemplated by federal and state authorities regarding important issues. These actions could have a material adverse effect on our business.

The laws in certain countries currently do not permit us to offer services directly in those countries.

Ownership of telecommunications facilities that originate or terminate traffic in certain countries, such as Canada and China, is currently limited to nationals of those countries. This restriction hinders our entry into those markets.

Potential regulation of Internet service providers in the United States could adversely affect our operations.

The FCC has, to date, treated Internet service providers as enhanced service providers. In addition, Congress has, to date, not sought to heavily regulate the provision of IP-based services. Both Congress and the FCC are considering proposals that involve greater regulation of IP-based service providers. Depending on the content and scope of any regulations, the imposition of such regulations could have a material adverse effect on our business and the profitability of our services.

The communications industry is highly competitive with participants that have greater resources and a greater number of existing customers.

The communications industry is highly competitive. Many of our existing and potential competitors have financial, personnel, marketing and other resources significantly greater than ours. Many of these competitors have the added competitive advantage of a larger existing customer base. In addition, significant new competition could arise as a result of:

- the consolidation in the industry;
- allowing foreign carriers to more extensively compete in the U.S. market;
- further technological advances; and
- further deregulation and other regulatory initiatives.

If we are unable to compete successfully, our business could be significantly affected.

We may be unable to successfully identify, manage and assimilate future acquisitions, investments and strategic alliances, which could adversely affect our results of operations.

We continually evaluate potential investments and strategic opportunities to expand our network, enhance connectivity and add traffic to our network. In the future, we may seek additional investments, strategic alliances or similar arrangements, which may expose us to risks such as:

- the difficulty of identifying appropriate investments, strategic allies or opportunities on terms acceptable to us;
- the possibility that senior management may be required to spend considerable time negotiating agreements and monitoring these arrangements;
- potential regulatory issues applicable to the telecommunications business;
- the loss or reduction in value of the capital investment;
- our inability to capitalize on the opportunities presented by these arrangements; and
- the possibility of insolvency of a strategic ally.

There can be no assurance that we would successfully overcome these risks or any other problems encountered with these investments, strategic alliances or similar arrangements.

Other Operations

Environmental liabilities from our historical operations could be material.

There could be environmental liabilities arising from historical operations of our predecessors, for which we may be liable. Our operations and properties are subject to a wide variety of laws and regulations relating to environmental protection, human health and safety. These laws and regulations include those concerning the use and management of hazardous and non-hazardous substances and wastes. We have made and will continue to make significant expenditures relating to our environmental compliance obligations. Despite our best efforts, we may not at all times be in compliance with all of these requirements.

In connection with certain historical operations, we have responded to or been notified of potential environmental liability at approximately 150 properties as of February 15, 2009. We are engaged in addressing or have liquidated environmental liabilities at 72 of those properties. Of these: (a) we have formal commitments or other potential future costs at 15 sites; (b) there are 10 sites with minimal future costs; (c) there are 12 sites with unknown future costs and (d) there are 35 sites with no likely future costs. The remaining 78 properties have been dormant for several years. We could be held liable, jointly or severally, and without regard to fault, for such investigation and remediation. The discovery of additional environmental liabilities related to historical operations or changes in existing environmental requirements could have a material adverse effect on our business.

Potential liabilities and claims arising from coal operations could be significant.

Our coal operations are subject to extensive laws and regulations that impose stringent operational, maintenance, financial assurance, environmental compliance, reclamation, restoration and closure requirements. These requirements include those governing air and water emissions, waste disposal, worker health and safety, benefits for current and retired coal miners, and other general permitting and licensing requirements. Despite our best efforts, we may not at all times be in compliance with all of these requirements. Liabilities or claims associated with this non-compliance could require us to incur material costs or suspend production. Mine reclamation costs that exceed reserves for these matters also could require us to incur material costs.

General

If we are unable to comply with the restrictions and covenants in our debt agreements, there would be a default under the terms of these agreements, and this could result in an acceleration of payment of funds that have been borrowed.

If we were unable to comply with the restrictions and covenants in any of our debt agreements, there would be a default under the terms of those agreements. As a result, borrowings under other debt instruments that contain cross-acceleration or cross-default provisions may also be accelerated and become due and payable. If any of these events occur, there can be no assurance that we would be able to make necessary payments to the lenders or that we would be able to find alternative financing. Even if we were able to obtain alternative financing, there can be no assurance that it would be on terms that are acceptable.

We have substantial debt, which may hinder our growth and put us at a competitive disadvantage.

Our substantial debt may have important consequences, including the following:

- the ability to obtain additional financing for acquisitions, working capital, investments and capital or other expenditures could be impaired or financing may not be available on acceptable terms;

- a substantial portion of our cash flows will be used to make principal and interest payments on outstanding debt, reducing the funds that would otherwise be available for operations and future business opportunities;
- a substantial decrease in cash flows from operating activities or an increase in expenses could make it difficult to meet debt service requirements and force modifications to operations;
- we have more debt than certain of our competitors, which may place us at a competitive disadvantage; and
- substantial debt may make us more vulnerable to a downturn in business or the economy generally.

We had deficiencies of earnings to cover fixed charges of \$236 million for the fiscal year ended December 31, 2008, \$1.068 billion for the fiscal year ended December 31, 2007, \$720 million for the fiscal year ended December 31, 2006, \$634 million for the fiscal year ended December 31, 2005, and \$409 million for the fiscal year ended December 31, 2004.

We may not be able to repay our existing debt; failure to do so or refinance the debt could prevent us from implementing our strategy and realizing anticipated profits.

If we were unable to refinance our debt or to raise additional capital on acceptable terms, our ability to operate our business would be impaired. As of December 31, 2008, we had an aggregate of approximately \$6.580 billion of long-term debt on a consolidated basis, including current maturities, premiums and discounts, capital leases and our commercial mortgage, and approximately \$876 million of stockholders' equity. Of this long-term debt, approximately \$186 million is due to mature in 2009, approximately \$583 million is due to mature in 2010 and approximately \$569 million is due to mature in 2011, in each case excluding issue discounts, premiums and fair value adjustments.

Our ability to make interest and principal payments on our debt and borrow additional funds on favorable terms depends on the future performance of the business. If we do not have enough cash flow in the future to make interest or principal payments on our debt, we may be required to refinance all or a part of our debt or to raise additional capital. We cannot be sure that we will be able to refinance our debt or raise additional capital on acceptable terms.

Restrictions and covenants in our debt agreements limit our ability to conduct our business and could prevent us from obtaining needed funds in the future.

Our debt and financing arrangements contain a number of significant limitations that restrict our ability to, among other things:

- borrow additional money or issue guarantees;
- pay dividends or other distributions to stockholders;
- make investments;
- create liens on assets;
- sell assets;
- enter into sale-leaseback transactions;
- enter into transactions with affiliates; and
- engage in mergers or consolidations.

The unpredictability of our quarterly results may adversely affect the trading price of our common stock.

Our revenue and operating results will vary significantly from quarter to quarter due to a number of factors, many of which are outside of our control and any of which may cause the price of our common stock to fluctuate. The primary factors, among other things, that may affect our quarterly results include the following:

- the timing of costs associated with the operation of our business and our integration activities with respect to our recently completed acquisitions;
- demand for communications services;
- loss of customers or the ability to attract new customers;
- changes in pricing policies or the pricing policies of our competitors;
- costs related to acquisitions of technology or businesses;
- changes in regulatory rulings; and
- general economic conditions as well as those specific to the communications and related industries.

A delay in generating revenue or the timing of recognizing revenue and expenses could cause significant variations in our operating results from quarter to quarter. It is possible that in some future quarters our results may be below analysts and investors expectations. In these circumstances, the price of our common stock will likely decrease.

If certain transactions occur with respect to our capital stock, we may be unable to fully utilize our net operating loss carryforwards to reduce our income taxes.

As of December 31, 2008, we had net operating loss carry forwards of approximately \$4.7 billion for federal income tax purposes. If certain transactions occur with respect to our capital stock that result in a cumulative ownership change of more than 50 percentage points by 5-percent stockholders over a three-year period as determined under rules prescribed by the U.S. Internal Revenue Code of 1986, as amended (the "Code") and applicable regulations, annual limitations would be imposed with respect to our ability to utilize our net operating loss carry forwards and certain current deductions against any taxable income we achieve in future periods.

We have entered into transactions over the applicable three year period that, when combined with other changes in ownership that are outside of our control, have resulted in cumulative changes in the ownership of our capital stock. Additional transactions that we enter into, as well as transactions by existing 5% stockholders and transactions by holders that become new 5% stockholders that we do not participate in, could cause us to incur a 50 percentage point ownership change by 5% stockholders and, if we trigger the above-noted Code imposed limitations, such transactions would prevent us from fully utilizing net operating loss carry forwards and certain current deductions to reduce income taxes.

Increased scrutiny of financial disclosure, particularly in the telecommunications industry in which we operate, could adversely affect investor confidence, and any restatement of earnings could increase litigation risks and limit our ability to access the capital markets.

Congress, the SEC, other regulatory authorities and the media are intensely scrutinizing a number of financial reporting issues and practices. If we were required to restate our financial statements as a result of a determination that we had incorrectly applied generally accepted accounting principles or as a result of other factors or errors, that restatement could adversely affect our ability to access the capital markets or the trading price of our securities. The recent scrutiny regarding financial reporting has also resulted in an increase in litigation in the telecommunications industry. There can be no

assurance that any such litigation against us would not materially adversely affect our business or the trading price of our securities.

Terrorist attacks and other acts of violence or war may adversely affect the financial markets and our business.

Since the September 11, 2001 terrorist attacks and subsequent events, there has been considerable uncertainty in world financial markets. The full effect on the financial markets of these events, as well as concerns about future terrorist attacks, is not yet known. They could, however, adversely affect our ability to obtain financing on terms acceptable to us, or at all.

There can be no assurance that there will not be further terrorist attacks against the United States or U.S. businesses. These attacks or armed conflicts may directly affect our physical facilities or those of our customers. These events could cause consumer confidence and spending to decrease or result in increased volatility in the U.S. and world financial markets and economy. Any of these occurrences could materially adversely affect our business.

Our international operations and investments expose us to risks that could materially adversely affect the business.

We have operations and investments outside of the United States, as well as rights to undersea cable capacity extending to other countries, that expose us to risks inherent in international operations. These include:

- general economic, social and political conditions;
- the difficulty of enforcing agreements and collecting receivables through certain foreign legal systems;
- tax rates in some foreign countries may exceed those in the U.S.;
- foreign currency exchange rates may fluctuate, which could adversely affect our results of operations and the value of our international assets and investments;
- foreign earnings may be subject to withholding requirements or the imposition of tariffs, exchange controls or other restrictions;
- difficulties and costs of compliance with foreign laws and regulations that impose restrictions on our investments and operations, with penalties for noncompliance, including loss of licenses and monetary fines;
- difficulties in obtaining licenses or interconnection arrangements on acceptable terms, if at all; and
- changes in U.S. laws and regulations relating to foreign trade and investment.

Additional issuances of equity securities by us would dilute the ownership of our existing stockholders.

We may issue equity in the future in connection with acquisitions or strategic transactions, to adjust our ratio of debt to equity, including through repayment of outstanding debt, to fund expansion of our operations or for other purposes. To the extent we issue additional equity securities, the percentage ownership of our existing stockholders would be reduced.

Anti-takeover provisions in our charter and by-laws could limit the share price and delay a change of management.

Our restated certificate of incorporation and by-laws contain provisions that could make it more difficult or even prevent a third party from acquiring us without the approval of our incumbent board of directors. These provisions, among other things:

- prohibit stockholder action by written consent in place of a meeting;
- limit the right of stockholders to call special meetings of stockholders;
- limit the right of stockholders to present proposals or nominate directors for election at annual meetings of stockholders; and
- authorize our board of directors to issue preferred stock in one or more series without any action on the part of stockholders.

In addition, the terms of most of our long term debt require that upon a "change of control," as defined in the agreements that contain the terms and conditions of the long term debt, we make an offer to purchase the outstanding long term debt at either 100% or 101% of the aggregate principal amount of that long term debt.

These provisions could limit the price that investors might be willing to pay in the future for shares of our common stock and significantly impede the ability of the holders of our common stock to change management. Provisions and agreements that inhibit or discourage takeover attempts could reduce the market value of our common stock.

If a large number of shares of our common stock is sold in the public market, the sales could reduce the trading price of our common stock and impede our ability to raise future capital.

We cannot predict what effect, if any, future issuances by us of our common stock will have on the market price of our common stock. In addition, shares of our common stock that we issue in connection with an acquisition may not be subject to resale restrictions. The market price of our common stock could drop significantly if certain large holders of our common stock, or recipients of our common stock in connection with an acquisition, sell all or a significant portion of their shares of common stock or are perceived by the market as intending to sell these shares other than in an orderly manner. In addition, these sales could impair our ability in the future to raise capital through the sale of additional common stock in the capital markets.

The market price of our common stock has been volatile and, in the future, the market price of our common stock may fluctuate substantially due to a variety of factors.

The market price of our common stock has been subject to volatility and, in the future, the market price of our common stock may fluctuate substantially due to a variety of factors, including:

- the depth and liquidity of the trading market for our common stock;
- quarterly variations in actual or anticipated operating results;
- changes in estimated earnings by securities analysts;
- market conditions in the communications and information services industries;
- announcement and performance by competitors;
- regulatory actions; and
- general economic conditions.

In addition, in recent months the stock market generally has experienced significant price and volume fluctuations. Those market fluctuations could have a material adverse effect on the market price or liquidity of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our headquarters are located on 46 acres in the Interlocken Advanced Technology Environment within the City and County of Broomfield, Colorado. The campus facility, which is owned by our wholly owned subsidiary HQ Realty, Inc., encompasses approximately 850,000 square feet of office space.

Additionally, we lease approximately 120,000 square feet of office and technical space in a building located at 180 Peachtree Street, NW in Atlanta, Georgia. We also lease approximately 143,000 square feet of office and technical space in the building known as One Technology Center located at 100 South Cincinnati Avenue in Tulsa, Oklahoma and approximately 42,000 square feet of office space in the Southpointe office park in Canonsburg, Pennsylvania. We also use approximately 8,900 square feet of office space that we own in the building located at 200 Technology Drive, Pittsburgh, Pennsylvania. We also lease approximately 128,000 square feet of office space in a building located at 1122 South Capital of Texas Highway in Austin, Texas. In Europe, we have approximately 211,000 square feet of office space in the United Kingdom and approximately 3,000 square feet of office space in France.

Properties relating to our network operations in the communications business are described under "ITEM 1. BUSINESS—Our Communications Network" above.

Our Gateway facilities are designed to house local sales staff, operational staff, our transmission and IP routing/switching facilities and technical space to accommodate colocation of equipment by high-volume Level 3 customers. We ended 2008 with approximately 6.9 million square feet of space for our Gateway and transmission facilities and have completed construction on approximately 4.6 million square feet of this space. Our Gateway space is either owned by us or is held pursuant to long-term lease agreements.

We have entered into various agreements regarding our unused office and technical space in order to reduce our ongoing operating expenses regarding such space.

Properties relating to our coal mining segment are described under "ITEM 1. BUSINESS—Our Other Businesses" above. In connection with certain existing and historical operations, we are subject to environmental risks.

ITEM 3. LEGAL PROCEEDINGS

In April 2002, Level 3 Communications, Inc., and two of its subsidiaries were named as defendants in *Bauer, et. al. v. Level 3 Communications, LLC, et al.*, a purported class action covering 22 states, filed in state court in Madison County, Illinois. In July 2001, Level 3 was named as a defendant in *Koyle, et. al. v. Level 3 Communications, Inc., et al.*, a purported two state class action filed in the U.S. District Court for the District of Idaho. In November of 2005, the court granted class certification only for the state of Idaho. In September 2002, Level 3 Communications, LLC and Williams Communications, LLC were named as defendants in *Smith et. al. v. Sprint Communications Company, L.P., et al.*, a purported nationwide class action filed in the United States District Court for the Northern District of Illinois. In April 2005, the Smith plaintiffs filed a Fourth Amended Complaint which did not include Level 3 or Williams Communications, Inc. as a party, thus ending both companies' involvement in the Smith case. On February 17, 2005, Level 3 Communications, LLC and Williams Communications, LLC were named as defendants in *McDaniel, et. al., v. Qwest Communications Corporation, et al.*, a purported class action

covering 10 states filed in the United States District Court for the Northern District of Illinois. All of these actions involve the companies' right to install its fiber optic cable network in easements and right-of-ways crossing the plaintiffs' land. In general, the companies obtained the rights to construct their networks from railroads, utilities, and others, and have installed their networks along the rights-of-way so granted. Plaintiffs in the purported class actions assert that they are the owners of lands over which the companies' fiber optic cable networks pass, and that the railroads, utilities, and others who granted the companies the right to construct and maintain their networks did not have the legal authority to do so. The complaints seek damages on theories of trespass, unjust enrichment and slander of title and property, as well as punitive damages. The companies have also received, and may in the future receive, claims and demands related to rights-of-way issues similar to the issues in these cases that may be based on similar or different legal theories.

The Company and its subsidiaries have negotiated a proposed nationwide class settlement affecting persons who own or owned land next to or near railroad rights of way. The United States District Court for the District of Massachusetts in *Kingsborough v. Sprint Communications Co. L.P.* has granted preliminary approval of the proposed settlement which, if finally approved, will resolve all of the pending actions. The proposed settlement will provide cash payments to class members based on various factors that include:

- the length of the right of way where the cable is installed;
- the state where the property is located; and
- how the railroad obtained its property rights.

The proposed settlement will also provide the Company and its subsidiaries with a permanent telecommunications easement, which gives them certain rights over the railroad right of way.

It is still too early for the Company to reach a conclusion as to the ultimate outcome of the proposed settlement of these actions. However, management believes that the Company and its subsidiaries have substantial defenses to the claims asserted in all of these actions (and any similar claims which may be named in the future), and intends to defend them vigorously if a satisfactory form of settlement is not ultimately approved. Additionally, management believes that any resulting liabilities for these actions, beyond amounts reserved, will not materially affect the Company's financial condition or future results of operations, but could affect future cash flows.

In February 2009, Level 3 Communications, Inc., certain of its current officers and a former officer were named as defendants in purported class action lawsuits filed in the United States District Court for the District of Colorado, which have been consolidated as *In re Level 3 Communications, Inc. Securities Litigation (Civil Case No. 09-cv-00200-PAB-CBS)*. The Plaintiffs in each complaint allege, in general, that throughout the purported class period of February 8, 2007 to October 23, 2007, the defendants failed to disclose material adverse facts about the Company's business and operations. Specifically, defendants failed to disclose or indicate the following: (1) that the Company's efforts to integrate the numerous acquired companies were not going well; (2) that, specifically, the Company was experiencing an increase in service activation times, which was negatively impacting the Company's service installation intervals and the rate of its revenue growth; (3) that the Company was also experiencing challenges in its service management processes that were resulting in longer response times to resolve customer's network service issues; (4) that steps taken by the Company to remedy the problems were not working and actually, further complicating the issues and making them worse; (5) that, as a result of the above, the Company did not have adequate provisioning capability to convert its increasing sales, or signed orders, into revenue generating service; (6) that the Company lacked adequate internal controls; and (7) that, as a result of the above, the statements made by the defendants during the purported class period lacked a reasonable basis. The complaints seek damages based on purported violations of Section 10(b) of the Securities Exchange Act of 1934, Securities and

Exchange Commission Rule 10b-5 promulgated thereunder and Section 20(a) of the Securities Exchange Act of 1934.

It is too early for the Company to reach a conclusion as to the ultimate outcome of these actions. However, management believes that the Company has substantial defenses to the claims asserted in all of these actions (and any similar claims which may be named in the future), and intends to defend these actions vigorously.

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

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

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

Part II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information. Our common stock is traded on the NASDAQ Global Select Market of The NASDAQ Stock Market LLC under the symbol "LVL.T." As of February 25, 2009, there were approximately 7,900 holders of record of our common stock, par value \$.01 per share. The table below sets forth, for the calendar quarters indicated, the high and low per share sale prices of our common stock as reported by the NASDAQ Global Select Market of The NASDAQ Stock Market LLC.

| <u>Year Ended December 31, 2008</u> | <u>High</u> | <u>Low</u> |
|-------------------------------------|-------------|------------|
| First Quarter | \$3.53 | \$1.68 |
| Second Quarter | 4.48 | 1.96 |
| Third Quarter | 3.90 | 2.44 |
| Fourth Quarter | 2.75 | 0.57 |

| <u>Year Ended December 31, 2007</u> | <u>High</u> | <u>Low</u> |
|-------------------------------------|-------------|------------|
| First Quarter | \$6.80 | \$5.54 |
| Second Quarter | 6.30 | 5.20 |
| Third Quarter | 6.42 | 4.28 |
| Fourth Quarter | 5.10 | 2.66 |

Equity Compensation Plan Information.

We have only one equity compensation plan—The 1995 Stock Plan, as amended—under which we may issue shares of our common stock to employees, officers, directors and consultants. This plan has been approved by our stockholders. The following table provides information about the shares of our common stock that may be issued upon exercise of awards under the 1995 Stock Plan as of December 31, 2008.

| <u>Plan Category</u> | <u>Number of securities to</u> | | <u>Weighted-average</u> | <u>Number of securities</u> |
|--|--------------------------------|--------------------------------|-----------------------------|------------------------------|
| | <u>be issued upon exercise</u> | <u>of outstanding options,</u> | | |
| | <u>warrants and rights</u> | <u>warrants and rights</u> | <u>outstanding options,</u> | <u>future issuance under</u> |
| Equity compensation plans approved by stockholders | 40,858,846 [†] | \$ 3.90 ^{†‡} | | 78,375,455 |
| Equity compensation plans not approved by stockholders | 0 | \$ 0.00 | | 0 |

[†] Includes awards of outperform stock options or outperform stock appreciate units ("OSOs"). For purposes of this table, these securities are considered to use a single share of our common stock from the total number of shares reserved for issuance under the 1995 Stock Plan.

[‡] Includes weighted-average exercise price of outstanding OSOs at the date of grant. The exercise price of an OSO is subject to change based upon the performance of our common stock relative to the performance of the S&P 500® Index from the time of the grant of the award until the award has been exercised.

OSOs are currently designed to provide recipients of the awards with the incentive to maximize stockholder value and to reward recipient employees only when the price of our common stock outperforms the S&P 500® Index between the date of grant and the date that the OSO is exercised or settled. For the OSOs granted beginning in April 2007, OSOs have a three-year life and vest 100% on

the third anniversary of the date of the award and will fully settle on that date. In other words, recipients of these OSOs will not be able to voluntarily exercise the OSOs as they will settle automatically with value on the third anniversary of the date of the award or expire without value on that date. This type of instrument is sometimes referred to as a "European style option." For OSOs granted prior to April 2007, the OSOs generally have a four-year life and vest 50% at the end of the first year after grant, with the remaining 50% vesting in four equal quarterly installments so that the OSOs are fully vested by the end of the second year after grant.

OSOs have an initial strike price that is equal to the closing market price of our common stock on the trading day immediately prior to the date of grant. This initial strike price is referred to as the "Initial Price." On the settlement date or the date that an employee elects to exercise an OSO, the Initial Price is adjusted—as of that date—by a percentage that is equal to the aggregate percentage increase or decrease in the S&P 500® Index over the period beginning on the date of grant and ending on the trading day immediately preceding the settlement or exercise date. The Initial Price, however, can not be adjusted below the closing price of our common stock on the day that the OSO was granted.

The value of all OSOs will increase as the price of our common stock increases relative to the performance of the S&P® 500 Index over time. This increase in value is attributable in part to the use of a "success multiplier."

The mechanism for determining the value of an individual OSO award is described below: The Initial Price is adjusted over time (the "Adjusted Strike Price") until the settlement or exercise date. The adjustment is an amount equal to the percentage appreciation or depreciation in the value of the S&P 500® Index from the date of grant to the settlement date. The value of the OSO increases for increasing levels of outperformance. OSOs have a multiplier range from zero to four depending upon the performance of our common stock relative to the S&P 500® Index as shown in the following table.

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

The pre-multiplier gain is our common stock price minus the Adjusted Strike Price on the settlement or exercise date.

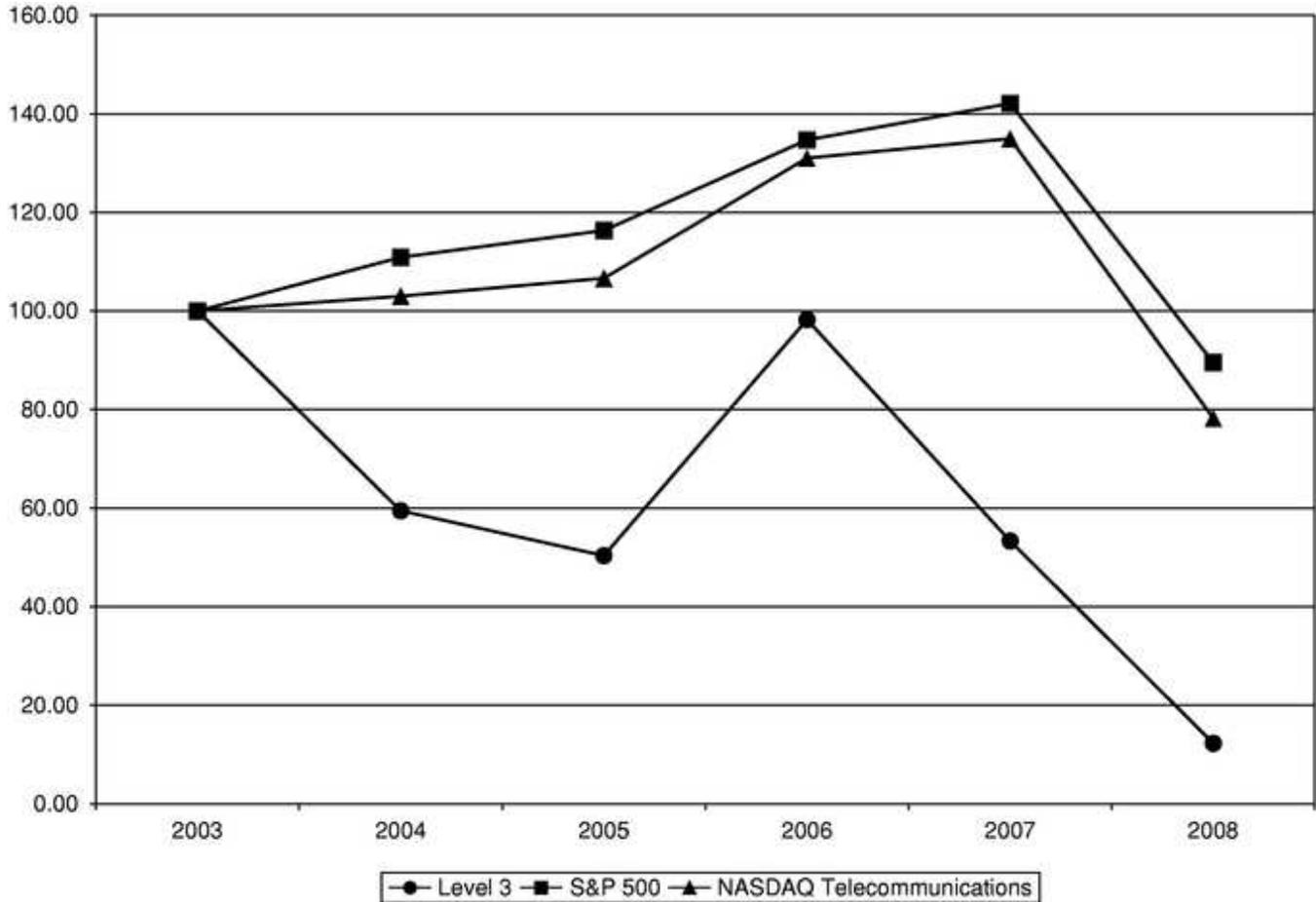
Dividend Policy. Our current dividend policy, in effect since April 1, 1998, is to retain future earnings for use in our business. As a result, our directors and management do not anticipate paying any cash dividends on shares of our common stock in the foreseeable future. In addition, under certain of our debt covenants we may be restricted from paying cash dividends on shares of our common stock.

Performance Graph.

The following performance graph shall not be deemed to be incorporated by reference by means of any general statement incorporating by reference this Form 10-K into any filing under the Securities Act of 1933, as amended or the Securities Exchange Act of 1934, except to the extent that the company specifically incorporates such information by reference, and shall not otherwise be deemed filed under such acts.

The graph compares the cumulative total return of our common stock for the five year period from 2004 through 2008 with the S&P® 500 Index and the Nasdaq Telecommunications Index. The graph assumes that the value of the investment was \$100 on December 31, 2003, and that all dividends and other distributions were reinvested.

**Comparison of Five Year Cumulative Total Return
Among Our Common Stock, the S&P® 500 Index
and the Nasdaq Telecommunications Index**



| | 12/03 | 12/04 | 12/05 | 12/06 | 12/07 | 12/08 |
|---------------------------|--------|--------|--------|--------|--------|-------|
| Level 3 Common Stock | 100.00 | 59.47 | 50.35 | 98.25 | 53.33 | 12.28 |
| S&P 500® Index | 100.00 | 110.88 | 116.33 | 134.70 | 142.10 | 89.53 |
| NASDAQ Telecommunications | 100.00 | 103.00 | 106.64 | 131.01 | 134.97 | 78.22 |

ITEM 6. SELECTED FINANCIAL DATA

The Selected Financial Data of Level 3 Communications, Inc. and its subsidiaries appear below.

| | Fiscal Year Ended(1) | | | | |
|---|----------------------|----------|---------|---------|---------|
| | 2008 | 2007 | 2006 | 2005 | 2004 |
| (dollars in millions, except per share amounts) | | | | | |
| Results of Operations: | | | | | |
| Revenue | \$4,301 | \$ 4,269 | \$3,378 | \$1,719 | \$1,776 |
| Loss from continuing operations(2) | (290) | (1,114) | (790) | (707) | (478) |
| Income (loss) from discontinued operations(3) | — | — | 46 | 69 | 20 |
| Net loss | (290) | (1,114) | (744) | (638) | (458) |
| Per Common Share: | | | | | |
| Loss from continuing operations(2) | (0.19) | (0.73) | (0.79) | (1.01) | (0.70) |
| Income (loss) from discontinued operations(3) | — | — | 0.05 | 0.10 | 0.03 |
| Net loss | (0.19) | (0.73) | (0.74) | (0.91) | (0.67) |
| Dividends(4) | — | — | — | — | — |
| Financial Position: | | | | | |
| Total assets | 9,638 | 10,254 | 9,994 | 8,277 | 7,544 |
| Current portion of long-term debt(5) | 186 | 32 | 5 | — | 143 |
| Long-term debt, less current portion(5) | 6,394 | 6,832 | 7,357 | 6,023 | 5,067 |
| Stockholders' equity (deficit)(6) | 876 | 1,070 | 374 | (476) | (157) |

- (1) The operating results of Software Spectrum, Inc. ("Software Spectrum"), which was sold in 2006, and (i)Structure, LLC (" i)Structure"), which was sold in 2005, are included in discontinued operations for all periods presented for which Level 3 owned each business.

The Company acquired the managed modem businesses of ICG Communications, Inc. and Sprint Communications Company, L.P. on April 1, 2004 and October 1, 2004, respectively.

The Company purchased WilTel Communications Group, LLC ("WilTel") on December 23, 2005, and recorded approximately \$38 million of revenue attributable to this business in 2005.

The Company purchased Progress Telecom, LLC ("Progress Telecom") on March 20, 2006; ICG Communications, Inc. ("ICG Communications") on May 31, 2006; TelCove, Inc. ("TelCove") on July 24, 2006 and Looking Glass Networks Holding Co., Inc. ("Looking Glass") on August 2, 2006. The WilTel, Progress Telecom, ICG Communications, TelCove and Looking Glass results of operations and financial position are included in the consolidated financial statements from the respective dates of their acquisition. During 2006, the Company recorded revenue attributable to Progress Telecom of \$49 million, ICG Communications of \$46 million, TelCove of \$166 million and Looking Glass of \$33 million.

The Company purchased Broadwing Corporation ("Broadwing") on January 3, 2007; the Content Delivery Network services business of SAVVIS, Inc. (the "CDN Business") on January 23, 2007 and Servecast Limited on July 11, 2007. During 2007, the Company recorded revenue attributable to Broadwing of \$946 million, the CDN Business of \$17 million and Servecast of \$3 million.

On June 5, 2008, Level 3 completed the sale of its Vyvx advertising distribution business to DG FastChannel, Inc. and received gross proceeds at closing of approximately \$129 million in cash. Net proceeds from the sale approximated \$121 million after deducting transaction-related costs. Revenue attributable to the Vyvx advertising distribution business totaled \$15 million in 2008 through the date of sale, \$36 million in 2007 and \$35 million in 2006. The Vyvx businesses were acquired by the Company at the end of 2005 in the WilTel acquisition.

- (2) In 2004, the Company recognized a gain of \$197 million as a result of the early extinguishments of certain long-term debt and \$113 million of termination revenue.

In 2005, the Company recognized \$133 million of termination revenue and approximately \$23 million of impairment and restructuring charges.

In 2006, the Company recognized approximately \$13 million of impairment and restructuring charges, and a loss on early extinguishment of debt of \$83 million as a result of the amendment and restatement of its senior secured credit facility and certain debt exchanges and redemptions.

In 2007, the Company recognized approximately \$12 million of impairment and restructuring charges, and a loss on the early extinguishment of debt of \$427 million as a result of the refinancing of its senior secured credit agreement and certain debt exchanges, redemptions and repurchases. The Company also recognized a gain of \$37 million on the sale of marketable equity securities and a tax benefit of \$23 million related to certain state tax matters.

In 2008, the Company recognized approximately \$25 million of impairment and restructuring charges, \$44 million of induced debt conversion expenses attributable to the exchange of certain of the Company's convertible debt securities, a gain on the early extinguishment of debt of \$125 million as a result of certain debt repurchases, and a \$99 million gain on the sale of the Company's Vyvx advertising distribution business and the sale of certain of its smaller long distance voice customers. The Company also revised its estimates of the amounts and timing of its original estimate of undiscounted cash flows related to certain future asset retirement obligations in the fourth quarter of 2008. As a result, the Company reduced its asset retirement obligations liability by \$103 million with an offsetting reduction to property, plant and equipment of \$21 million, selling, general and administrative expenses of \$86 million, depreciation and amortization of \$11 million and an increase to goodwill of \$15 million.

- (3) In 2005, the Company sold (i)Structure and recognized a gain on the sale of \$49 million. For fiscal years 2005 and 2004, (i)Structure revenue approximated costs.

In 2006, the Company sold Software Spectrum and recognized a gain on the sale of \$33 million. The income from the operations of Software Spectrum was \$13 million, \$20 million and \$20 million for the fiscal years 2006, 2005 and 2004, respectively.

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

- (5) In 2004, the Company received net proceeds of \$987 million from the issuance of a \$730 million Senior Secured Term Loan due 2011 and the issuance of \$345 million of 5.25% Convertible Senior Notes due 2011. The Company used the net proceeds to repay portions of its 9.125% Senior Notes due 2008, 11% Senior Notes due 2008, 10.5% Senior Discount Notes due 2008 and 10.75% Senior Euro Notes due 2008. The Company repurchased portions of the outstanding notes at prices ranging from 83 percent to 89 percent of the repurchased principal balances. The net gain on the early extinguishment of the debt, including transaction costs, realized foreign currency losses and unamortized debt issuance costs, was \$50 million for these transactions. Also in 2004, the Company paid approximately \$54 million and assumed certain obligations to extinguish a Genuity capital lease obligation and recognized a gain of \$147 million on the transaction.

In 2005, the Company received net proceeds of \$877 million from the issuance of \$880 million of 10% Convertible Senior Notes due 2011. Also in 2005, a wholly owned subsidiary of the Company received net proceeds of \$66 million from the completion of a refinancing of the mortgage of its

corporate headquarters. The subsidiary entered into a new mortgage loan of \$70 million at an initial fixed rate of 6.86% through 2010.

In 2006, the Company received net proceeds of \$142 million from the issuance by its wholly owned subsidiary of \$150 million of Floating Rate Senior Notes due 2011, net proceeds of \$538 million from the issuance of \$550 million of 12.25% Senior Notes due 2013, net proceeds of \$326 million from its issuance of \$335 million of 3.5% Convertible Senior Notes due 2012 and net proceeds of \$1.239 billion (excluding prepaid interest) from the issuance by its wholly owned subsidiary of \$1.250 billion of 9.25% Senior Notes due 2014. Also in 2006, the Company exchanged a portion of its outstanding 9.125% Senior Notes due 2008, 11% Senior Notes due 2008 and 10.5% Senior Discount Notes due 2008 for \$46 million of cash and \$692 million aggregate principal of new 11.5% Senior Notes due 2010. In addition, the Company redeemed the remaining outstanding 9.125% Senior Notes due 2008 totaling \$398 million, 10.5% Senior Discount Notes due 2008 totaling \$62 million and repurchased 99.3% of its wholly owned subsidiary's 10.75% Senior Notes due 2011 totaling \$497 million.

In 2007, the Company received net proceeds of \$982 million from the issuance by its wholly owned subsidiary of 8.75% Senior Notes due 2017 and Floating Rate Senior Notes due 2015 and net proceeds of \$1.382 billion for the refinancing of its senior secured credit agreement. In connection with the refinancing of the senior secured credit agreement the borrower repaid its \$730 million Senior Secured Term Loan due 2011. In 2007, the Company redeemed \$488 million of its outstanding 12.875% Senior Notes due 2010, \$96 million of outstanding 11.25% Senior Notes due 2010 and \$138 million (€104 million) of outstanding 11.25% Senior Euro Notes due 2010. Also in 2007, the Company's wholly owned subsidiary repurchased \$144 million of its outstanding Floating Rate Senior Notes due 2011, the Company repurchased \$59 million of its outstanding 11% Senior Notes due 2008, \$677 million of its outstanding 11.5% Senior Notes due 2010 and \$61 million (€46 million) of its outstanding 10.75% Senior Euro Notes due 2008. The Company also completed the exchange of \$605 million of its 10% Convertible Senior Notes due 2011 for a total of 197 million shares of common stock during 2007. The Company also converted or repurchased \$180 million of Broadwing's outstanding 3.125% Convertible Senior Debentures due 2026 through the issuance of 17 million shares of common stock and the payment of \$106 million in cash in 2007.

In 2008, the Company received proceeds of \$400 million from the issuance of its 15% Convertible Senior Notes due 2013. In connection with the issuance of the 15% Convertible Senior Notes due 2013, the Company completed tender offers and repurchased \$163 million of its 2.875% Convertible Senior Notes due 2010, \$173 million of its 6% Convertible Subordinated Notes due 2010 and \$124 million of its 6% Convertible Subordinated Notes due 2009. In 2008, the Company completed exchanges with holders of various issues of its convertible debt in which the Company issued approximately 48 million shares of the Company's common stock in exchange for \$18 million of its 6% Convertible Subordinated Notes due 2009, \$47 million of its 10% Convertible Senior Notes due 2011, \$19 million of its 2.875% Convertible Senior Notes due 2010, \$15 million of its 5.25% Convertible Senior Notes due 2011 and \$9 million of its 3.5% Convertible Senior Notes due 2012. Also in 2008, the Company repurchased \$39 million aggregate principal amount of its 6% Convertible Subordinated Notes due 2009 and \$32 million aggregate principal amount of its 6% Convertible Subordinated Notes due 2010. The Company also repaid at maturity the remaining \$20 million of its outstanding 11% Senior Notes due 2008 and approximately \$6 million (€4 million) of its outstanding 10.75% Senior Euro Notes due 2008.

- (6) In 2004, the Company realized \$95 million of foreign currency losses on the repurchase of its Euro denominated debt.

In 2005, the Company issued 115 million shares of common stock, valued at approximately \$313 million, as the stock portion of the purchase price paid to acquire WilTel.

In 2006, the Company issued approximately 125 million shares of common stock in a public offering, valued at approximately \$543 million.

In 2006, the Company issued 20 million shares of common stock, valued at approximately \$66 million, as the stock portion of the purchase price paid to acquire Progress Telecom; 26 million shares of common stock, valued at approximately \$131 million, as the stock portion of the purchase price paid to acquire ICG Communications; 150 million shares of common stock, valued at approximately \$623 million, as the stock portion of the purchase price paid to acquire TelCove; and 21 million shares of common stock, valued at approximately \$84 million, as the stock portion of the purchase price paid to acquire Looking Glass.

In 2007, the Company issued 197 million shares of common stock in exchange for \$605 million of its 10% Convertible Senior Notes due 2011. The Company also issued 123 million shares of common stock, valued at approximately \$688 million, as the stock portion of the purchase price to acquire Broadwing Corporation. Also in 2007, the Company issued 17 million shares of common stock in connection with the conversion of \$179 million of Broadwing's outstanding 3.125% Convertible Senior Debentures due 2026.

In 2008, the Company issued approximately 48 million shares of common stock in exchange for \$108 million aggregate principal amount of various issues of its convertible debt.

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

This document contains forward looking statements and information that are based on the beliefs of management as well as assumptions made by and information currently available to Level 3 Communications, Inc. and its subsidiaries ("Level 3" or the "Company"). When used in this document, the words "anticipate", "believe", "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.

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

Level 3 Communications, Inc., through its operating subsidiaries, is primarily engaged in the communications business, with additional operations in coal mining.

Communications Business

The Company is a facilities based provider of a broad range of communications services. Revenue for communications services is recognized on a monthly basis as these services are provided. For contracts involving private line, wavelengths 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. At December 31, 2008, for contracts where up-front payments were received for services to be delivered in the future, the Company's weighted average remaining contract period was approximately 12 years.

Communications revenue consists of:

- Core Communications Services
- Other Communications Services

The two categories of Communications revenue are in different phases of the service life cycle, requiring different levels of investment and focus, and providing different contributions to the Company's Communications Adjusted EBITDA. Management of Level 3 believes that growth in revenue from its Core Communications Services is critical to the long-term success of its communications business. At the same time, the Company believes it must continue to effectively manage the positive cash flows from its Other Communications Services. Core Communications Services includes revenue from Core Network Services and Wholesale Voice Services. Core Network Services revenue represents higher margin services and Wholesale Voice Services represents lower margin services. The Company believes that trends in the communications business are best gauged by looking at revenue trends in Core Network Services. The Company manages Wholesale Voice performance based on gross margin contribution. Core Network Services includes revenue from transport and infrastructure, IP and data services, including content delivery network services, local and enterprise voice services and Level 3 Vyvx broadcast services. Wholesale Voice Services includes revenue from long distance voice services, including domestic voice termination, international voice termination and toll free services. Other Communications Services includes revenue from managed modem and its related reciprocal 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 ("WilTel").

Core Communications Services

The Company's transport and infrastructure services include metropolitan and intercity wavelengths, private line, ethernet private line, dark fiber, colocation services, professional services and transoceanic services. Growth in transport and infrastructure 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 services to its customers to directly connect customer locations with a private network. Pricing for end-to-end services has been stable. For metropolitan transport services, prices have been stable and in some instances are increasing. For intercity transport services, the Company continues to experience pricing pressure for point-to-point locations, particularly in locations where a large number of carriers co-locate their facilities. An increase in demand may be partially offset by declines in unit pricing.

IP and data services primarily include the Company's high speed Internet access service, dedicated Internet access ("DIA") service, ATM and frame relay services, IP and ethernet virtual private network ("VPN") services, and content delivery network ("CDN") services, which includes streaming services. Level 3's Internet access service is a high quality and high-speed Internet access service offered in a variety of capacities. The Company's VPN services permit 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 services also permit 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 Communications 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 usage by both enterprises and consumers 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 stable, the IP market is generally characterized by price compression and high unit growth rates depending upon the type of service, resulting in growth in absolute revenue. The Company experienced price compression in the high-speed IP market in 2008 and expects that pricing for its high-speed IP services will continue to decline in 2009.

The Company's Core Network Services includes local and enterprise voice services. Local voice services are primarily components that enable other service providers to deliver business or consumer-ready voice products to their end customers. Enterprise voice services are business-grade voice services that the Company sells directly to its business customers.

The Company, through its Level 3 Vyvx business, provides transport services for the audio and video programming of its customers over the Company's fiber-optic network and via satellite. It uses the Company's fiber-optic network to carry live traditional broadcast and cable television events from the site of the event to the network control centers of the broadcasters of the event.

For live events where the location is not known in advance, such as breaking news stories in remote locations, the Company provides an integrated satellite and fiber-optic network-based service to transmit the content to its customers. Most of Level 3 Vyvx's customers for these services contract for the service on an event-by-event basis; however, there are some customers who have purchased a dedicated point-to-point service which enables these customers to transmit programming at any time.

Prior to the sale of the Vyvx advertising distribution business, Level 3 Vyvx distributed advertising spots to radio and television stations throughout the U.S., both electronically and in physical form. Customers for these services utilized a network-based method for aggregating, managing, storing and distributing content for content owners and rights holders.

On June 5, 2008, Level 3 completed the sale of its Vyvx advertising distribution business to DG FastChannel, Inc. and received gross proceeds at closing of approximately \$129 million in cash. Level 3 has retained ownership of Vyvx's core broadcast business, including the Vyvx Services Broadcast Business' content distribution capabilities.

The financial results of the Vyvx advertising distribution business are included in the Company's consolidated results of operations through the date of sale on June 5, 2008.

Level 3 recognized a gain on the sale of the Vyvx advertising distribution business of \$96 million in 2008. The gain is presented in the consolidated statements of operations as "Gain on sale of business groups, net."

The Company has developed content distribution services through the acquisition of the Content Delivery Network services business ("CDN Business") of SAVVIS, which it purchased in January 2007 from SAVVIS, and the acquisition of Dublin, Ireland based Servecast Ltd., which it purchased in July 2007. The Company believes that the addition of the CDN Business with its strong, broad portfolio of patents will help the Company secure its commercial efforts in the heavily patented CDN market, in which a number of competitors have significant, patented intellectual property. Level 3 believes that one of the largest sources of future incremental demand for communications services will be derived from customers that are seeking to distribute their feature rich content or video over the Internet.

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.

Core Communications Services Market Groups

In order to serve the changing needs of customers in growing markets and to drive growth across the Communications organization, Core Communications Services revenue by customer is also disaggregated into four customer-facing market groups as follows:

- The Wholesale Markets Group services the communications needs of the largest national and global service providers, including carriers, cable companies, wireless companies, voice service providers, systems integrators and the federal government. These customers typically integrate Level 3 services into their own products and services to offer to their end user customers.
- The Business Markets Group targets enterprise customers and regional carriers who value a local, professional sales force. Specific customer markets include medium and large businesses, local and regional carriers, state and local government entities, and higher education institutions and consortia.
- The Content Markets Group focuses on serving media and content companies with large and growing bandwidth needs. Customers in this market include video distribution companies, providers of gaming, mega-portals, software service providers, social networking providers, as well as more traditional media distribution companies such as broadcasters, satellite companies, television networks and sports leagues.
- The European Markets Group serves large European consumers of bandwidth, including the largest European and international carriers, large system integrators, voice service providers,

cable operators, Internet service providers, content providers, and government and education sectors.

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

Core Communications Services revenue by customer-facing market group was as follows:

| (dollars in millions) | Year Ended December 31, | | |
|------------------------------------|-------------------------|----------------|----------------|
| | 2008 | 2007 | 2006 |
| Wholesale Markets Group | \$2,177 | \$2,045 | \$1,205 |
| Business Markets Group | 959 | 941 | 327 |
| Content Markets Group | 398 | 380 | 254 |
| European Markets Group | 326 | 256 | 187 |
| Total Core Communications Services | <u>\$3,860</u> | <u>\$3,622</u> | <u>\$1,973</u> |

The classification of customers within each customer-facing market group can change based upon sales team assignments, merger and acquisition activity by customers and other factors.

Other Communications Services

The Company's Other Communications Services are mature services that are not critical areas of emphasis for the Company. Other Communications Services includes revenue from managed modem and its related reciprocal compensation services and SBC Contract Services, which includes revenue derived under the SBC Master Services Agreement that was obtained in the WilTel acquisition. 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. Additionally, America Online, a primary consumer of the Company's dial-up services, has been implementing a strategic change in its approach to its dial-up internet access business over the past few years that has accelerated the loss of its dial-up subscribers. During 2007, America Online's strategy accelerated the decline in managed modem revenue and contributed to further declines in managed modem revenue in 2008. The Company recognized approximately \$103 million of managed modem revenue in 2008, a 35% decline from the \$158 million of managed modem revenue recognized in 2007. The declines in managed modem revenue from America Online have been offset to some extent by an increase in market share as a result of certain competitors exiting segments of this business. The Company believes that the low-cost structure of its network will enable it to compete aggressively for new business in the declining managed modem market.

The Company receives compensation from other carriers when it terminates traffic originating on those carriers' networks. This reciprocal compensation is based on interconnection agreements with the respective carriers or rates mandated by the FCC. The Company has interconnection agreements in place for the majority of traffic subject to reciprocal compensation. In addition, a majority of the Company's existing reciprocal compensation revenue is associated with agreements that are in effect through 2009 or beyond. The Company continues to negotiate new interconnection agreements or amendments to its existing interconnection agreements with local carriers as needed. The Company earns the majority of its reciprocal compensation revenue from providing managed modem services. The Company also receives reciprocal compensation from its voice services.

Communications Business Strategy and Objectives

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, business groups 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.

The Company is focusing its attention on the following operational and financial objectives:

- increasing sales;
- improving the customer experience to increase customer retention and reducing customer churn;
- achieving sustainable generation of positive cash flows from operations in excess of capital expenditures;
- reducing network costs and operating expenses;
- growing Core Communications Services revenue, particularly Core Network Services revenue;
- continuing to show improvements in Adjusted EBITDA as a percentage of revenue;
- completing the integration of acquired businesses;
- growing its content delivery network services;
- continuing to implement its metro network strategy;
- managing cash flows provided by its Other Communications Services; and
- refinancing its future debt maturities.

The Company's management believes the introduction of new services or technologies, as well as the further development of existing technologies, may reduce the cost or increase the supply of certain services similar to those provided by Level 3. The ability of the Company to anticipate, adapt and invest in these technology changes in a timely manner may affect the Company's future success.

In 2006, the Company strategically expanded its presence in metropolitan markets and began offering services to enterprise customers through its Business Markets Group. This strategy allowed the Company to terminate traffic over its owned facilities rather than paying third parties to terminate the traffic. The expansion into new metro markets also provided additional opportunities to sell services to bandwidth intensive businesses on the Company's national and international networks. In order to expedite the expansion of its metro business, Level 3 acquired Progress Telecom, ICG Communications, TelCove and Looking Glass in 2006 and Broadwing in the first quarter of 2007. Level 3 also strategically expanded its content delivery network services with the acquisitions of the CDN Business in the first quarter of 2007 and Servecast in the third quarter of 2007. The results of operations attributable to each acquisition are included in the consolidated financial statements from the date of acquisition. Below is a summary of the Company's 2007 and 2006 acquisitions.

Servecast Acquisition: On July 11, 2007, Level 3 completed the acquisition of Servecast Limited, a Dublin, Ireland based provider of live and on-demand video management and streaming services for broadband and mobile platforms. Level 3 paid approximately €34 million, or \$46 million, in cash, including transaction costs, to complete the acquisition of Servecast.

CDN Business Acquisition: On January 23, 2007, Level 3 completed the acquisition of the Content Delivery Network services business of SAVVIS, Inc. Level 3 paid approximately \$133 million in cash,

including transaction costs, to acquire the assets of the CDN Business, including network elements, customer contracts and intellectual property used in the CDN Business.

Broadwing Acquisition: On January 3, 2007, Level 3 acquired Broadwing, a publicly held provider of optical network communications services. Under the terms of the merger agreement, Level 3 paid \$8.18 of cash plus 1.3411 shares of Level 3 common stock for each share of Broadwing common stock outstanding at closing. In total, Level 3 paid approximately \$755 million of cash, including transaction costs, and issued approximately 123 million shares of the Company's common stock, valued at \$688 million. As part of the Broadwing acquisition, approximately 3.8 million previously issued Broadwing warrants (valued at approximately \$4 million) became exercisable for approximately 5.1 million shares of Level 3 common stock.

In connection with the acquisition of Broadwing, the Company guaranteed \$180 million in aggregate principal amount of Broadwing Corporation's 3.125% Convertible Senior Debentures due 2026 (the "Broadwing Debentures") and the transaction included \$24 million in capital lease obligations related primarily to a metro fiber IRU agreement. As of February 16, 2007, the holders of \$179 million in aggregate principal amount of the Broadwing Debentures converted their Broadwing Debentures into a total of 17 million shares of Level 3 common stock and approximately \$105 million in cash pursuant to the terms of the indenture governing the Broadwing Debentures and the agreement whereby Level 3 acquired Broadwing. The remaining \$1 million in aggregate principal amount of the Broadwing Debentures was repurchased by Broadwing at 100% of par as required by the indenture governing the Broadwing Debentures.

Looking Glass Acquisition: On August 2, 2006, Level 3 completed the acquisition of Looking Glass, a privately held Illinois-based telecommunications company. The consideration paid by Level 3 consisted of approximately \$13 million in cash, including transaction costs, and approximately 21 million shares of Level 3 common stock valued at \$84 million. In addition, at the closing, Level 3 repaid approximately \$67 million of Looking Glass liabilities.

TelCove Acquisition: On July 24, 2006, Level 3 completed the acquisition of TelCove, a privately held Pennsylvania-based telecommunications company. The consideration paid by Level 3 consisted of approximately \$461 million in cash, including transaction costs, and approximately 150 million shares of Level 3 common stock valued at \$623 million. In addition, Level 3 repaid approximately \$132 million of TelCove liabilities.

ICG Communications: On May 31, 2006, Level 3 acquired all of the stock of ICG Communications, a privately held Colorado-based telecommunications company, from MCCC ICG Holdings, LLC excluding certain assets and liabilities. Under the terms of the purchase agreement, Level 3 purchased ICG Communications for aggregate consideration consisting of approximately 26 million shares of Level 3 common stock, valued at \$131 million, and approximately \$47 million in cash, including transaction costs and working capital adjustments.

Progress Telecom: On March 20, 2006, Level 3 completed its acquisition of all of the membership interests of Progress Telecom from PT Holding Company LLC ("PT Holding") excluding certain specified assets and liabilities of Progress Telecom. Progress Telecom was owned by PT Holding which is jointly owned by Progress Energy, Inc. and Odyssey Telecorp, Inc. Under the terms of the purchase agreement, Level 3 purchased Progress Telecom for an aggregate purchase price consisting of approximately \$68 million in cash, including transaction costs and working capital adjustments, and approximately 20 million shares of Level 3 common stock, valued at \$66 million.

Level 3 will continue to evaluate acquisition opportunities and could make additional acquisitions in the future.

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

In 2007, during the second quarter and portions of the third quarter, the Company's service activation times increased as a result of the following issues:

- Continuing to use the multiple order entry and provisioning systems and processes that were operated by the acquired companies to provision end-to-end services.
- Insufficient training on the multiple systems for employees performing service activation functions.
- Lack of sufficient staffing levels in some service activation areas.
- Identifying and fixing service activation throughput issues was challenging as a result of decentralizing service activation functions across the customer facing groups.

This increase in service activation cycle time had a negative effect on the Company's service installation intervals and the rate of Core Communications Services revenue growth during 2007. During this same period, the Company also experienced challenges in its service management processes that resulted in longer response times to resolve customer's network service issues. As a result of consolidating key operational functions and organizations as part of the integration effort, the Company's operating environment became more complex in the first half of 2007.

During the second and third quarters of 2007, the Company implemented certain process and organizational changes that were expected to improve service activation times and allow it to achieve its previously forecasted revenue and Adjusted EBITDA growth. However, these changes were not adequate to address the breadth of the problems encountered during the second and third quarters of 2007. As a result of these service activation and service management issues, the growth in Communications Services revenue and Adjusted EBITDA was lower than originally expected for the full year 2007.

The Company has taken steps to improve its existing processes and systems to address the increase in service activation times and improve its service management. With respect to the latter, the Company saw improvements in its service management during the fourth quarter of 2007 and in 2008. Additionally, the Company believes it has implemented sufficient improvements in service activation capabilities to match installation capacity to customer demand for services.

The Company has ongoing process and system development work that is being implemented as part of the integration efforts which have and are expected to further address the service activation and service management issues of systems and processes utilized by acquired companies as well as provide significant overall improvements to operations. The Company completed the foundation of its processes and systems development objectives at the end of 2008 and is now focused on operational efficiency improvements.

Recent changes in the composition of the Company's revenue have required the Company to manage operating expenses carefully and to concentrate its capital expenditures on those technologies and assets that enable the Company to develop its Core Communications Services further and replace the decline in revenue and earnings from Other Communications Services. Recent uncertainty in the

global financial markets and economy has also required the Company to continue to manage its cost structure more efficiently. In addition, our operating results and financial condition could be negatively affected if as a result of economic conditions:

- customers defer or forgo purchases of our services;
- customers are unable to make timely payments to us;
- the demand for, and prices of, our services are reduced as a result of actions by our competitors or otherwise;
- key suppliers upon which we rely are unable to provide us with the materials we need for our network on a timely basis; or
- our financial counterparties, insurance providers or other contractual counterparties are unable to, or do not meet, their contractual commitments to us.

In addition to the operational objectives mentioned above, the Company has also been focused on improving its liquidity, financial condition, and extending the maturity dates of certain debt.

In December 2008, the Company completed tender offers for and repurchased \$163 million in the aggregate of its 2.875% Convertible Senior Notes due 2010, \$173 million of its 6% Convertible Subordinated Notes due 2010 and \$124 million of its 6% Convertible Subordinated Notes due 2009. In connection with the completion of the tender offers, the Company issued \$400 million aggregate principal amount of its 15% Convertible Senior Notes due 2013.

In October 2008, the Company completed exchanges with holders of various issues of its convertible debt in which the Company issued approximately 48 million shares of the Company's common stock in exchange for \$18 million of its 6% Convertible Subordinated Notes due 2009, \$47 million of its 10% Convertible Senior Notes due 2011, \$19 million of its 2.875% Convertible Senior Notes due 2010, \$15 million of its 5.25% Convertible Senior Notes due 2011 and \$9 million of its 3.5% Convertible Senior Notes due 2012.

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 communications business.

Coal Mining

Level 3, through its two 50% owned joint-venture surface mines, one each in Montana and Wyoming, sells coal primarily through long-term contracts with public utilities. The long-term contracts for the delivery of coal establish the price, volume, and quality requirements of the coal to be delivered. Revenue under these and other contracts is generally recognized when coal is shipped to the customer.

Information Services

On November 30, 2005, the Company sold its wholly owned subsidiary, (i)Structure, LLC, which provided computer outsourcing services primarily to small and medium-sized businesses. The Company also completed the disposition of its remaining subsidiary in the information services business, Software Spectrum, Inc. on September 7, 2006. The results of operations and financial position for (i)Structure and Software Spectrum are reflected as discontinued operations for all applicable periods presented in this report.

Critical Accounting Policies and Estimates

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of

assets, liabilities, revenue, expenses and related disclosures. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The Company evaluates these estimates on an ongoing basis. Actual results may differ from these estimates under different assumptions or conditions.

While the Company has other accounting policies that involve estimates such as the allowance for doubtful accounts, revenue reserves, useful lives of long-lived assets, accruals for estimated tax and legal liabilities, cost of revenue disputes for communications services, valuation allowance for deferred tax assets, and unfavorable contracts recognized in purchase accounting, management has identified the policies below, which require the most significant judgments and estimates to be made in the preparation of the consolidated financial statements, as critical to its business operations and the understanding of its results of operations.

Revenue

Revenue for communications services, including transport, infrastructure, data, colocation, IP, Vvix broadcast, voice, and managed modem, is recognized monthly as the services are provided. Communications services are provided either on a usage basis, which can vary period to period, or at a contractually committed amount.

Reciprocal compensation revenue is recognized when an interconnection agreement is in place with another carrier, or if an agreement has expired, when the parties have agreed to continue operating under the previous agreement until a new agreement is negotiated and executed; or at rates mandated by the FCC. Periodically, the Company will receive payment for reciprocal compensation services in excess of FCC rates and before an agreement is in place. These amounts are included in other current liabilities on the consolidated balance sheets until a final agreement has been reached and the necessary regulatory approvals have been received at which time the reciprocal compensation revenue is recognized. These amounts were insignificant to the Company in 2008, 2007 and 2006.

Revenue attributable to leases of dark fiber pursuant to indefeasible rights-of-use agreements ("IRUs") that qualified for sales-type lease accounting and were entered into prior to June 30, 1999, were recognized at the time of delivery and acceptance of the fiber by the customer. Certain sale and long-term IRU agreements of dark fiber and capacity entered into after June 30, 1999, are required to be accounted for in the same manner as sales of real estate with property improvements or integral equipment. This accounting treatment results in the deferral of revenue for the cash that has been received and the recognition of revenue ratably over the term of the agreement (generally up to 20 years).

Termination revenue is recognized when a customer disconnects service prior to the end of the contract period and for which Level 3 had previously received consideration and for which revenue recognition was deferred. Termination revenue is also recognized when customers make termination penalty payments to Level 3 to settle contractually committed purchase amounts that the customer no longer expects to meet or when a customer and Level 3 renegotiate a contract under which Level 3 is no longer obligated to provide product or services for consideration previously received and for which revenue recognition has been deferred. Termination revenue is reported in the same manner as the original product or service provided.

Accounting practice and guidance with respect to the accounting treatment of revenue continues to evolve. Any changes in the accounting treatment could affect the manner in which the Company accounts for revenue within its communications and coal businesses.

Non-Cash Compensation

The Company recognizes stock-based compensation expense for all share-based payment awards in accordance with Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share-Based Payment" ("SFAS No. 123R"). Under the fair value recognition provisions of SFAS 123R, the Company recognizes stock-based compensation expense net of an estimated forfeiture rate, recognizing compensation cost for only those awards expected to vest over the requisite service period of the awards. Determining the appropriate fair value model and calculating the fair value of share-based payment awards require subjective assumptions, including the expected life of the share-based payment awards and stock price volatility. The Company issues outperform stock options in which the value received is based on a formula involving a multiplier related to the level by which the Company's common stock outperforms the S&P 500® Index. The Company utilizes a modified Black-Scholes model due to the additional variables required to calculate the effect of the success multiplier for its outperform stock options, including estimating the expected volatility of the S&P 500® Index. As a result of the deterioration of the Company's stock price at the end of 2008, the aggregate intrinsic value of outstanding outperform stock options was zero as of December 31, 2008.

The assumptions used in calculating the fair value of share-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and the Company uses different assumptions, stock-based compensation expense could be materially different in the future. In addition, the Company is required to estimate the expected forfeiture rate and recognize expense only for those shares expected to vest. If actual forfeiture rates are materially different from the Company's estimate, stock-based compensation expense could be significantly different from what the Company has recorded in the current period.

Valuation of Long-Lived Assets

The Company performs an assessment of its long-lived assets, including finite-lived acquisition-related intangible assets, for impairment when events or changes in circumstances indicate that the carrying value of assets or asset groupings may not be recoverable. This review requires the identification of the lowest level of identifiable cash flows for purposes of grouping assets subject to review. The estimate of undiscounted cash flows includes long-term forecasts of revenue growth, gross margins and operating expenses. All of these items require significant judgment and assumptions. The impairment analysis of long-lived assets also requires the Company to make certain subjective assumptions and estimates regarding the expected future use of certain additional conduits and the expected future use of certain empty conduit. An impairment loss may exist when the estimated undiscounted cash flows attributable to the assets are less than their carrying amount. If an asset is deemed to be impaired, the amount of the impairment loss recognized represents the excess of the long-lived asset's carrying value as compared to its estimated fair value, based on management's assumptions and projections.

The Company conducted a long-lived asset impairment analysis in the fourth quarter of 2008 and concluded that its long-lived assets, including finite-lived acquisition-related intangible assets, were not impaired. To the extent that future changes in assumptions and estimates cause a change in estimates of future cash flows that indicate the carrying amount of the Company's long-lived assets, including finite-lived acquisition-related intangible assets, may not be recoverable, the Company may incur impairment charges in the future to write-down the carrying amount of the Company's long-lived assets, including finite-lived acquisition-related intangible assets, to their estimated fair value.

Valuation of Goodwill and Acquired Indefinite-Lived Intangible Assets

The Company performs an assessment of its goodwill for impairment annually at the end of the fourth quarter, or more frequently if the Company determines that indicators of impairment exist. The Company's impairment review process compares the fair value of each reporting unit to its carrying

value. The Company's reporting units are consistent with the reportable segments identified in Note 14 to the Consolidated Financial Statements. If the fair value of the reporting unit exceeds its carrying value, goodwill is not impaired and no further testing is performed. If the carrying value of the reporting unit exceeds its fair value, then a second step must be performed, and the implied fair value of the reporting unit's goodwill must be determined and compared to the carrying value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then an impairment loss equal to the difference will be recorded.

The Company's fair value methodology consists of a quoted market price approach whereby the Company calculates the market capitalization of Level 3 using quoted market prices, adds an estimated control premium, and then assigns that fair value to the reporting units. The Company also performs a discounted cash flow analysis that includes estimates of revenue, costs, growth rates and an appropriate discount rate. These estimates are based on historical data, various internal estimates and management's expectations of future trends.

The Company conducted its goodwill impairment analysis at the end of the fourth quarter of 2008 and concluded that its goodwill was not impaired.

The Company also performs an assessment of its indefinite-lived acquisition-related intangible assets annually at the end of the fourth quarter, or more frequently if the Company determines that indicators of impairment exist. The Company's impairment review process compares the fair value of the indefinite-lived acquisition-related intangible assets to their respective carrying values. If the fair value of the indefinite-lived acquisition-related intangible assets exceeds their carrying values, then the indefinite-lived acquisition-related intangible assets are not impaired.

The Company's fair value methodology primarily consists of a discounted cash flow analysis that includes estimates of revenue, costs, growth rates and an appropriate discount rate and market comparable estimates. These estimates are based on historical data, various internal estimates and management's expectations of future trends.

The Company conducted its indefinite-lived acquisition-related intangible asset impairment analyses at the end of the fourth quarter of 2008 and concluded that there was no impairment. As a result of the sale of the Vyvx advertising distribution business in the second quarter of 2008, the Company also performed an impairment analysis of its indefinite-lived, Vyvx trade name and concluded that there was no impairment as of June 30, 2008.

To the extent that future changes in the Company's assumptions and estimates cause a change in the related fair value estimates that indicate the carrying amount of the Company's goodwill and indefinite-lived acquisition-related intangible assets may not be recoverable, the Company may incur impairment charges in the future to write-down the carrying amount of the Company's goodwill and indefinite-lived acquisition-related intangible assets to their estimated fair value.

Asset Retirement Obligations

The Company's asset retirement obligations consist of legal requirements to remove certain of its network infrastructure at the expiration of the underlying right-of-way ("ROW") term, restoration requirements for leased facilities and reclamation requirements in the coal mining business to remediate previously mined properties. The initial and subsequent measurement of the Company's asset retirement obligations require the Company to make significant estimates regarding the eventual costs and probability or likelihood that the Company will be required to remove certain of its network infrastructure, restore certain of its leased properties and remediate certain of its previously mined properties. In addition, the Company must estimate the periods over which these costs will be incurred and present value the total of such costs using the Company's estimate of its credit-adjusted risk-free interest rate.

The Company regularly evaluates its asset retirement obligations to determine if the amount and timing of its cash flow estimates continue to be appropriate based on current facts and circumstances.

As a result of indicators suggesting that the estimated cash flows underlying the Company's ROW asset retirement obligations were too high, the Company revised its assessment on December 31, 2008. Network infrastructure relocations indicated that the Company is not being required to physically remove its underground network infrastructure at rates consistent with the Company's previous estimates. Other internal and external information corroborated these lower rates. As a result, on December 31, 2008, the Company revised its probability assessment related to its requirement to physically remove its underground network infrastructure at the end of the underlying ROW terms, which caused a significant reduction to the related cash flows that the Company believes will be required to settle its ROW asset retirement obligations. The Company reduced its asset retirement obligation liability accordingly as of December 31, 2008.

As part of the ROW asset retirement obligation change in estimate, the Company determined that certain of its asset retirement obligations for acquired entities should have been higher at the acquisition date. As a result, the Company increased goodwill by approximately \$15 million as of December 31, 2008.

The Company also determined that its estimates of restoration costs for its leased facility asset retirement obligations were too high based on current costs to restore. As a result, on December 31, 2008, the Company reduced its estimates of the cash flows that it believes will be required to settle its leased facility asset retirement obligations at the end of the respective lease terms, which resulted in a reduction to the Company's asset retirement obligation liability.

In the fourth quarter of 2008, the Company was awarded a long-term coal contract, which will extend the life of one of the Company's coal mining operations. As a result of the increase in the estimated life of one of the Company's coal mining operations, the Company revised the timing of its cash flows to remediate the mining site causing a reduction in its asset retirement obligation liability in the fourth quarter of 2008.

As a result of the aforementioned revisions in the estimated amount and timing of cash flows for asset retirement obligations, the Company reduced its asset retirement obligation liability by \$103 million with an offsetting reduction to property, plant and equipment of \$21 million, general and administrative expenses of \$86 million, depreciation and amortization of \$11 million and an increase to goodwill of \$15 million. The Company reduced property, plant and equipment to the extent of the carrying amount of the related long-lived asset initially recorded when the asset retirement obligation liability was established. The remaining amount of the reduction to the asset retirement obligation was recorded as a reduction to depreciation expense, to the extent of historical depreciation of the related long-lived asset, and selling, general and administrative expense.

Recently Issued Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement was effective for financial assets and liabilities, as well as for non-financial assets and liabilities that are recognized or disclosed at fair value on a recurring basis for fiscal years beginning after November 15, 2007 and interim periods within that fiscal year. FASB Staff Position ("FSP") FAS 157-2, "Effective Date of FASB Statement No. 157" ("FSP 157-2") defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years, for non-financial assets and liabilities that are not recognized or disclosed at fair value on a recurring basis. SFAS No. 157 did not have a material effect on the Company's

consolidated results of operations or financial condition in 2008. The Company does not expect the adoption of the remaining portions of SFAS No. 157 to have a material effect on the Company's consolidated results of operations and financial position.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" ("SFAS No. 141R"), which replaces SFAS No. 141, "Business Combinations" ("SFAS No. 141"). SFAS No 141R retains the underlying concepts of SFAS No. 141 in that an entity is required to recognize the assets acquired and liabilities assumed at their fair value on the acquisition date. SFAS No. 141R will change the accounting treatment for certain specific acquisition related items to require: (1) expensing acquisition related costs as incurred; (2) expensing changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date; (3) valuing noncontrolling interests at fair value at the acquisition date; (4) generally expensing restructuring costs associated with an acquired business; (5) capitalizing in-process research and development assets acquired; and (6) measuring acquirer shares issued in consideration for a business combination at fair value on the acquisition date opposed to the announcement date. SFAS No. 141R also includes a substantial number of new disclosure requirements. SFAS No. 141R is to be applied prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The effect of adopting SFAS No. 141R on the Company's consolidated results of operations and financial condition will be largely dependent on the size and nature of business combinations completed after December 31, 2008.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" ("SFAS No. 160"). SFAS No. 160 requires noncontrolling interests, previously referred to as minority interests, to be treated as a separate component of equity, not as a liability or other item outside of permanent equity and applies to the accounting for noncontrolling interests and transactions with noncontrolling interest holders in consolidated financial statements. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This statement is effective for the Company beginning January 1, 2009. The Company does not currently expect the adoption of SFAS No. 160 to have a material effect on its consolidated results of operations and financial condition.

In March 2008, the FASB issued Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133" ("SFAS No. 161"). SFAS 161 applies to all derivative instruments and related hedged items accounted for under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). SFAS No. 161 requires entities to provide greater transparency about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. This statement is effective for the Company beginning January 1, 2009. The Company does not expect the adoption of SFAS No. 161 to have a material effect on its consolidated results of operations and financial condition.

On May 9, 2008, the FASB issued FSP APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)" ("FSP APB 14-1"). FSP APB 14-1 requires issuers of a certain type of convertible debt to separately account for the debt and equity components of the convertible debt in a way that reflects the issuer's borrowing rate at the date of issuance for similar debt instruments without the conversion feature. FSP APB 14-1 applies to certain of the Company's convertible debt. FSP APB 14-1 is effective for the Company beginning on January 1, 2009 and will be applied retrospectively to all quarterly and annual periods that will be presented in the Company's consolidated financial statements. Early adoption of FSP APB 14-1 is not permitted. The adoption of FSP APB 14-1 is expected to significantly increase the Company's non-cash interest expense and reduce basic and diluted earnings (loss) per share.

In November 2008, the FASB ratified EITF Issue No. 08-7, "Accounting for Defensive Intangible Assets," ("EITF 08-7"). EITF 08-7 applies to defensive intangible assets, which are acquired intangible

assets that the acquirer does not intend to actively use but intends to hold to prevent its competitors from obtaining access to them. As these assets are separately identifiable, EITF 08-7 requires an acquiring entity to account for defensive intangible assets as a separate unit of accounting. Defensive intangible assets must be recognized at fair value in accordance with SFAS No. 141R and SFAS No. 157. EITF 08-7 is effective for defensive intangible assets acquired in fiscal years beginning on or after December 15, 2008 and will be adopted by the Company beginning on January 1, 2009. The effect of adopting EITF 08-7 on the Company's consolidated results of operations and financial condition will be largely dependent on the size and nature of business combinations completed after December 31, 2008.

Results of Operations 2008 vs. 2007

| (dollars in millions) | Year Ended | | |
|--|-------------------|-------------------|----------|
| | December 31, 2008 | December 31, 2007 | Change % |
| Revenue: | | | |
| Communications | \$ 4,226 | \$ 4,199 | 1% |
| Coal mining | 75 | 70 | 7% |
| Total revenue | 4,301 | 4,269 | 1% |
| Costs and Expenses: (exclusive of depreciation and amortization shown separately below) | | | |
| Cost of revenue: | | | |
| Communications | 1,740 | 1,769 | (2)% |
| Coal mining | 69 | 64 | 8% |
| Cost of revenue | 1,809 | 1,833 | (1)% |
| Depreciation and amortization | 931 | 942 | (1)% |
| Selling, general and administrative | 1,505 | 1,723 | (13)% |
| Restructuring and non-cash impairment charges | 25 | 12 | 108% |
| Total costs and expenses | 4,270 | 4,510 | (5)% |
| Operating Income (Loss) | 31 | (241) | 113% |
| Other Income (Expense): | | | |
| Interest income | 15 | 54 | (7)% |
| Interest expense | (534) | (577) | 7% |
| Gain (Loss) on extinguishment of debt, net | 81 | (427) | — |
| Gain on sale of business groups | 99 | — | — |
| Other, net | 24 | 55 | (56)% |
| Total other income (expense) | (315) | (895) | 65% |
| Loss Before Income Taxes | (284) | (1,136) | 75% |
| Income Tax (Expense) Benefit | (6) | 22 | — |
| Net Loss | \$ (290) | \$ (1,114) | 74% |

Communications revenue consists of:

- 1) Core Communications Services, which includes Core Network Services and Wholesale Voice Services;
 - Core Network Services includes revenue from transport and infrastructure, IP and data services, local and enterprise voice services and Level 3 Vyvx broadcast services.
 - Wholesale Voice Services includes revenue from long distance voice services, including domestic voice termination, international voice termination and toll free services.

- 2) Other Communications Services includes revenue from managed modem and its related reciprocal compensation services and SBC Contract Services, which includes revenue from the SBC Master Services Agreement, which was obtained in the December 2005 acquisition of WiTel.

Communications revenue attributable to each of these services is as follows:

| <u>(dollars in millions)</u> | <u>Year Ended December 31,</u> | |
|---------------------------------------|--------------------------------|-----------------|
| | <u>2008</u> | <u>2007</u> |
| Communications Services: | | |
| Core Network Services | \$ 3,147 | \$ 2,994 |
| Wholesale Voice Services | 713 | 628 |
| Total Core Communications Services | 3,860 | 3,622 |
| Other Communications Services | 366 | 577 |
| Total Communications Services Revenue | <u>\$ 4,226</u> | <u>\$ 4,199</u> |

Communications Revenue increased 1% in 2008 compared to 2007. Contributing to this increase in Communications revenue was an increase in Core Communications Services revenue in 2008 compared to 2007. This increase in Core Communications Services revenue is the result of a combination of growth in the Company's Core Network Services and Wholesale Voice Services.

The Company experienced growth across several services within Core Network Services in 2008 compared to 2007, including infrastructure, transport, colocation, data, IP, including CDN services, and Vyvx broadcast services. The Company continues to experience strong demand for infrastructure and transport services for complex nationwide solutions and colocation capacity in large markets. Vyvx broadcast revenue increased primarily as a result of the proliferation of high definition sports, news and entertainment programming. Partially offsetting the increase in Core Network Services revenue was lower Vyvx advertising distribution revenue. On June 5, 2008, the Company completed the sale of the Vyvx advertising distribution business and therefore only recorded Vyvx advertising distribution revenue in 2008 from January 1, 2008 through June 5, 2008. Revenue attributable to the Vyvx advertising distribution business was \$15 million in 2008 compared to \$36 million in 2007.

The increase in Wholesale Voice Services revenue is attributable to an increase in voice termination and toll free voice services. The growth in voice termination revenue is primarily attributable to an increase in demand from wireless carrier customers. Toll free revenue increased primarily due to higher traffic attributable to conferencing provider customers. The Company continues to concentrate its sales efforts on maintaining incremental gross margins in the 30% range for these services. The Company expects to experience some volatility in revenue as a result of this strategy.

Other Communications Revenue declined to \$366 million in 2008 from \$577 million in 2007. The decrease is primarily the result of a decline in managed modem revenue as a result of the continued migration from narrow band dial-up services to higher speed broadband services by end user customers, especially in large metropolitan areas. The Company expects managed modem revenue to continue to decline in the future due to an increase in the number of subscribers migrating to broadband services and potential pricing concessions in 2009 as contracts are renewed.

Reciprocal compensation revenue from managed modem services also declined in 2008 compared to 2007 as a result of the continuing decline in demand for managed modem services. The Company has historically earned the majority of its reciprocal compensation revenue from managed modem services, although the Company continues to generate a portion of its reciprocal compensation revenue from voice services, which is reported within Core Network Services revenue. To the extent the Company is unable to sign new interconnection agreements or signs new agreements containing lower rates, or there is a significant decline in the Company's managed modem dial-up business, or FCC or state regulations change such that carriers are not required to compensate other carriers for terminating ISP-bound traffic, reciprocal compensation revenue may decline significantly over time.

Also contributing to the decrease in Other Communications revenue was lower SBC Contract Services revenue as a result of the migration of the SBC traffic to the AT&T network and the satisfaction by SBC of its gross margin commitment under the SBC Master Services Agreement in 2008. During the second quarter of 2008, the gross margin commitment on the SBC Master Services Agreement was satisfied; however AT&T, Inc. ("AT&T"), which merged with SBC in 2005, continues to purchase services from Level 3 under the SBC Master Services Agreement as it continues to migrate the services provided under the agreement to its own network facilities. The SBC Master Services Agreement was an agreement between SBC Services Inc. and WilTel and was obtained in the WilTel acquisition. WilTel and SBC amended their agreement in June 2005 to run through 2009. The Company recognized \$201 million and \$303 million of revenue under the SBC Contract Services Agreement during 2008 and 2007, respectively. The agreement provided a gross margin purchase commitment of \$335 million from December 2005 through the end of 2007 and \$75 million from January 2008 through the end of 2009 and stipulated that originating and terminating access charges paid to local phone companies get passed through to SBC in accordance with a formula that approximates costs and do not count against the gross margin purchase commitment. SBC fully satisfied the \$335 million gross margin purchase commitment during the third quarter of 2007. As a result of satisfying the initial gross margin purchase commitment, SBC's purchases of services that exceeded the original \$335 million gross margin purchase commitment counted toward the \$75 million gross margin purchase commitment for the period from January 2008 through the end of 2009. SBC satisfied \$39 million of the \$75 million gross margin purchase commitment in 2007 with the remaining \$36 million satisfied in 2008.

Additionally, the SBC Contract Services Agreement provided for the payment of \$50 million by SBC if certain performance criteria were met by Level 3. The performance-based incentive provisions of the agreement ended on December 31, 2007. The Company met the required performance criteria and recorded annual revenue of \$25 million in both 2006 and 2007 under the agreement.

Coal mining revenue increased to \$75 million in 2008 from \$70 million in 2007, primarily as a result of a long-term supply contract that enabled a customer to buyout future coal purchase commitments with the Company. The Company does not have any further obligations with respect to future coal commitments under the contract, and therefore recognized the transaction as revenue in 2008. Partially offsetting this increase were lower volumes of coal sold in 2008 compared to 2007.

Cost of Revenue for the communications business 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. Prior to the sale of the Vyvx advertising distribution business, the Company included in communications cost of revenue package delivery costs and the blank tape media costs associated with this business.

Cost of revenue for the communications business, as a percentage of communications revenue, was 41% in 2008 compared to 42% in 2007. This decrease is primarily attributable to the synergies derived from acquisitions. During 2007 and the first part of 2008, the Company was able to eliminate some of the costs associated with duplicate circuits serving the same markets. Also contributing to the decrease was the continued reduction in Other Communications Services revenue, in particular, SBC Contract Services revenue. The gross margins for SBC Contract Services revenue are lower than the gross margins for Core Communications Services revenue and managed modem and reciprocal compensation from managed modem revenue. Partially offsetting this decrease were increases in Wholesale Voice Services revenue as a percentage of total communications revenue and lower managed modem revenue. The incremental gross margins for Wholesale Voice Services revenue are in the 30% range versus 80% for Core Network Services revenue and the gross margin for managed modem revenue is generally higher than for Core Network Services revenue.

Coal mining cost of revenue approximated 92% of coal mining revenue in 2008 and 91% in 2007. The increase in coal mining cost of revenue as a percentage of coal mining revenue in 2008 is the

result of an increase in energy costs to mine the coal partially offset by the buyout by a coal customer of future coal purchase commitments resulting in the recognition of revenue with no associated costs in 2008.

Depreciation and Amortization expense decreased 1% to \$931 million in 2008 from \$942 million in 2007. The decrease is primarily attributable to the \$11 million reduction to depreciation and amortization expense resulting from the Company revising its estimates of its asset retirement obligations liability in the fourth quarter of 2008. Also contributing to the decrease was reduced amortization expense on intangible assets due to the disposal of \$22 million of carrying value of amortizable intangible assets in the Vyvx advertising distribution sale and certain of the Company's amortizable intangible assets becoming fully amortized in early 2008. These decreases in depreciation and amortization were partially offset by higher accelerated depreciation in 2008 on network infrastructure assets that were abandoned as a result of the Company relocating small scale portions of its network and reductions in the useful lives of certain of the Company's amortizable intangible assets in the second quarter of 2007.

The Company expects depreciation and amortization expense of between \$900 million to \$940 million in 2009 based on the Company's current expectations of the timing and amounts of capital expenditures in 2009.

Selling, General and Administrative 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. Selling, general and administrative expenses also include certain network related expenses such as network facility rent, utilities and maintenance costs.

Selling, general and administrative expenses decreased 13% to \$1.5 billion in 2008 compared to \$1.7 billion in 2007. The decrease is primarily attributable to the \$86 million reduction to selling, general and administrative expenses resulting from the Company revising its estimates of its asset retirement obligations liability in the fourth quarter of 2008. Also contributing to the decrease were synergies that have been achieved as a result of acquisition integration efforts and the Company's focus on reducing operating expenses. Specifically, decreases in employee compensation and related costs, professional fees and vendor services, and facilities-based expenses all contributed to the decrease in selling, general and administrative expenses in 2008 compared to 2007.

Included in selling, general and administrative expenses in 2008 and 2007 were \$78 million and \$122 million, respectively, of non-cash, stock-based compensation expenses related to grants of outperform stock options and restricted stock units and restricted stock shares. The decrease in non-cash, stock-based compensation expense in 2008 compared to 2007, is primarily due to the Company not making its annual discretionary grant to its 401(k) plan. The Company made a discretionary contribution to the 401(k) plan in Level 3 common stock for the year ended December 31, 2007 of \$16 million. Non-cash, stock-based compensation also decreased in 2008 compared to 2007 for those employees eligible for accelerated vesting of stock awards at retirement and as a result of a lower weighted-average fair value of restricted stock awards granted in 2008 compared to 2007. See Note 12 of the Notes to Consolidated Financial Statements for more details.

The Company expects to continue its focus on reducing selling, general and administrative expenses in 2009.

Restructuring and Impairment Charges increased to \$25 million in 2008 from \$12 million in 2007 as a result of an increase in costs associated with employee terminations. See Note 8 of the Notes to Consolidated Financial Statements for more details.

The Company may experience further restructuring charges in 2009 in connection with the continued integration of acquired businesses as a result of the deployment of improved business

processes and systems and the possible need to adjust its cost structure if revenue performance is not satisfactory due to negative effects of the current economy or other reasons, which could result in additional headcount reductions.

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

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

Adjusted EBITDA excludes non-cash impairment charges and non-cash stock compensation expense because of the non-cash nature of these items. Adjusted EBITDA also excludes interest income, interest expense, income taxes and gain (loss) on extinguishment of debt 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 should be evaluated through cash flow measures. Adjusted EBITDA excludes the gain on sale of business groups and 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 taxes, depreciation and amortization, non-cash impairment charges, non-cash stock compensation expense, gain (loss) on early extinguishment of debt, the gain on sale of business groups and net other income (expense). Adjusted EBITDA should not be considered a substitute for other measures of financial performance reported in accordance with GAAP.

Note 14 of the Notes to Consolidated Financial Statements provides a reconciliation of Adjusted EBITDA for each of the Company's reportable operating segments.

Adjusted EBITDA for the communications business was \$1.0 billion in 2008 compared to \$823 million in 2007. The increase in Adjusted EBITDA for the communications business is primarily attributable to the growth in the Company's Core Communications Services revenue and the benefits of continued operating expense reductions from integration activities, partially offset by declines in Other Communications Services revenue. Also contributing to the increase in Adjusted EBITDA for the communications business in 2008 was the \$86 million reduction to selling, general and administrative expenses resulting from the Company revising its estimates of the amounts of its asset retirement obligations liability in the fourth quarter of 2008.

Interest Income decreased to \$15 million in 2008 from \$54 million in 2007. The decrease in interest income was primarily due to a decrease in the Company's average invested cash balances and a decrease in the average returns on the portfolio. The Company's average return on its portfolio decreased to 2.0% in 2008 compared to 4.8% in 2007. The average portfolio balance decreased to \$735 million in 2008 compared to \$1.0 billion in 2007.

The Company invests its funds primarily in government and government agency securities, money market funds and commercial paper depending on liquidity requirements. The Company's investment strategy generally provides lower yields on the funds than would be obtained on alternative investments, but reduces the risk to principal in the short term prior to these funds being used in the Company's business.

Interest Expense decreased 7% to \$534 million in 2008 from \$577 million in 2007. Interest expense decreased primarily as a result of a decrease in interest rates on the Company's unhedged variable rate debt. Interest rates on the Company's unhedged variable rate debt approximated 6% in 2008 and 8% in 2007. Interest expense also decreased as a result of the debt for equity exchanges, debt redemptions, debt repurchases and debt repayment transactions that were completed by the Company in 2007 and 2008. See Note 11 of the Notes to Consolidated Financial Statements for more details.

Gain on Sale of Business Groups totaled \$99 million in 2008 compared to zero 2007. On June 5, 2008, Level 3 completed the sale of its Vyvx advertising distribution business to DG FastChannel, Inc. and recognized a gain on the sale of \$96 million in the second quarter of 2008. In addition, in the fourth quarter of 2008 Level 3 completed the sale of certain of its smaller long distance voice customers and recognized a gain on the sale of approximately \$3 million. See Note 2 of the Notes to Consolidated Financial Statements for more details.

Gain (Loss) on Extinguishment of Debt was a gain of \$81 million in 2008 compared a loss of \$427 million in 2007. The 2008 gain on extinguishment of debt consisted of a gain of \$125 million as a result of certain debt repurchases prior to maturity, partially offset by a \$44 million loss attributable to induced debt conversion expenses related to the exchange of certain of the Company's convertible debt securities. The 2007 loss on extinguishment of debt consisted of a loss of \$427 million as a result of the refinancing of the Company's senior secured credit agreement and certain debt exchanges, redemptions and repurchases prior to maturity. See Note 11 of the Notes to Consolidated Financial Statements for more details.

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 \$24 million in 2008 and \$55 million in 2007. Other, net is primarily comprised of gains and losses on the sale of non-operating assets, marketable securities, realized foreign currency gains and losses and other income.

Income Tax Benefit (Expense) was a \$6 million expense in 2008 and was a \$22 million benefit in 2007. The income tax expense for 2008 was primarily the result of state income taxes.

The Company incurs income tax expense attributable to income in various Level 3 subsidiaries, including the coal business, 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 that have not been recognized in the Company's tax returns.

As of December 31, 2008, the Company had net operating loss carry forwards of approximately \$4.7 billion for federal income tax purposes. Under the rules prescribed by U.S. Internal Revenue Code ("IRC") Section 382 and applicable regulations, if certain transactions occur with respect to an entity's capital stock that result in a cumulative ownership shift of more than 50 percentage points by 5-percent stockholders over a testing period, annual limitations are imposed with respect to the entity's ability to utilize its net operating loss carry forwards and certain current deductions against any taxable income the entity achieves in future periods. The Company had entered into transactions over the testing period resulting in significant cumulative shifts in the ownership of its capital stock which alone would not have resulted in an ownership change under IRC Section 382. However, when the Company's actions are coupled with the trading activity in the Company's common stock throughout 2008 by third-party market participants, the Company believes that in 2008 the Company experienced a cumulative

ownership change of more than 50 percentage points by 5-percent stockholders during the applicable testing period. Prior to the ownership change, the Company had net operating loss carry forwards of \$9.7 billion. The Company believes that the limitation of its net operating loss carry forwards will not have a near term effect on its consolidated results of operations and financial position. The Company also believes that the limitation of its net operating loss carry forwards has an immaterial effect on the current intrinsic value of the Company's business taken as a whole. Additional transactions could cause the Company to incur a subsequent 50 percentage point ownership change by 5-percent stockholders and, if the Company triggers the above-noted IRC imposed limitations, could further limit it from fully utilizing the remaining net operating loss carry forwards and certain current deductions to reduce income taxes.

Results of Operations 2007 vs. 2006

| (dollars in millions) | Year Ended | | |
|--|-------------------|-------------------|----------|
| | December 31, 2007 | December 31, 2006 | Change % |
| Revenue: | | | |
| Communications | \$ 4,199 | \$ 3,311 | 27% |
| Coal mining | 70 | 67 | 4% |
| Total revenue | 4,269 | 3,378 | 26% |
| Costs and Expenses: (exclusive of depreciation and amortization shown separately below) | | | |
| Cost of revenue: | | | |
| Communications | 1,769 | 1,460 | 21% |
| Coal mining | 64 | 57 | 12% |
| Cost of revenue | 1,833 | 1,517 | 21% |
| Depreciation and amortization | 942 | 730 | 29% |
| Selling, general and administrative | 1,723 | 1,258 | 37% |
| Restructuring and non-cash impairment charges | 12 | 13 | (8)% |
| Total costs and expenses | 4,510 | 3,518 | 28% |
| Operating Loss | (241) | (140) | (72)% |
| Other Income (Expense): | | | |
| Interest income | 54 | 64 | (16)% |
| Interest expense | (577) | (648) | 11% |
| Loss on extinguishment of debt, net | (427) | (83) | (414)% |
| Other, net | 55 | 19 | 189% |
| Total other income (expense) | (895) | (648) | (38)% |
| Loss from Continuing Operations Before Income Taxes | (1,136) | (788) | (44)% |
| Income Tax Benefit (Expense) | 22 | (2) | — |
| Loss from Continuing Operations | (1,114) | (790) | (41)% |
| Income from Discontinued Operations | — | 46 | (100)% |
| Net Loss | \$ (1,114) | \$ (744) | (50)% |

Communications revenue consists of the following:

| <u>(dollars in millions)</u> | <u>Year Ended December 31,</u> | |
|---------------------------------------|--------------------------------|-----------------|
| | <u>2007</u> | <u>2006</u> |
| Communications Services: | | |
| Core Network Services | \$ 2,994 | \$ 1,518 |
| Wholesale Voice Services | 628 | 455 |
| Total Core Communications Services | 3,622 | 1,973 |
| Other Communications Services | 577 | 1,338 |
| Total Communications Services Revenue | <u>\$ 4,199</u> | <u>\$ 3,311</u> |

The 84% increase in Core Communications Services revenue for 2007 compared to 2006 is due to growth in the Company's revenue from existing services, as well as revenue from the Progress Telecom, ICG Communications, TelCove, Looking Glass, Broadwing, CDN Business and Servecast acquisitions. The Company purchased Progress Telecom in March 2006, ICG Communications in May 2006, TelCove in July 2006 and Looking Glass in August 2006. The Company purchased Broadwing and the CDN Business in January 2007 and Servecast in July 2007. From a financial reporting perspective, the Company integrated into the Level 3 business the operations of WilTel, Progress Telecom, ICG Communications, TelCove and Looking Glass in 2006, and Broadwing and the CDN Business in the first half of 2007. As a result, separate revenue information by revenue category for these acquired companies is no longer reported other than for the SBC Contract Services revenue acquired from WilTel.

As described earlier, the growth in Core Communications Services revenue was lower than expected during the second, third and fourth quarters of 2007 as a result of an increase in service activation times and challenges in service management processes. Service activation times increased during the second and third quarters of 2007 as a result of the following issues.

- Continuing to use the multiple order entry and provisioning systems and processes that were operated by the acquired companies to provision end-to-end services.
- Insufficient training on the multiple systems for employees performing service activation functions.
- Lack of sufficient staffing levels in some service activation areas.
- Identifying and fixing service activation throughput issues was challenging as a result of decentralizing service activation functions across the customer facing groups in the third quarter of 2006.

Transport and infrastructure revenue increased 69% for 2007 compared to 2006. The increase was the result of growth in existing services and the recognition of a full year of revenue in 2007 for Progress Telecom, ICG Communications, TelCove and Looking Glass acquisitions completed in 2006, as well as the revenue from the Broadwing acquisition completed in January 2007. Increased demand in the cable and wireless market segments for complex nationwide solutions and colocation capacity in large markets contributed to the revenue growth in existing services in 2007 as compared to 2006.

IP and data revenue increased 94% for 2007 compared to 2006. The increase was the result of growth in existing services and the recognition of a full year of revenue in 2007 for Progress Telecom, ICG Communications, TelCove and Looking Glass acquisitions completed in 2006, as well as a full year of revenue from the Broadwing acquisition completed in early January 2007. IP and data revenue also increased in 2007 as a result of the CDN Business acquisition completed in January 2007 and the Servecast acquisition completed in July 2007. IP and data revenue also increased due to traffic growth

in North America from new and existing customers that exceeded the rate of price compression experienced in 2007. During the second quarter of 2007, the Company also implemented new, reduced pricing under the terms of a contract renewal for its largest IP and data customer which partially offset the overall growth of IP and data revenue in the last half of 2007. Continued revenue growth in the Company's VPN service also contributed to the increase in IP and data revenue during 2007.

Level 3's voice revenue increased 121% for 2007 compared to 2006. The increase is primarily attributable to the operations acquired in the TelCove and Broadwing acquisitions, particularly domestic and international voice termination services, and growth in Level 3's existing wholesale and VoIP-related services including voice termination, local inbound, enhanced local and toll free services.

Level 3 Vyx revenue increased 15% for 2007 compared to 2006. The increase was a result of an increase in advertising distribution revenue and the continued demand for high-definition broadcast services in sports, news and entertainment.

Managed modem revenue declined 45% to \$158 million for 2007 compared to 2006 as a result of the continued migration from narrow band dial-up services to higher speed broadband services by end user customers, especially in large metropolitan areas. This change has resulted in a decline in the demand for managed modem ports.

Reciprocal compensation revenue from managed modem services declined 8% to \$94 million for 2007 compared to 2006 as a result of the continuing decline in demand for managed modem services. As a result of the Company's acquisitions of WilTel, TelCove and Broadwing, the Company has started to generate a portion of its reciprocal compensation revenue from voice services. For the full year ending December 31, 2007, the Company recognized \$26 million of reciprocal compensation revenue earned from voice services, which are included in Core Communications Services revenue.

Managed IP services revenue declined 61% to \$22 million for 2007 compared to 2006. As discussed earlier, to date the Company has not invested in this service and the decline in revenue is attributable to the disconnection of service by existing customers. The Company's legacy managed IP services business consists primarily of a business that was acquired in 2003.

SBC Contract Services revenue decreased 66% to \$303 million for 2007 compared to 2006 as expected due to the migration of the SBC traffic to the AT&T network. The SBC Contract Services agreement was obtained in December 2005 as part of the WilTel acquisition. Under the terms of the agreement, SBC has gross margin purchase commitments through 2009. SBC fully satisfied the \$335 million gross margin purchase commitment for the period from December 2005 through December 2007 during the third quarter of 2007. As a result of satisfying the initial gross margin purchase commitment, SBC's purchases of services that exceed the original \$335 million gross margin purchase commitment counted toward the \$75 million gross margin purchase commitment for the period from January 2008 through the end of 2009. As of December 31, 2007, SBC had satisfied \$39 million of the \$75 million gross margin purchase commitment.

Coal mining revenue increased 4% to \$70 million in 2007 compared to 2006. The increase was attributable to an increase in the tons of coal sold from the Black Butte mine, partially offset by a decrease in the tons of coal sold from the Decker mine. Overall, the price per ton for coal from both mines was up slightly in 2007 compared to 2006.

Cost of Revenue for the communications business, as a percentage of revenue, for 2007 and 2006 was 42% and 44%, respectively. The decrease in the 2007 cost of revenue, as a percentage of revenue, was primarily attributable to the continued decrease in SBC Contract Services revenue from 2006 to 2007. The margins for SBC Contract Services revenue are lower than the margins earned on other components included in Core and Other Communications Services revenue. Also contributing to the decrease in 2007 cost of revenue, as a percentage of revenue, were cost of revenue synergy savings that have been achieved as a result of acquisition integration efforts. The Company believes that cost of revenue synergy savings of \$80 million on an annualized basis have been achieved through integration efforts in 2007.

Coal mining cost of revenue, as a percentage of revenue, increased to 91% for 2007 compared to 85% in 2006. The increase in cost of revenue, as a percentage of revenue, in 2007 as compared to 2006 was due to planned equipment maintenance costs at one mine and higher costs related to overburden removal at another mine.

Depreciation and Amortization expense increased 29% to \$942 million for 2007 compared to 2006. The increase is primarily attributable to the increased depreciation and amortization expense recognized on communications tangible and intangible assets that were acquired through acquisitions completed in 2006 and 2007, as well as depreciation expense on the approximately \$241 million increase in capital expenditures for 2007 compared to 2006.

In addition, during the second quarter of 2007, the Company reviewed and adjusted the estimated useful lives used for amortization of customer-related intangible assets for the ICG Communications, TelCove and Looking Glass acquisitions effective June 1, 2007. This resulted in increased amortization expense of \$9 million during the year ended December 31, 2007.

During the fourth quarter of 2007, the Company finalized the purchase price allocation for the Broadwing acquisition which resulted in reduced amortization expense related to intangible assets for the Broadwing acquisition from the date of acquisition totaling approximately \$18 million, as compared to the total amortization expense that would have been recognized for 2007 prior to the change in the valuation of the intangible assets.

The increase in depreciation expense for 2007 was partially offset by a \$44 million decrease in depreciation expense compared to the same period in 2006 attributable to the increase in estimated useful lives for network fiber and IP and transmission equipment implemented in the second and third quarters of 2006.

Selling, General and Administrative expenses increased 37% to \$1.7 billion in 2007 compared to 2006. This increase is primarily attributable to the expenses associated with the operations acquired in the Progress Telecom, ICG Communications, TelCove and Looking Glass transactions during 2006; the Broadwing and CDN Business transactions in January 2007; and the Servecast transaction in July 2007. Specifically, increases in compensation, bonus and employee related costs, network related costs and facility-based expenses all contributed to the increase in selling, general and administrative expenses in 2007. Offsetting the increases discussed above were selling, general and administrative expense synergy savings that have been achieved as a result of acquisition integration efforts. As of the end of 2007, the Company believes that it has achieved annualized run rate synergies in selling, general and administrative expenses totaling approximately \$105 million. Also offsetting the increase in selling, general and administrative expenses in 2007 compared to 2006 was a reduction in incentive-based compensation expense of \$32 million as a result of lower than expected financial performance in 2007.

Included in selling, general and administrative expenses for 2007 and 2006 were \$122 million and \$84 million, respectively, of non-cash stock-based compensation expense related to grants of outperform stock options and restricted stock units and restricted stock shares. The increase in non-cash compensation expense in 2007 compared to 2006, is due to an increase in the number of restricted stock units and restricted stock shares issued to employees as a result of an increase in the number of employees eligible in 2007 compared to 2006, an increase in the 401(k) employee match and annual discretionary grant made to the 401(k) plan and an increase in non-cash compensation expense for those employees eligible for accelerated vesting of stock awards at retirement; with the overall increase partially offset by a reduction in the number of outperform stock options and units issued in 2007 compared to 2006. The number of employees eligible to participate in the Company's stock-based long-term incentive plan increased significantly from 2006 to 2007 as a result of the employees of acquired companies becoming eligible to participate in the long-term incentive plan at the beginning of 2007.

In 2007, the Company recognized additional non-cash stock-based compensation expense totaling approximately \$11 million for those employees eligible for accelerated vesting of stock awards at retirement. The Company provides accelerated vesting of stock awards at the date an employee retires if the employee meets certain age and years of service requirements and certain other requirements. Under SFAS No. 123R, the fair value of stock-based employee awards are expensed over the minimum service period, which is from the grant date to the earliest vesting date. Therefore, the Company is required to fully expense at the grant date the value of stock awards made to those employees that already meet both the age and years of service requirements for accelerated vesting at retirement at the date of grant. If the employee will meet the age and years of service requirements for accelerated vesting at retirement sooner than the normal vesting period for the stock awards, then the Company is required to use that shorter period for recognition of the non-cash compensation expense associated with the grant.

Included in the 2006 non-cash compensation expense of \$84 million was \$6 million related to the revaluation of the October 2005 and January 2006 grants using May 15, 2006 as the revised grant date, as there had not been stockholder approval of those awards prior to that date, which was deemed necessary for determination of the grant date for those awards under SFAS No. 123R.

Restructuring and Non-Cash Impairment Charges declined 8% to \$12 million in 2007 compared to 2006. The Company recognized severance charges of \$11 million in 2007 and \$5 million in 2006 related to workforce reductions in the communications business in North America. The workforce reductions completed in 2007 were primarily related to the integration of companies acquired by Level 3 in 2006 and January 2007. The Company recognized non-cash impairment charges of \$1 million and \$8 million in 2007 and 2006, respectively. The non-cash impairment charge of \$1 million in 2007 and \$4 million of the 2006 charge were primarily related to previously capitalized costs of certain information technology development projects no longer used by the Company. The costs incurred for these projects, including capitalized labor, were impaired as the Company did not expect to utilize the assets in the future. The remaining \$4 million non-cash impairment charge in 2006 was related to excess land of the communications business deemed available for sale in Germany. This charge resulted from the difference between the recorded carrying value and the estimated market value of the land. During the third quarter of 2007, the Company reclassified the excess land in Germany to property, plant and equipment due to the fact the land had not been sold and was no longer being actively marketed for sale.

Adjusted EBITDA for the communications business was \$823 million and \$677 million in 2007 and 2006, respectively. The increase was primarily attributable to the Adjusted EBITDA contribution from the operations acquired in the Progress Telecom, ICG Communications, TelCove, Looking Glass, Broadwing, CDN Business and Servecast acquisitions, growth in the Company's Core Communications Services revenue and the benefits of cost of revenue and operating expense synergies realized in 2007 from integration activities, partially offset by declines in other communications services revenue, SBC Contract Services revenue and costs of integration incurred during 2007 as compared to 2006.

Adjusted EBITDA for the coal mining business decreased to \$5 million in 2007 from \$8 million in 2006. The decrease is primarily attributable to an increase in the amount of coal sold from the Black Butte mine which has higher stripping ratios that result in higher overall costs and a planned increase in maintenance costs for mining equipment in 2007.

Interest Income decreased 16% to \$54 million in 2007 compared to 2006. The decrease in interest income was primarily due to a decrease in the average invested balance partially offset by an increase in the average return on the portfolio. The Company's average return on its portfolio increased to 4.8% in 2007 compared to 4.3% in 2006. The average portfolio balance decreased to \$1.0 billion in 2007 compared to \$1.5 billion in 2006.

Interest Expense decreased 11% to \$577 million in 2007 compared to 2006. Interest expense decreased primarily as a result of the debt for equity exchanges, debt redemptions and debt repurchases that were completed by the Company in the first quarter of 2007 and the debt repurchased in 2006. The decrease in interest expense was partially offset by the 2006 and 2007 debt issuances. See Note 11 of the Notes to Consolidated Financial Statements for more details.

Loss on Extinguishment of Debt was \$427 million in 2007 compared to \$83 million in 2006. The 2007 loss on extinguishment of debt consisted of a loss of \$427 million as a result of the refinancing of its senior secured credit agreement and certain debt exchanges, redemptions and repurchases prior to maturity. The 2006 loss on extinguishment of debt consisted of a \$54 million loss from the repurchase of certain debt and a \$55 million loss on the amendment and restatement of Level 3 Financing's Senior Secured Term Loan due 2011, partially offset by a \$27 million gain realized on a debt exchange.

Other, net increased 189% to \$55 million in 2007 compared to \$19 million in 2006. Other, net is primarily comprised of gains and losses on the sale of marketable securities and non-operating assets, realized foreign currency gains and losses and other income. The increase in 2007 compared to 2006 is primarily due to a gain of \$37 million recognized in the fourth quarter of 2007 on the sale of 80% of the Company's holdings of Infinera common stock.

Income Tax Benefit (Expense) was a \$22 million benefit in 2007 and was a \$2 million expense in 2006. The income tax benefit for 2007 was primarily the result of reversing \$23 million of the valuation allowance against the Company's deferred tax asset for certain state NOLs. These state tax NOLs were converted to a state tax credit carry forward associated with a change in the state tax law that replaced the tax on net income with a tax on gross margin. The Company now expects it will be able to use this state tax credit carry forward against current and future state taxable gross margin.

Income from Discontinued Operations in 2006 of \$46 million was related to the discontinued operations of the Company's Information Services segment. The Company sold Software Spectrum, Inc. ("Software Spectrum") to Insight Enterprises, Inc. ("Insight") in September 2006. There were no gains or losses from discontinued operations recognized in 2007. Software Spectrum, Inc.'s results of operations resulted in income from discontinued operations of \$13 million in 2006. In addition, Level 3 recognized a gain on the sale of Software Spectrum to Insight in 2006 of \$33 million.

Financial Condition—December 31, 2008

Cash flows provided by (used in) operating activities, investing activities and financing activities for the years ended December 31, 2008 and 2007, respectively are summarized as follows:

| (dollars in millions) | Year Ended | | |
|---|-------------------|-------------------|----------------|
| | December 31, 2008 | December 31, 2007 | Change |
| Net Cash Provided by Operating Activities | \$ 413 | \$ 231 | \$ 182 |
| Net Cash Used in Investing Activities | (321) | (961) | 640 |
| Net Cash Used In Financing Activities | (34) | (243) | 209 |
| Effect of Exchange Rates on Cash and Cash Equivalents | (4) | 6 | (10) |
| Net Change in Cash and Cash Equivalents | <u>\$ 54</u> | <u>\$ (967)</u> | <u>\$1,021</u> |

Operating Activities

Cash provided by operating activities increased by \$182 million in 2008 compared to 2007. The increase in cash provided by operating activities was primarily due to an increase in Adjusted EBITDA, favorable changes in working capital items and lower interest payments. The favorable change in

working capital items is primarily due to the changes in accounts payable and other current liabilities, partially offset by changes in accounts receivable, other current assets and deferred revenue.

Investing Activities

Cash used in investing activities decreased by \$640 million in 2008 compared to 2007. Cash used for acquisitions totaled \$670 million, net of cash acquired, in 2007 as a result of the acquisitions of Broadwing, Servecast and the CDN business. The Company did not complete any acquisitions in 2008. In addition, the Company received net proceeds from the sale of its Vyvx advertising distribution business and the sale of certain of its smaller long distance voice customers of \$124 million in 2008. The Company also reduced its capital expenditures by \$184 million in 2008 compared to 2007, primarily as a result of a reduction in integration-related capital expenditures and more efficiently managing capital expenditure requirements. Partially offsetting these favorable changes in 2008 was cash received in 2007 of \$333 million from the sale and maturity of marketable securities compared to \$4 million in 2008, and an increase in restricted cash.

Financing Activities

Cash used in financing activities decreased \$209 million in 2008 compared to 2007. In 2008, cash flows from financing activities include \$400 million of proceeds from the issuance of the 15% Convertible Senior Notes. The Company used the proceeds from this offering to repurchase portions of its 6% Convertible Subordinated Notes due 2009 and 2010 and 2.875% Convertible Senior Notes due 2010 for approximately \$336 million. In addition, the Company repaid the final amounts due under the 11% Senior Notes due 2008 and 10.75% Senior Euro Notes due 2008 of approximately \$26 million, repurchased a portion of its 6% Convertible Subordinated Notes due 2009 and 2010 for \$68 million, and made capital lease and commercial mortgage payments of approximately \$6 million using cash on hand.

In 2007, cash flows from financing activities include approximately \$2.4 billion of net proceeds from the issuance of the Floating Rate Senior Notes due 2015, the 8.75% Senior Notes due 2017 and the Senior Secured Credit Facility due 2014. The Company used the net proceeds from these offerings along with cash on hand to retire or refinance approximately \$2.6 billion of its debt. Financing activities for 2007 also include proceeds of \$26 million from the exercise of warrants for the Company's common stock associated with the Broadwing transaction and other equity-based instruments.

Liquidity and Capital Resources

The Company incurred a net loss of \$290 million in 2008 and \$1.1 billion in 2007. The Company used \$449 million for capital expenditures and generated \$413 million in cash flows from operating activities in 2008. This compares to \$633 million of cash used for capital expenditures and \$231 million of cash flows provided by operating activities in 2007.

Cash interest payments are expected to be lower than the \$531 million made in 2008 based on current debt outstanding, current interest rates on the Company's variable rate debt and the financing and other capital markets transactions completed in 2007 and 2008. Capital expenditures for 2009 are expected to be lower than the \$449 million in 2008 as the Company expects to continue to efficiently manage its capital expenditure requirements. The Company expects to invest in base capital expenditures (estimated capital required to keep the network operating efficiently and new service development) with the remaining capital expenditures expected to be success-based, or tied to incremental revenue. As of December 31, 2008, the Company had long-term debt contractual obligations, including capital lease and commercial mortgage obligations and excluding premium and discounts on debt issuance and fair value adjustments of approximately \$186 million that mature in

2009 and \$583 million that mature in 2010. The Company's commercial mortgage obligation matures in 2010, but may be extended to 2015 at the election of the Company.

Level 3 had \$768 million of cash and cash equivalents on hand at December 31, 2008. In addition, \$130 million of current and non-current restricted cash and securities are used to collateralize outstanding letters of credit, long-term debt, certain operating obligations of the Company and certain reclamation liabilities associated with the coal mining business. 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 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 then 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. See Note 11 of the Notes to Consolidated Financial Statements for more details regarding the Company's 2008 and 2007 financing transactions.

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. For example, in 2008, Level 3 completed the sale of its Vyvx advertising distribution business and the sale of certain of its smaller long distance voice customers and received aggregate net cash proceeds of \$124 million.

Consolidation of the communications industry may continue. In 2006 and 2007, Level 3 participated in the consolidation of the communications industry with the acquisitions of several companies. 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 that have had, or are likely to have, a current or future material effect to its results of operations or its financial position.

Contractual Obligations

The following table summarizes the contractual obligations and commercial commitments of the Company at December 31, 2008, as further described in the Notes to Consolidated Financial Statements.

Payments Due by Period

| | Total | Less than 1 Year | 1 - 3 Years | 4 - 5 Years | After 5 Years |
|---|---------|---------------------|----------------|----------------|------------------|
| Contractual Obligations | | | | | |
| Long-Term Debt, including current portion | \$6,586 | \$ 186 | \$1,152 | \$1,575 | \$3,673 |
| Interest Obligations | 2,801 | 521 | 1,020 | 850 | 410 |
| Asset Retirement Obligations | 151 | 8 | 14 | 18 | 111 |
| Operating Leases | 882 | 153 | 259 | 209 | 261 |
| Right of Way Agreements | 1,175 | 110 | 174 | 158 | 733 |
| Purchase Obligations | 365 | 365 | — | — | — |
| Other Commercial Commitments | | | | | |
| Letters of Credit | 30 | 2 | 2 | — | 26 |

The Company's debt instruments contain certain covenants which, among other things, limit additional indebtedness, dividend payments, certain investments and transactions with affiliates. If the Company should fail to comply with these covenants, amounts due under the instruments may be accelerated at the note holder's discretion after the declaration of an event of default.

Long-term debt obligations exclude issue discounts and premiums and fair value adjustments.

Interest obligations assume interest rates on variable rate debt do not change from December 31, 2008. In addition, interest is calculated based on debt outstanding as of December 31, 2008, and on existing maturity dates.

Certain right of way agreements include provisions for increases in payments in future periods based on the rate of inflation as measured by various price indexes. The Company has not included estimates for unknown increases in future periods in the amounts included above.

Certain non-cancelable right of way agreements provide for automatic renewal on a periodic basis. Payments due under these agreements with automatic renewal options have been included in the table above for a period of 17 years from January 1, 2009, which approximates the economic remaining useful life of the Company's conduit. In addition, certain other right of way agreements are cancellable or can be terminated under certain conditions by the Company. The Company includes the payments under such cancelable right of way agreements in the table above for a period of 1 year from January 1, 2009, if the Company does not consider it likely that it will cancel the right of way agreement within the next year.

Purchase obligations represent all outstanding purchase order amounts of the Company as of December 31, 2008.

The table above does not include other long-term liabilities, such as liabilities recorded for legal matters and income taxes that are not contractual obligations by nature. The Company cannot determine with any degree of certainty the years in which these liabilities might ultimately be paid.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Level 3 is subject to market risks arising from changes in interest rates and foreign exchange rates. As of December 31, 2008, the Company had borrowed a total of \$1.7 billion primarily under a Senior Secured Term Loan due 2014 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. The weighted average interest rate on the variable rate instruments at December 31, 2008, was approximately 7.0%.

In March 2007, Level 3 Financing, Inc., the Company's wholly owned subsidiary, 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. Level 3 has designated the interest rate swap agreements as a cash flow hedge on the interest payments for \$1 billion of floating rate debt.

The remaining, or unhedged, variable rate debt has a weighted average interest rate of 7.0% at December 31, 2008. A hypothetical increase in the weighted average rate by 1% point (i.e. a weighted average rate of 8.0%) would increase the Company's annual interest expense by approximately \$7.0 million. At December 31, 2008, the Company had \$4.9 billion (excluding fair value adjustments, discounts and premiums) of fixed rate debt bearing a weighted average interest rate of 8.7%. A decline in interest rates in the future will not 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. Correspondingly, 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 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 effect the Company's operating results.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of 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 December 31, 2008. 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.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the fourth quarter of 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, management assessed the effectiveness of internal controls over financial reporting as of December 31, 2008 based on the guidelines established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our assessment, management has concluded that our internal control over financial reporting was effective as of December 31, 2008.

The Company's independent registered public accounting firm, KPMG LLP, has issued an audit report on its assessment of the Company's internal control over financial reporting as of December 31, 2008. This report appears on page F-3.

ITEM 9B. OTHER INFORMATION

None.

Part III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item 10 is incorporated by reference to our definitive proxy statement for the 2009 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission, however certain information is included in ITEM 1. BUSINESS above under the caption "Directors and Executive Officers."

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item 11 is incorporated by reference to our definitive proxy statement for the 2009 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

For information as of December 31, 2008, with respect to compensation plans (including individual compensation arrangements) under which our equity securities are authorized for issuance, please see "Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER REPURCHASES OF EQUITY SECURITIES" above.

The information required by this Item 12 is incorporated by reference to our definitive proxy statement for the 2009 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item 13 is incorporated by reference to our definitive proxy statement for the 2009 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item 14 is incorporated by reference to our definitive proxy statement for the 2009 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission.

Part IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

- (a) Financial statements and financial statement schedules required to be filed for the registrant under Items 8 or 15 are set forth following the index page at page F-l. Exhibits filed as a part of this report are listed below. Exhibits incorporated by reference are indicated in parentheses.
- 3.1 Restated Certificate of Incorporation of Level 3 Communications, Inc. (Exhibit 3(i) to the Registrant's Current Reports on Form 8-K filed on May 23, 2008).
 - 3.2 Specimen Stock Certificate of Common Stock, par value \$.01 per share (Exhibit 3 to the Registrant's Form 8-A filed on March 31, 1998).
 - 3.3 Amended and Restated By-laws of Level 3 Communications, Inc. (Exhibit 3(ii) to the Registrant's Current Report on Form 8-K filed on May 23, 2008).

- 4.1.1 Form of Subordinated Debt Securities Indenture (incorporated by reference to Exhibit 4.2 to Amendment 1 to the Registrant's Registration Statement on Form S-3 (File No. 333-68887) filed with the Securities and Exchange Commission on February 3, 1999).
- 4.1.2 First Supplemental Indenture, dated as of September 20, 1999, between the Registrant and IBJ Whitehall Bank & Trust Company as Trustee relating to the Registrant's 6% Convertible Subordinated Notes due 2009 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated September 20, 1999).
- 4.1.3 Second Supplemental Indenture, dated as of February 29, 2000, between the Registrant and The Bank of New York as Trustee relating to the Registrant's 6% Convertible Subordinated Notes due 2010 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated February 29, 2000).
- 4.2 Indenture, dated as of February 29, 2000, between the Registrant and The Bank of New York as Trustee relating to the Registrant's 11 ¹ / 4 % Senior Notes due 2010 (Exhibit 4.2 to the Registrant's Registration Statement on Form S-4 File No. 333-37362).
- 4.3 Indenture, dated as of February 29, 2000, between the Registrant and The Bank of New York as Trustee relating to the Registrant's 11 ¹ / 4 % Senior Euro Notes due 2010 (Exhibit 4.2 to the Registrant's Registration Statement on Form S-4 File No. 333-37364).
- 4.4 Amended and Restated Indenture dated as of July 8, 2003, by and between the Company and The Bank of New York, as successor to IBJ Whitehall Bank & Trust Company, as trustee (amends and restates the Senior Debt Indenture, a Form of which was filed as an Exhibit to the Company's Registration Statement on Form S-3-File No. 333-68887) (Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed July 8, 2003).
- 4.5 First Supplemental Indenture, dated as of July 8, 2003, by and between the Company and The Bank of New York, as successor to IBJ Whitehall Bank & Trust Company, as Trustee (Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed July 8, 2003).
- 4.6 Indenture, dated as of October 1, 2003, by and between Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc. as Issuer and The Bank of New York as Trustee relating to the Level 3 Financing, Inc. 10.75% Senior Notes due 2011 (Exhibit 4.11 to the Registrant's Annual Report on Form 10-K for the year ending December 31, 2003).
- 4.7.1 Indenture, dated as of October 24, 2003, by and between the Registrant and The Bank of New York as Trustee relating to the Registrant's 9% Convertible Senior Discount Notes due 2013 (Exhibit 4.12 to the Registrant's Annual Report on Form 10-K for the year ending December 31, 2003).
- 4.7.2 First Supplemental Indenture, dated as of February 7, 2005, by and between the Company and The Bank of New York, as Trustee relating to the Registrant's 9% Convertible Senior Discount Notes due 2013. (Exhibit 4.12.2 to the Registrant's Annual Report on Form 10-K for the year ending December 31, 2005).
- 4.8 Supplemental Indenture, dated as of October 20, 2004, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of October 1, 2003, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 10.75% Senior Notes due 2014. (Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed October 22, 2004).

- 4.9 Supplemental Indenture, dated as of October 20, 2004 among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of October 1 2003, among Level 3 Financing, Inc. as Issuer, Level 3 Communications, Inc. as Guarantor and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 10.75% Senior Notes due 2011. (Exhibit 99.1 to the Registrant's Current Report on Form 8-K/A-1 filed October 22, 2004).
- 4.10 Indenture, dated December 2, 2004, among Level 3 Communications, Inc. and The Bank of New York. (Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 4.11 Supplemental Indenture, dated December 1, 2004, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York, as Trustee, relating to the Level 3 Financing 10.75% Senior Notes due 2011. (Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 4.12 Second Supplemental Indenture dated as of April 4, 2005, by and between Level 3 Communications, Inc. and the Bank of New York, as trustee (Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed April 8, 2005).
- 4.13 Indenture, dated as of January 13, 2006, among Level 3 Communications, Inc. as Issuer and The Bank of New York, as Trustee relating to the 11.50% Senior Notes Due 2010 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated January 17, 2006).
- 4.14 Indenture, dated as of March 14, 2006, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer and The Bank of New York, as Trustee, relating to the Floating Rate Senior Notes due 2011 of Level 3 Financing, Inc. (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated March 16, 2006).
- 4.15 Indenture, dated as of March 14, 2006, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer and The Bank of New York, as Trustee, relating to the 12.25% Senior Notes due 2013 of Level 3 Financing, Inc. (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated March 16, 2006).
- 4.16 Third Supplemental Indenture between Level 3 Communications, Inc. and The Bank of New York, as Trustee, relating to up to \$345,000,000 aggregate principal amount of 3.5% Convertible Senior Notes due 2012, dated as of June 13, 2006 supplement to the Amended and Restated Indenture dated as of July 8, 2003 (Senior Debt Securities) (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated June 13, 2006).
- 4.17 Supplemental Indenture, dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes due 2011 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated October 17, 2006).
- 4.18 Supplemental Indenture, dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, Supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes due 2011 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated October 17, 2006).

- 4.19 Supplemental Indenture, dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 12.25% Senior Notes due 2013 (Exhibit 4.3 to the Registrant's Current Report on Form 8-K dated October 17, 2006).
- 4.20 Supplemental Indenture, dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 12.25% Senior Notes due 2013 (Exhibit 4.4 to the Registrant's Current Report on Form 8-K dated October 17, 2006).
- 4.21 Indenture, dated as of October 30, 2006, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer, and The Bank of New York, as Trustee, relating to the 9.25% Senior Notes due 2014 of Level 3 Financing, Inc. (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated October 30, 2006).
- 4.22 Supplemental Indenture, dated as of December 27, 2006, among Level 3 Communications, Inc., Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of October 1, 2003, among Level 3 Financing, Inc., as Issuer, Level 3 Communications, Inc., as Guarantor, and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 10.75% Senior Notes due 2011 2014 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated December 28, 2006).
- 4.23 Indenture, dated as of February 14, 2007, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer and The Bank of New York, as Trustee, relating to the Floating Rate Senior Notes due 2015 of Level 3 Financing, Inc. (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated February 20, 2007).
- 4.24 Indenture, dated as of February 14, 2007, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer and The Bank of New York, as Trustee, relating to the 8.75% Senior Notes due 2017 of Level 3 Financing, Inc. (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated February 20, 2007).
- 4.25 Supplemental Indenture, dated as of February 23, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC, Broadwing Financial Services, Inc. and The Bank of New York, as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., as Issuer, Level 3 Communications, Inc., as Guarantor, and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 12.25% Senior Notes due 2013 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed February 26, 2007).

- 4.26 Supplemental Indenture, dated as of March 1, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC, Broadwing Financial Services, Inc., together with Level 3 Communications, Inc. and Level 3 Communications, LLC, as Guarantors and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, the supplemental Indenture dated as of October 12, 2006, by and among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, the supplemental Indenture dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, and the supplemental Indenture dated as of January 4, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC, Broadwing Financial Services, Inc. and The Bank of New York as Trustee relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes Due 2011 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated March 2, 2007).
- 4.27 Amended and Restated Supplemental Indenture, dated as of March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, the supplemental Indenture dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, and the supplemental Indenture dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes Due 2011 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 4.28 Amended and Restated Supplemental Indenture, dated as of March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Broadwing Financial Services, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, the supplemental Indenture dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, and the supplemental Indenture dated as of January 4, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC, Broadwing Financial Services, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes Due 2011 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 4.29 Amended and Restated Supplemental Indenture, dated as of March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, the supplemental Indenture dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, and the supplemental Indenture dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 12.25% Senior Notes Due 2013 (Exhibit 4.3 to the Registrant's Current Report on Form 8-K dated March 16, 2007).

- 4.30 Amended and Restated Supplemental Indenture, dated as of March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Broadwing Financial Services, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, and the supplemental Indenture dated as of January 4, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC, Broadwing Financial Services, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 12.25% Senior Notes Due 2013 (Exhibit 4.4 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 4.31 Amended and Restated Supplemental Indenture, dated as of March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of October 1, 2003, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, the supplemental Indenture dated as of October 20, 2004 among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, and the supplemental Indenture dated December 1, 2004, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 10.75% Senior Notes Due 2011 (Exhibit 4.5 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 4.32 Amended and Restated Supplemental Indenture, dated as of March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Broadwing Financial Services, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated as of October 30, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, the supplemental Indenture dated as of January 4, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, and the supplemental Indenture dated as of January 4, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 9.25% Senior Notes Due 2014 (Exhibit 4.6 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 4.33 Supplemental Indenture, dated as of March 13, 2007, among Level 3 Communications, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated as of January 13, 2006, among Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Communications, Inc.'s 11.5% Senior Notes Due 2010 (Exhibit 4.7 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 4.34 Supplemental Indenture, dated as of April 9, 2007, among Level 3 Communications, LLC, Level 3 Communications, Inc., Level 3 Financing, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated October 30, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 9.25% Senior Notes Due 2014 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated April 11, 2007).
- 4.35 Supplemental Indenture, dated as of April 9, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated October 30, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 9.25% Senior Notes Due 2014 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated April 11, 2007).

- 4.36 Supplemental Indenture, dated as of January 4, 2007, among Broadwing Financial Services, Inc., Level 3 Communications, Inc., Level 3 Financing, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated October 30, 2006 among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 9.25% Senior Notes Due 2014 (Exhibit 4.2 to the Registrant's Current Report on Form S-4/A dated May 14, 2007).
- 4.37 Supplemental Indenture, dated as of May 29, 2007, among Level 3 Communications, LLC, Level 3 Communications, Inc., Level 3 Financing, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated February 14, 2007 among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 8.75% Senior Notes Due 2017 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated May 31, 2007).
- 4.38 Supplemental Indenture, dated as of May 29, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated February 14, 2007 among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 8.75% Senior Notes Due 2017 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated May 31, 2007).
- 4.39 Supplemental Indenture, dated as of May 29, 2007, among Level 3 Communications, LLC, Level 3 Communications, Inc., Level 3 Financing, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated February 14, 2007 among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes Due 2015 (Exhibit 4.3 to the Registrant's Current Report on Form 8-K dated May 31, 2007).
- 4.40 Supplemental Indenture, dated as of May 29, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated February 14, 2007 among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes Due 2015 (Exhibit 4.4 to the Registrant's Current Report on Form 8-K dated May 31, 2007).
- 4.41 Indenture, dated as of December 24, 2008, among Level 3 Communications, Inc. and The Bank of New York Mellon as Trustee, relating to Senior Debt Securities (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated December 24, 2008).
- 4.42 First Supplemental Indenture, dated as of December 24, 2008, among Level 3 Communications, Inc. and The Bank of New York Mellon as Trustee, relating to Level 3 Communications, Inc.'s 15% Convertible Senior Notes due 2013 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated December 24, 2008).
- 10.1 Separation Agreement, dated December 8, 1997, by and among Peter Kiewit Sons', Inc., Kiewit Diversified Group Inc., PKS Holdings, Inc. and Kiewit Construction Group Inc. (Exhibit 10.1 to the Registrant's Form 10-K for 1997).
- 10.2 Amendment No. 1 to Separation Agreement, dated March 18, 1997, by and among Peter Kiewit Sons', Inc., Kiewit Diversified Group Inc., PKS Holdings, Inc. and Kiewit Construction Group Inc. (Exhibit 10.1 to the Registrant's Form 10-K for 1997).
- 10.3 Form of Aircraft Time-Share Agreement (Exhibit 10.7 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001).

- 10.4 Securities Purchase Agreement, dated as of February 18, 2005, among Level 3 Communications, Inc. and the Investors named therein (Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed February 22, 2005).
- 10.5 1995 Stock Plan of Level 3 Communications, Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated December 20, 2007).
- 10.6.1 Outperform Stock Option Amended and Restated Master Award Agreement of Level 3 Communications, Inc. (Exhibit 10.2 to the Registrant's Current Report on Form 8-K dated December 20, 2007).
- 10.6.2 Form of OSO Master Award Agreement of Level 3 Communications, Inc. (Exhibit 10.3 to the Registrant's Current Report on Form 8-K dated December 20, 2007).
- 10.7 Form of Amended Master Deferred Issuance Stock Agreement of Level 3 Communications, Inc. (Exhibit 10.4 to the Registrant's Current Report on Form 8-K dated December 20, 2007).
- 10.8 Form of Amended and Restated Deferred Issuance Stock Agreement (Exhibit 10 to the Registrant's Quarterly Report on Form 10-Q for the three months ended March 31, 2008 dated May 12, 2008).
- 10.9 Purchase Agreement by and among Level 3 Communications, LLC, PT Holding Company LLC, Progress Telecommunications Corporation, EPIK Communications Incorporated, Florida Progress Corporation, Odyssey Telecorp, Inc. and Level 3 Communications, Inc. dated as of January 25, 2006 (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated January 30, 2006).
- 10.10 Form of Registration Rights and Transfer Restriction Agreement by and among Level 3 Communications, Inc., PT Holding Company LLC, Progress Telecommunications Corporation, Caronet, Inc., and EPIK Communications Incorporated to be entered into on the closing of the transaction contemplated by the Purchase Agreement 2006 (Exhibit 10.2 to the Registrant's Current Report on Form 8-K dated January 30, 2006).
- 10.11 Agreement and Plan of Merger by and among Level 3 Communications, Inc., Eldorado Acquisition Three, LLC and TelCove, Inc. dated as of April 30, 2006. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated April 19, 2006).
- 10.12 Registration Rights and Transfer Restriction Agreement, dated May 31, 2006, by and among Level 3 Communications, Inc., MCCC ICG Holdings LLC, Columbia Capital Equity Partners III(QP), L.P., Columbia Capital Partners III (Cayman), L.P., Columbia Capital Equity Partners III (AI), L.P., Columbia Capital Investors III, L.L.C., Columbia Capital Employees Investors III, L.L.C., M/C Venture Partners V, L.P., M/C Venture Investors, L.L.C., Chestnut Venture Partners, L.P., and Bear Investments, LLLP. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated June 1, 2006).
- 10.13 Stock Purchase Agreement, dated July 20, 2006, among Level 3 Communications, Inc., Technology Spectrum, Inc. and Insight Enterprises, Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated July 26, 2006).
- 10.14 Registration Rights Agreement, dated as of August 2, 2006, between Level 3 Communications, Inc. and Cheshire Holding Corp., as agent for the security holders of Looking Glass Networks Holding Co., Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated August 3, 2006).

- 10.15 Agreement and Plan of Merger among Level 3 Communications, Inc., Level 3 Services, LLC, Level 3 Colorado, Inc. and Broadwing Corporation, dated as of October 16, 2006 (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated October 17, 2006).
- 10.16 Agreement and Plan of Merger, dated as of October 16, 2006, as Amended by the First Amendment to Agreement and Plan of Merger Dated as of November 21, 2006, among Level 3 Communications, Inc., Level 3 Services, LLC, Level 3 Colorado, LLC (n/k/a Level 3 Colorado, Inc.) and Broadwing Corporation (attached as Annex A to the proxy statement/prospectus included in the registrant's Registration Statement on Form S-4 (333-138462) (Incorporated by reference to Exhibit 2.1 to the Registrant's Registration Statement on Form S-4 (333-138462)). (Exhibit 10.1 to the Registrant's Current Report on Form 8-K/A dated November 27, 2006).
- 10.17 Exchange Agreement, dated as of January 11, 2007, among Level 3 Communications, Inc., Southeastern Asset Management, Inc., on behalf of its investment advisory clients, and Legg Mason Opportunity Trust, a series of Legg Mason Investment Trust, Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated January 17, 2007).
- 10.18 Credit Agreement, dated as of March 13, 2007, among Level 3 Communications, Inc., Level 3 Financing, Inc. and Merrill Lynch Capital Corporation (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.19 Guarantee Agreement, dated as of March 13, 2007, among Level 3 Communications, Inc., the Subsidiaries of Level 3 Communications, Inc. and Merrill Lynch Capital Corporation (Exhibit 10.2 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.20 Collateral Agreement, dated as of March 13, 2007, among Level 3 Communications, Inc., Level 3 Financing, Inc., the Subsidiaries of Level 3 Communications, Inc. and Merrill Lynch Capital Corporation (Exhibit 10.3 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.21 Indemnity, Subrogation and Contribution Agreement, dated as of March 13, 2007, among Level 3 Communications, Inc., Level 3 Financing, Inc., the Subsidiaries of Level 3 Communications, Inc. and Merrill Lynch Capital Corporation (Exhibit 10.4 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.22 Omnibus Offering Proceeds Note Subordination Agreement, dated as of March 13, 2007, among Level 3 Communications, Inc., Level 3 Financing, Inc., Level 3 Communications, LLC, the Subsidiaries (Exhibit 10.5 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.23 Supplement No. 1 to Omnibus Offering Proceeds Note Subordination Agreement, dated as of March 13, 2007, among Level 3 Communications, Inc., Level 3 Communications, LLC, Level 3 Financing, Inc., the Subsidiaries (Exhibit 10.6 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.24 Amended and Restated Loan Proceeds Note, dated March 13, 2007, issued by Level 3 Communications, LLC to Level 3 Financing, Inc. (Exhibit 10.7 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.25 Amended and Restated Loan Proceeds Note Collateral Agreement, dated March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, LLC and Merrill Lynch Capital Corporation (Exhibit 10.8 to the Registrant's Current Report on Form 8-K dated March 16, 2007).

- 10.26 Amended and Restated Loan Proceeds Note Guarantee Agreement, dated March 13, 2007, among Broadwing Financial Services, Inc., and Level 3 Financing, Inc. (Exhibit 10.9 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.27 Standstill Agreement, dated November 19, 2007, by and between Level 3 Communications, Inc. and Southeastern Asset Management, Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated November 19, 2007).
- 10.28 Separation Agreement and General Release, dated March 20, 2008, among Kevin J. O'Hara and Level 3 Communications, LLC (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated March 20, 2008).
- 10.29 Consulting Agreement, dated March 20, 2008, among Level 3 Communications, LLC and Kevin J. O'Hara (Exhibit 10.2 to the Registrant's Current Report on Form 8-K dated March 20, 2008).
- 10.30 Securities Purchase Agreement, dated November 17, 2008, among Level 3 Communications, Inc. and the Investors named therein (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated November 18, 2008).
- 10.31 Amendment No. 1 to Securities Purchase Agreement, dated December 16, 2008, among Level 3 Communications, Inc. and the Investors named therein (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated December 16, 2008).
- 10.32 Amendment No. 2 to Securities Purchase Agreement, dated December 24, 2008, among Level 3 Communications, Inc. and the Investors named therein (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated December 24, 2008).
- 10.33 Separation Agreement and General Release, dated December 31, 2008, among John Neil Hobbs and Level 3 Communications, LLC.
- 10.34 Consulting Agreement, dated December 31, 2008, among Level 3 Communications, LLC and Hobbs Management, LLC.
- 12 Statements re computation of ratios.
- 21 List of subsidiaries of the Company.
- 23 Consent of KPMG LLP.
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer.
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 27th day of February, 2009.

LEVEL 3 COMMUNICATIONS, INC.

By: /s/ JAMES Q. CROWE

Name: James Q. Crowe
Title: *Chief Executive Officer*

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

| | | |
|---|--|-------------------|
| <u> /s/ WALTER SCOTT, JR. </u> Walter Scott, Jr. | Chairman of the Board | February 27, 2009 |
| <u> /s/ JAMES Q. CROWE </u> James Q. Crowe | Chief Executive Officer and Director | February 27, 2009 |
| <u> /s/ SUNIT S. PATEL </u> Sunit S. Patel | Executive Vice President and Chief Financial Officer (Principal Financial Officer) | February 27, 2009 |
| <u> /s/ ERIC J. MORTENSEN </u> Eric J. Mortensen | Senior Vice President and Controller (Principal Accounting Officer) | February 27, 2009 |
| <u> /s/ R. DOUGLAS BRADBURY </u> R. Douglas Bradbury | Director | February 27, 2009 |
| <u> /s/ DOUGLAS C. EBY </u> Douglas C. Eby | Director | February 27, 2009 |
| <u> /s/ JAMES O. ELLIS, JR. </u> James O. Ellis, Jr. | Director | February 27, 2009 |
| <u> /s/ RICHARD R. JAROS </u> Richard R. Jaros | Director | February 27, 2009 |

| | | |
|---|---|-------------------|
| <u>/s/ ROBERT E. JULIAN</u> Robert E. Julian | Director | February 27, 2009 |
| <u>/s/ CHARLES C. MILLER, III</u> Charles C. Miller, III | Executive Vice President, Vice Chairman and Director | February 27, 2009 |
| <u>/s/ MICHAEL J. MAHONEY</u> Michael J. Mahoney | Director | February 27, 2009 |
| <u>/s/ ARUN NETRAVALI</u> Arun Netravali | Director | February 27, 2009 |
| <u>/s/ JOHN T. REED</u> John T. Reed | Director | February 27, 2009 |
| <u>/s/ MICHAEL B. YANNEY</u> Michael B. Yanney | Director | February 27, 2009 |
| <u>/s/ ALBERT C. YATES</u> Albert C. Yates | Director | February 27, 2009 |

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

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

Report of Independent Registered Public Accounting Firm

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

We have audited the accompanying consolidated balance sheets of Level 3 Communications, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of operations, cash flows, changes in stockholders' equity (deficit) and comprehensive loss for each of the years in the three-year period ended December 31, 2008. These consolidated financial statements are the responsibility of Level 3 Communications, Inc.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Level 3 Communications, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Level 3 Communications, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 27, 2009 expressed an unqualified opinion on the effectiveness of Level 3 Communications, Inc.'s internal control over financial reporting.

/s/ KPMG LLP

Denver, Colorado
February 27, 2009

Report of Independent Registered Public Accounting Firm

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

We have audited Level 3 Communications, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Level 3 Communications, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying "Management's Report on Internal Control Over Financial Reporting". Our responsibility is to express an opinion on Level 3 Communications Inc.'s internal control over financial reporting based on our audit.

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

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

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

In our opinion, Level 3 Communications, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Level 3 Communications, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of operations, cash flows, changes in stockholders' equity (deficit) and comprehensive loss for each of the years in the three-year period ended December 31, 2008, and our report dated February 27, 2009 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Denver, Colorado
February 27, 2009

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

For each of the three years ended December 31, 2008

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---|--|-------------------|------------------|
| | (dollars in millions, except per share data) | | |
| Revenue: | | | |
| Communications | \$ 4,226 | \$ 4,199 | \$ 3,311 |
| Coal mining | 75 | 70 | 67 |
| Total revenue | <u>4,301</u> | <u>4,269</u> | <u>3,378</u> |
| Costs and Expenses (exclusive of depreciation and amortization shown separately below): | | | |
| Cost of revenue: | | | |
| Communications | 1,740 | 1,769 | 1,460 |
| Coal mining | 69 | 64 | 57 |
| Total cost of revenue | <u>1,809</u> | <u>1,833</u> | <u>1,517</u> |
| Depreciation and amortization | 931 | 942 | 730 |
| Selling, general and administrative | 1,505 | 1,723 | 1,258 |
| Restructuring and impairment charges | 25 | 12 | 13 |
| Total costs and expenses | <u>4,270</u> | <u>4,510</u> | <u>3,518</u> |
| Operating Income (Loss) | <u>31</u> | <u>(241)</u> | <u>(140)</u> |
| Other Income (Expense): | | | |
| Interest income | 15 | 54 | 64 |
| Interest expense | (534) | (577) | (648) |
| Gain on sale of business groups, net | 99 | — | — |
| Gain (loss) on early extinguishment of debt, net | 81 | (427) | (83) |
| Other, net | 24 | 55 | 19 |
| Total other income (expense) | <u>(315)</u> | <u>(895)</u> | <u>(648)</u> |
| Loss from Continuing Operations Before Income Taxes | (284) | (1,136) | (788) |
| Income Tax (Expense) Benefit | (6) | 22 | (2) |
| Loss from Continuing Operations | <u>(290)</u> | <u>(1,114)</u> | <u>(790)</u> |
| Discontinued Operations: | | | |
| Income from discontinued operations | — | — | 13 |
| Gain on sale of discontinued operations | — | — | 33 |
| Income from Discontinued Operations | <u>—</u> | <u>—</u> | <u>46</u> |
| Net Loss | <u>\$ (290)</u> | <u>\$ (1,114)</u> | <u>\$ (744)</u> |
| Shares Used to Compute Basic and Diluted Loss Per Share (in thousands) | <u>1,564,996</u> | <u>1,517,616</u> | <u>1,003,255</u> |
| Earnings (Loss) Per Share (Basic and Diluted): | | | |
| Loss from Continuing Operations | \$ (0.19) | \$ (0.73) | \$ (0.79) |
| Income from Discontinued Operations | — | — | .05 |
| Net Loss | <u>\$ (0.19)</u> | <u>\$ (0.73)</u> | <u>\$ (0.74)</u> |

See accompanying notes to consolidated financial statements.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2008 AND 2007

| | <u>2008</u> | <u>2007</u> |
|---|---|------------------|
| | (dollars in millions, except per share data) | |
| <i>Assets</i> | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 768 | \$ 714 |
| Marketable securities | — | 9 |
| Restricted cash and securities | 3 | 10 |
| Receivables, less allowances for doubtful accounts of \$16 and \$20, respectively | 390 | 404 |
| Other | 83 | 88 |
| Total Current Assets | <u>1,244</u> | <u>1,225</u> |
| Property, Plant and Equipment, net | 6,159 | 6,669 |
| Restricted Cash and Securities | 127 | 117 |
| Goodwill | 1,432 | 1,421 |
| Other Intangibles, net | 559 | 680 |
| Other Assets, net | 117 | 142 |
| Total Assets | <u>\$ 9,638</u> | <u>\$ 10,254</u> |
| <i>Liabilities and Stockholders' Equity</i> | | |
| Current Liabilities: | | |
| Accounts payable | \$ 365 | \$ 396 |
| Current portion of long-term debt | 186 | 32 |
| Accrued payroll and employee benefits | 105 | 97 |
| Accrued interest | 117 | 128 |
| Current portion of deferred revenue | 168 | 175 |
| Other | 111 | 144 |
| Total Current Liabilities | <u>1,052</u> | <u>972</u> |
| Long-Term Debt, less current portion | 6,394 | 6,832 |
| Deferred Revenue, less current portion | 719 | 763 |
| Other Liabilities | 597 | 617 |
| Total Liabilities | <u>8,762</u> | <u>9,184</u> |
| Commitments and Contingencies | | |
| Stockholders' Equity: | | |
| Preferred stock, \$.01 par value, authorized 10,000,000 shares: no shares outstanding | — | — |
| Common stock, \$.01 par value, authorized 2,250,000,000 shares: 1,617,615,258 issued and outstanding in 2008 and 1,537,862,685 issued and outstanding in 2007 | 16 | 15 |
| Additional paid-in capital | 11,254 | 11,004 |
| Accumulated other comprehensive income (loss) | (51) | 104 |
| Accumulated deficit | (10,343) | (10,053) |
| Total Stockholders' Equity | <u>876</u> | <u>1,070</u> |
| Total Liabilities and Stockholders' Equity | <u>\$ 9,638</u> | <u>\$ 10,254</u> |

See accompanying notes to consolidated financial statements.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

For each of the three years ended December 31, 2008

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---|-----------------------|----------------|----------------|
| | (dollars in millions) | | |
| Cash Flows from Operating Activities: | | | |
| Net Loss | \$(290) | \$(1,114) | \$(744) |
| Income from discontinued operations | — | — | (46) |
| Loss from continuing operations | (290) | (1,114) | (790) |
| Adjustments to reconcile loss from continuing operations to net cash provided by operating activities of continuing operations: | | | |
| Depreciation and amortization | 931 | 942 | 730 |
| (Gain) loss on debt extinguishments, net | (81) | 427 | 83 |
| Asset retirement obligation adjustment | (86) | — | — |
| Loss on impairments | 8 | 1 | 8 |
| Gain on sale of property, plant and equipment and other assets | (3) | (40) | (7) |
| Gain on sale of business groups, net | (99) | — | — |
| Non-cash compensation expense attributable to stock awards | 78 | 122 | 84 |
| Deferred income taxes | — | (23) | — |
| Amortization of debt issuance costs | 16 | 15 | 19 |
| Accreted interest on long-term debt discount | — | 22 | 38 |
| Accrued interest on long-term debt | (13) | (5) | 32 |
| Change in working capital items net of amounts acquired: | | | |
| Receivables | 5 | 21 | 131 |
| Other current assets | 2 | 18 | 8 |
| Payables | (26) | (73) | (23) |
| Deferred revenue | (34) | 17 | (53) |
| Other current liabilities | 6 | (105) | (32) |
| Other, net | (1) | 6 | (7) |
| Net Cash Provided by Operating Activities of Continuing Operations | 413 | 231 | 221 |
| Cash Flows from Investing Activities: | | | |
| Capital expenditures | (449) | (633) | (392) |
| Proceeds from sale of business groups, net | 124 | — | — |
| Proceeds from sales and maturities of marketable securities | 4 | 333 | 280 |
| Purchases of marketable securities | — | — | (98) |
| (Increase) decrease in restricted cash and securities, net | (5) | 12 | (21) |
| Advances from discontinued operations, net | — | — | 18 |
| Acquisitions, net of cash acquired | — | (670) | (749) |
| Proceeds from sale of discontinued operations, net of cash sold | — | (2) | 307 |
| Proceeds from sale of property, plant and equipment | 3 | 5 | 7 |
| Other | 2 | (6) | — |
| Net Cash Used in Investing Activities | \$(321) | \$(961) | \$(648) |

(continued)

See accompanying notes to consolidated financial statements.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
For each of the three years ended December 31, 2008

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|--|-----------------------|---------------|-----------------|
| | (dollars in millions) | | |
| Cash Flows from Financing Activities: | | | |
| Long-term debt borrowings, net of issuance costs | \$ 400 | \$ 2,349 | \$ 2,256 |
| Payments on and repurchases of long-term debt, including current portion and refinancing costs | (436) | (2,618) | (1,110) |
| Proceeds from warrants and stock-based equity plans | — | 26 | — |
| Equity offering | — | — | 543 |
| Other | 2 | — | — |
| Net Cash Provided by (Used in) Financing Activities | (34) | (243) | 1,689 |
| Discontinued Operations: | | | |
| Net cash used in discontinued operating activities | — | — | (20) |
| Net cash used in investing activities | — | — | (23) |
| Net Cash Used in Discontinued Operations | — | — | (43) |
| Effect of Exchange Rates on Cash and Cash Equivalents | (4) | 6 | 10 |
| Net Change in Cash and Cash Equivalents | 54 | (967) | 1,229 |
| Cash and Cash Equivalents at Beginning of Year: | | | |
| Cash and cash equivalents of continuing operations | 714 | 1,681 | 379 |
| Cash and cash equivalents of discontinued operations | — | — | 73 |
| Cash and Cash Equivalents at End of Year: | | | |
| Cash and cash equivalents of continuing operations | <u>\$ 768</u> | <u>\$ 714</u> | <u>\$ 1,681</u> |
| Supplemental Disclosure of Cash Flow Information: | | | |
| Cash interest paid | \$ 531 | \$ 545 | \$ 559 |
| Income taxes paid | 4 | 1 | — |
| Noncash Investing and Financing Activities: | | | |
| Common stock issued for acquisitions | \$ — | \$ 692 | \$ 904 |
| Long-term debt converted to equity | 151 | 879 | — |
| Decrease in deferred revenue related to acquisitions | — | — | 10 |

See accompanying notes to consolidated financial statements.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)

For each of the three years ended December 31, 2008

| | <u>Common Stock</u> | | <u>Additional Paid-in Capital</u> | <u>Accumulated Other Comprehensive Income (Loss)</u> | <u>Accumulated Deficit</u> | <u>Total</u> |
|--|---------------------|-----------|---|--|--------------------------------|--------------|
| | <u>Shares</u> | <u>\$</u> | | | | |
| | | | | | | |
| Balances at December 31, 2005 | 817,767,818 | \$ 8 | \$ 7,759 | \$ (51) | \$ (8,192) | \$ (476) |
| Adjustment for EITF No. 04-6 | — | — | — | — | (3) | (3) |
| Adjusted balances at December 31, 2005 | 817,767,818 | 8 | 7,759 | (51) | (8,195) | (479) |
| Common Stock: | | | | | | |
| Acquisitions | 216,917,837 | 2 | 902 | — | — | 904 |
| Equity offering, net of offering costs | 125,000,000 | 2 | 541 | — | — | 543 |
| Common stock issued under employee stock and benefit plans and other | 18,737,450 | — | 15 | — | — | 15 |
| Stock-based compensation expense | — | — | 88 | — | — | 88 |
| Net Loss | — | — | — | — | (744) | (744) |
| Other Comprehensive Income | — | — | — | 47 | — | 47 |
| Balances at December 31, 2006 | 1,178,423,105 | 12 | 9,305 | (4) | (8,939) | 374 |
| Common Stock: | | | | | | |
| Acquisitions | 122,942,018 | 1 | 691 | — | — | 692 |
| Common stock issued under employee stock and benefit plans and other | 22,558,511 | — | 8 | — | — | 8 |
| Debt conversion to equity | 213,939,051 | 2 | 877 | — | — | 879 |
| Stock-based compensation expense | — | — | 123 | — | — | 123 |
| Net Loss | — | — | — | — | (1,114) | (1,114) |
| Other Comprehensive Income | — | — | — | 108 | — | 108 |
| Balances at December 31, 2007 | 1,537,862,685 | 15 | 11,004 | 104 | (10,053) | 1,070 |
| Common Stock: | | | | | | |
| Common stock issued under employee stock and benefit plans and other | 32,131,248 | — | 21 | — | — | 21 |
| Debt conversion to equity | 47,621,325 | 1 | 150 | — | — | 151 |
| Stock-based compensation expense | — | — | 79 | — | — | 79 |
| Net Loss | — | — | — | — | (290) | (290) |
| Other Comprehensive Loss | — | — | — | (155) | — | (155) |
| Balances at December 31, 2008 | 1,617,615,258 | \$16 | \$ 11,254 | \$ (51) | \$ (10,343) | \$ 876 |

See accompanying notes to consolidated financial statements.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

For each of the three years ended December 31, 2008

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|--|-----------------------|------------------|----------------|
| | (dollars in millions) | | |
| Net Loss | \$(290) | \$(1,114) | \$(744) |
| Other Comprehensive Income (Loss) Before Income Taxes: | | | |
| Foreign currency translation | (63) | 131 | 48 |
| Unrealized holding gain (loss) on available-for-sale investment | (7) | 7 | 1 |
| Unrealized holding loss on interest rate swaps | (60) | (37) | — |
| Other, net | (25) | 7 | (2) |
| Other Comprehensive Income (Loss), Before Income Taxes | (155) | 108 | 47 |
| Income Tax Related to Items of Other Comprehensive Income (Loss) | — | — | — |
| Other Comprehensive Income (Loss), Net of Income Taxes | (155) | 108 | 47 |
| Comprehensive Loss | <u>\$(445)</u> | <u>\$(1,006)</u> | <u>\$(697)</u> |

SUPPLEMENTARY STOCKHOLDERS' EQUITY (DEFICIT) INFORMATION

| | Net Foreign Currency Translation <u>Adjustment</u> | Unrealized Holding Gain (Loss) on Investment <u>and Interest Rate Swaps</u> | <u>Other</u> | <u>Total</u> |
|--|--|---|---------------|----------------|
| | (dollars in millions) | | | |
| Accumulated Other Comprehensive Income (Loss): | | | | |
| Balance at December 31, 2005 | \$ (19) | \$ (1) | \$(31) | \$ (51) |
| Change | 48 | 1 | (2) | 47 |
| Balance at December 31, 2006 | 29 | — | (33) | (4) |
| Change | 131 | (30) | 7 | 108 |
| Balance at December 31, 2007 | 160 | (30) | (26) | 104 |
| Change | (63) | (67) | (25) | (155) |
| Balance at December 31, 2008 | <u>\$ 97</u> | <u>\$ (97)</u> | <u>\$(51)</u> | <u>\$ (51)</u> |

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

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

The Company is also engaged in coal mining through its two 50% owned joint-venture surface mines, one each in Montana and Wyoming.

Principles of Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of Level 3 Communications, Inc. and subsidiaries (the "Company" or "Level 3") in which it has control, which are enterprises engaged in the communications and coal mining businesses. Fifty-percent-owned mining joint ventures are consolidated on a pro rata basis. All significant intercompany accounts and transactions have been eliminated. The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States.

Level 3 acquired WilTel Communications Group, LLC ("WilTel") on December 23, 2005; Progress Telecom, LLC ("Progress Telecom") on March 20, 2006; ICG Communications, Inc. ("ICG Communications") on May 31, 2006; TelCove, Inc. ("TelCove") on July 24, 2006; Looking Glass Networks Holding Co., Inc. ("Looking Glass") on August 2, 2006; Broadwing Corporation ("Broadwing") on January 3, 2007; the Content Delivery Network services business ("CDN Business") of SAVVIS, Inc. on January 23, 2007; and Servecast Limited ("Servecast") on July 11, 2007. As applicable, the Company also acquired these companies' operating subsidiaries. The results of operations, cash flows and financial position attributable to these acquisitions are included in the consolidated financial statements from the respective dates of their acquisition.

On September 7, 2006, Level 3 sold Software Spectrum, Inc. ("Software Spectrum"), the Company's software reseller business, to Insight Enterprises, Inc. ("Insight Enterprises"). The results of operations, financial condition and cash flows for the Software Spectrum business have been classified as discontinued operations in the consolidated financial statements and related notes through its date of sale.

On June 5, 2008, Level 3 completed the sale of its Vyvx advertising distribution business to DG FastChannel, Inc. Level 3 has retained ownership of Vyvx's core broadcast business, including the Vyvx Services Broadcast Business' content distribution capabilities. The financial results of the Vyvx advertising distribution business are included in the Company's consolidated results of operations through the date of sale. See Note 2 for more details regarding the disposition of the Vyvx advertising distribution business. The disposal of the Vyvx advertising distribution business did not meet the criteria under Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144") for presentation as discontinued operations since the business was not considered an asset group.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Foreign Currency Translation

Generally, local currencies of foreign subsidiaries are the functional currencies for financial reporting purposes. Assets and liabilities are translated into U.S. dollars at year-end exchange rates. Revenue, expenses and cash flows are translated using average exchange rates prevailing during the year. Gains or losses resulting from currency translation are recorded as a component of accumulated other comprehensive income (loss) in stockholders' equity (deficit) and in the statements of comprehensive loss. A significant portion of the Company's foreign subsidiaries have either the British Pound or the Euro as the functional currency, both of which experienced significant fluctuations against the U.S. dollar during 2008, 2007 and 2006. As a result, the Company has experienced significant foreign currency translation adjustments that are recognized as a component of accumulated other comprehensive income (loss) in stockholders' equity (deficit) and in the statement of comprehensive loss in accordance with SFAS No. 52 "Foreign Currency Translation". The Company considers its investments in its foreign subsidiaries to be long-term in nature.

Reclassifications

Certain immaterial reclassifications have been made to prior years to conform to the current period's presentation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The accounting estimates that require management's most significant and subjective judgments include revenue recognition, the valuation and recognition of stock-based compensation expense, the valuation of long-lived assets, goodwill and acquired indefinite-lived intangible assets and the valuation of asset retirement obligations. In addition, the Company has other accounting policies that involve estimates such as the allowance for doubtful accounts, revenue reserves, the determination of the useful lives of long-lived assets, the recognition of the fair value of assets acquired and liabilities assumed in business combinations, accruals for estimated tax and legal liabilities, valuation allowance for deferred tax assets and cost of revenue disputes for communications services. Actual results may differ from these estimates under different assumptions or conditions and such differences could be material.

Communications

Revenue for communications services is recognized on a monthly basis as these services are provided based on contractual amounts expected to be collected. Management establishes appropriate revenue reserves at the time services are rendered based on an analysis of historical credit activity to address, where significant, situations in which collection is not reasonably assured as a result of credit risk, potential billing disputes or other reasons.

Reciprocal compensation revenue is recognized when an interconnection agreement is in place with another carrier, or if an agreement has expired, when the parties have agreed to continue operating under the previous agreement until a new agreement is negotiated and executed; or at rates mandated by the FCC. Periodically, the Company will receive payment for reciprocal compensation

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

services in excess of FCC rates and before an agreement is in place. These amounts are included in other current liabilities on the consolidated balance sheet until a final agreement has been reached and the necessary regulatory approvals have been received at which time the reciprocal compensation revenue is recognized. These amounts were insignificant to the Company in 2008, 2007 and 2006.

For certain sale and long-term infeasible right of use or IRU contracts involving private line, wavelengths and dark fiber services, the Company may receive up-front payments for services to be delivered for a period of up to 20 years. In these situations, the Company defers the revenue and amortizes it on a straight-line basis to earnings over the term of the contract.

Termination revenue is recognized when a customer discontinues service prior to the end of the contract period, for which Level 3 had previously received consideration and for which revenue recognition was deferred. Termination revenue is also recognized when customers are required to make termination penalty payments to Level 3 to settle contractually committed purchase amounts that the customer no longer expects to meet or when a customer and Level 3 renegotiate a contract under which Level 3 is no longer obligated to provide services for consideration previously received and for which revenue recognition has been deferred.

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

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

Cost of revenue for the communications business includes leased capacity, right-of-way costs, access charges, satellite transponder lease costs and other third party costs directly attributable to the network, but excludes depreciation and amortization and related impairment expenses. Prior to the sale of the Vyvx advertising distribution business, the Company included in communications cost of revenue package delivery costs and blank tape media costs associated with this business.

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

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

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Coal Mining

The Company sells coal primarily through long-term contracts with public utilities. The long-term contracts for the delivery of coal establish the price, volume, and quality requirements of the coal to be delivered. Revenue under these and other contracts is generally recognized when coal is shipped to the customer.

USF and Gross Receipts Taxes

Emerging Issues Task Force Issue ("EITF") 06-03 "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)" ("EITF 06-03") provides guidance regarding the accounting and financial statement presentation for certain taxes assessed by a governmental authority. The Company adopted EITF Issue No. 06-03 on January 1, 2007. The scope of EITF No. 06-3 includes any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, Universal Service Fund ("USF") contributions and some excise taxes. The Task Force concluded that entities should present these taxes in the income statement on either a gross or a net basis. The Company records USF contributions on a gross basis in its consolidated statements of operations, but records sales, use, value added and excise taxes billed to its customers on a net basis in its consolidated statements of operations. Communications revenue and cost of revenue on the consolidated statements of operations includes USF contributions totaling \$65 million, \$63 million and \$19 million for the years ended December 31, 2008, 2007 and 2006, respectively.

Advertising Costs

The Company expenses the cost of advertising as incurred. Advertising expense is included as a component of selling, general and administrative expenses in the accompanying consolidated statements of operations. Advertising expense was \$8 million, \$16 million and \$8 million for the years ended December 31, 2008, 2007 and 2006, respectively.

Stock-Based Compensation

Beginning January 1, 2006, the Company adopted the provisions of SFAS No. 123R, "Share-Based Payment" ("SFAS No. 123R"). The Company recognizes the estimated fair value of these compensation costs, net of an estimated forfeiture rate, over the requisite service period of the award, which is generally the option vesting term. The Company estimates forfeiture rates based on its historical experience.

Income Taxes

The Company recognizes deferred tax assets and liabilities for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts using enacted tax rates in effect for the year the differences are expected to reverse. The Company records a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not to be realized. The Company recognizes interest and penalty expense associated with uncertain tax positions as a component of income tax expense in the consolidated statements of operations.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Cash and Cash Equivalents

The Company classifies investments as cash equivalents if they are readily convertible to cash and have original maturities of three months or less at the time of acquisition. Cash and cash equivalents consist primarily of highly liquid investments in government and government agency securities and money market funds issued or managed by financial institutions in the United States and Europe and commercial paper depending on liquidity requirements. As of December 31, 2008 and 2007, the carrying value of cash and cash equivalents approximates fair value due to the short period of time to maturity.

Derivative Financial Instruments

The Company uses derivative financial instruments, primarily interest rate swaps, to hedge certain interest rate exposures. The Company has designated its interest rate swap agreements as a cash flow hedge. The change in the fair value of the interest rate swap agreements is reflected in other comprehensive income (loss) due to the fact that the interest rate swap agreements are designated as an effective cash flow hedge. The Company evaluates the effectiveness of the hedge on a quarterly basis. The Company recognizes any ineffective portion of the hedge in the consolidated statements of operations. The Company does not use derivative financial instruments for speculative purposes.

The Company also has equity conversion rights associated with debt instruments, which are not designated as hedging instruments, and were considered derivative instruments as of December 31, 2008. The Company recognizes the gains or losses from changes in fair values of these derivative instruments in other income (expense) in the statements of operations. Gains and losses from these derivative instruments were not material for any period presented.

Allowance for Doubtful Accounts

Trade accounts receivable are recorded at the invoiced amount and can bear interest. The Company establishes an allowance for doubtful accounts for accounts receivable amounts that may not be collectible. The Company determines the allowance for doubtful accounts based on the aging of its accounts receivable balances and an analysis of its historical experience of bad debt write-offs. The Company reviews its allowance for doubtful accounts quarterly. Past due balances over 60 days and over a specified amount are reviewed individually for collectability. Accounts receivable balances are written-off against the allowance for doubtful accounts after all means of collection have been exhausted and the potential for recovery is considered remote. All of the Company's allowance for doubtful accounts relates to its communications business. The Company recognized bad debt expense, net of recoveries, of approximately \$9 million in 2008, \$11 million in 2007 and \$1 million in 2006.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Property, Plant and Equipment

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

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

The Company capitalizes costs directly associated with expansions and improvements of the Company's communications network, customer installations, including employee related costs, and generally capitalizes costs associated with network construction and provisioning of services. The Company amortizes such costs over an estimated useful life of three to seven years.

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

Capitalized labor and related costs associated with employees and contract labor working on capital projects were approximately \$83 million, \$102 million and \$72 million for the years ended December 31, 2008, 2007 and 2006, respectively.

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

The Company performs periodic internal reviews to determine depreciable lives of its property, plant and equipment based on input from global network services personnel, actual usage and the physical condition of the Company's property, plant and equipment.

Asset Retirement Obligations

The Company recognizes a liability for legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or the normal operation of a long-lived asset in the period incurred in accordance with SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"). The fair value of the obligation is also capitalized as property, plant and equipment and then amortized over the estimated remaining useful life of the associated asset. Increases to the asset retirement obligation liability due to the passage of time are recognized as accretion expense and included within selling, general and administrative expenses for the Communications business and within cost of revenue for the Coal Mining business on the Company's consolidated statements of operations. Changes in the liability due to revisions to future cash flows are recognized by increasing or decreasing the liability with the offset adjusting the carrying amount of the related long-lived asset. To the extent that the downward revisions exceed the carrying amount of the related long-lived asset initially recorded when the asset retirement obligation liability was established, the Company records the remaining adjustment as a reduction to depreciation expense, to the extent of historical depreciation of the related long-lived asset, and selling, general and administrative expense.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

The Company revised its estimates of the amounts and timing of its original estimate of undiscounted cash flows related to certain future asset retirement obligations in the fourth quarter of 2008. As a result, the Company reduced its asset retirement obligations liability by \$103 million with an offsetting reduction to property, plant and equipment of \$21 million, selling, general and administrative expenses of \$86 million, depreciation and amortization of \$11 million and an increase to goodwill of \$15 million. See Note 5 for more details regarding the Company's asset retirement obligation activities.

Business Combinations

All of the Company's business combinations have been accounted for using the purchase method of accounting and, accordingly, are included in Level 3's results of operations as of the date of each acquisition. The Company allocates the purchase price of its acquisitions to the tangible assets acquired, liabilities assumed and intangible assets acquired, including in-process research & development ("IPR&D"), based on their estimated fair values. The excess purchase price over those fair values is recorded as goodwill. The excess of those fair values over the purchase price is recorded as a reduction to long-lived assets.

Goodwill and Acquired Indefinite-Lived Intangible Assets

SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), prohibits the amortization of goodwill and purchased intangible assets with indefinite useful lives. The Company reviews goodwill and purchased intangible assets with indefinite lives for impairment annually at the end of the fourth quarter and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with SFAS No. 142. For goodwill, the Company performs a two-step impairment test. In the first step, the Company compares the fair value of each reporting unit to its carrying value. The Company's reporting units are consistent with the reportable segments identified in Note 14. The Company estimates the fair value of its reporting units based on a combination of quoted market price and income approaches. Under the quoted market price approach, the Company estimates the fair value based upon the market capitalization of Level 3 using quoted market prices, adds an estimated control premium, and then assigns that fair market value to the reporting units. Under the income approach, the Company calculates the fair value of a reporting unit based on the present value of estimated future cash flows. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and no further testing is performed. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then a second step is performed and the implied fair value of the reporting unit's goodwill is determined and compared to the carrying value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then an impairment loss equal to the difference is recorded.

SFAS 142 also requires that the fair value of acquired indefinite-lived intangible assets be estimated and compared to their carrying value each year. The Company estimates the fair value of these intangible assets primarily utilizing an income approach. The Company recognizes an impairment loss when the estimated fair value of the indefinite-lived purchased intangible assets is less than the carrying value.

The Company conducted its goodwill and acquired indefinite-lived intangible assets impairment analyses at the end of the fourth quarters of 2008, 2007 and 2006 and concluded that its goodwill and acquired indefinite-lived intangible assets were not impaired in any of those periods. As a result of the

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

sale of the Vyvx advertising distribution business in the second quarter of 2008, the Company also performed an impairment analysis of its indefinite-lived Vyvx trade name and concluded that there was no impairment as of June 30, 2008.

Long-Lived Assets Including Finite-Lived Purchased Intangible Assets

The Company amortizes acquired intangible assets with finite lives using the straight-line method over the estimated economic lives of the assets, ranging from four to twelve years.

The Company evaluates long-lived assets, such as property, plant and equipment and acquired intangible assets with finite lives, for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with SFAS No. 144. The Company assesses the recoverability of the assets based on the undiscounted future cash flows the assets are expected to generate and recognizes an impairment loss when estimated undiscounted future cash flows expected to result from the use of the assets plus net proceeds expected from disposition of the assets, if any, are less than the carrying value of the assets. If an asset is deemed to be impaired, the amount of the impairment loss represents the excess of the asset's carrying value compared to its estimated fair value.

The Company conducted a long-lived asset impairment analysis at the end of the fourth quarter of 2008 and concluded that its long-lived assets, including finite-lived acquired intangible assets, were not impaired.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash equivalents, accounts receivable, restricted cash and securities and derivatives. The Company maintains its cash equivalents, restricted cash and securities and derivatives with various financial institutions. These financial institutions are primarily located in the United States and Europe and the Company's policy is to limit exposure with any one institution. As part of its cash and risk management processes, the Company performs periodic evaluations of the relative credit standing of the financial institutions. The Company also has established guidelines relative to financial instrument credit ratings, diversification and maturities that seek to maintain safety and liquidity. The Company's investment strategy generally results in lower yields on investments but reduces the risk to principal in the short term prior to these funds being used in the Company's business. The Company has not experienced any material losses on financial instruments held at financial institutions. The Company utilizes interest rate swap contracts to protect against the effects of interest rate fluctuations. Such contracts involve the risk of non-performance by the counterparty, which could result in a material loss.

The Company provides communications services to a wide range of wholesale and enterprise customers, ranging from well capitalized national carriers to small early stage companies in the United States and Europe. Credit risk with respect to accounts receivable is generally diversified due to the large number of entities comprising Level 3's customer base and their dispersion across many different industries and geographical regions. The Company performs ongoing credit evaluations of its customers' financial condition and generally requires no collateral from its customers, although letters of credit and deposits are required in certain limited circumstances. The Company has from time to time entered into agreements with value-added resellers and other channel partners to reach consumer and enterprise markets for voice services. The Company has policies and procedures in place to

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

evaluate the financial condition of these resellers prior to initiating service to the final customer. The Company maintains an allowance for doubtful accounts based upon the expected collectability of accounts receivable. Due to the Company's credit evaluation and collection process, bad debt expenses have not been significant; however, the Company is not able to predict changes in the financial stability of its customers. Any material change in the financial status of any one or a particular group of customers may cause the Company to adjust its estimate of the recoverability of receivables and could have a material adverse effect on the Company's results of operations. At December 31, 2008, one customer with operations in North America and Europe accounted for approximately 12% of gross accounts receivable. Fair values of accounts receivable approximate cost due to the short period of time to collection.

A relatively small number of customers account for a significant percentage of the Company's revenue. The Company's top ten customers accounted for approximately 32%, 34% and 55% of Level 3's communications revenue for the years ended December 31, 2008, 2007 and 2006, respectively. Revenue attributable to AT&T, Inc. and its subsidiaries, including SBC Communications, Bell South Communications and AT&T Mobility (formerly Cingular Wireless) accounted for approximately 12%, 15% and 32% of consolidated revenue for the years ended December 31, 2008, 2007 and 2006, respectively. Revenue attributable to AT&T is included in the communications business.

Recently Issued Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement was effective for financial assets and liabilities, as well as for non-financial assets and liabilities that are recognized or disclosed at fair value on a recurring basis for fiscal years beginning after November 15, 2007 and interim periods within that fiscal year. FASB Staff Position ("FSP") FAS 157-2, "Effective Date of FASB Statement No. 157" ("FSP 157-2") defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years, for non-financial assets and liabilities that are not recognized or disclosed at fair value on a recurring basis. SFAS No. 157 did not have a material effect on the Company's consolidated results of operations or financial condition in 2008. The Company does not expect that the adoption of the remaining portions of SFAS No. 157 to have a material effect on the Company's consolidated results of operations and financial position.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" ("SFAS No. 141R"), which replaces SFAS No. 141, "Business Combinations" ("SFAS No. 141"). SFAS No. 141R retains the underlying concepts of SFAS No. 141 in that an entity is required to recognize the assets acquired and liabilities assumed at their fair value on the acquisition date. SFAS No. 141R will change the accounting treatment for certain specific acquisition related items to require: (1) expensing acquisition related costs as incurred; (2) expensing changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date; (3) valuing noncontrolling interests at fair value at the acquisition date; (4) generally expensing restructuring costs associated with an acquired business; (5) capitalizing in-process research; and development assets acquired and (6) measuring acquirer shares issued in consideration for a business combination at fair value on the acquisition date opposed to the

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

announcement date. SFAS No. 141R also includes a substantial number of new disclosure requirements. SFAS No. 141R is to be applied prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The effect of adopting SFAS No. 141R on the Company's consolidated results of operations and financial condition will be largely dependent on the size and nature of business combinations completed after December 31, 2008.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" ("SFAS No. 160"). SFAS No. 160 requires noncontrolling interests, previously referred to as minority interests, to be treated as a separate component of equity, not as a liability or other item outside of permanent equity and applies to the accounting for noncontrolling interests and transactions with noncontrolling interest holders in consolidated financial statements. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This statement is effective for the Company beginning January 1, 2009. The Company does not currently expect the adoption of SFAS No. 160 to have a material effect on its consolidated results of operations and financial condition.

In March 2008, the FASB issued Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133" ("SFAS No. 161"). SFAS 161 applies to all derivative instruments and related hedged items accounted for under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). SFAS No. 161 requires entities to provide greater transparency about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. This statement is effective for the Company beginning January 1, 2009. The Company does not expect the adoption of SFAS No. 161 to have a material effect on its consolidated results of operations and financial condition.

On May 9, 2008, the FASB issued FSP APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)" ("FSP APB 14-1"). FSP APB 14-1 requires issuers of a certain type of convertible debt to separately account for the debt and equity components of the convertible debt in a way that reflects the issuer's borrowing rate at the date of issuance for similar debt instruments without the conversion feature. FSP APB 14-1 applies to certain of the Company's convertible debt. FSP APB 14-1 is effective for the Company beginning on January 1, 2009 and will be applied retrospectively to all quarterly and annual periods that will be presented in the Company's consolidated financial statements. Early adoption of FSP APB 14-1 is not permitted. The adoption of FSP APB 14-1 is expected to significantly increase the Company's non-cash interest expense and reduce basic and diluted earnings (loss) per share.

In November 2008, the FASB ratified EITF Issue No. 08-7, "Accounting for Defensive Intangible Assets," ("EITF 08-7"). EITF 08-7 applies to defensive intangible assets, which are acquired intangible assets that the acquirer does not intend to actively use but intends to hold to prevent its competitors from obtaining access to them. As these assets are separately identifiable, EITF 08-7 requires an acquiring entity to account for defensive intangible assets as a separate unit of accounting. Defensive intangible assets must be recognized at fair value in accordance with SFAS No. 141R and SFAS No. 157. EITF 08-7 is effective for defensive intangible assets acquired in fiscal years beginning on or after December 15, 2008, and will be adopted by the Company in the first quarter of 2009. The effect of adopting EITF 08-7 on the Company's consolidated results of operations and financial

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

condition will be largely dependent on the size and nature of business combinations completed after December 31, 2008.

(2) Vyvx Advertising Distribution Business Disposition

On June 5, 2008, Level 3 completed the sale of its Vyvx advertising distribution business to DG FastChannel, Inc. and received gross proceeds at closing of approximately \$129 million in cash. Net proceeds from the sale approximated \$121 million after deducting transaction-related costs.

Operating results and cash flows from the Vyvx advertising distribution business are presented in continuing operations for all periods presented through the date of sale. The disposal of the Vyvx advertising distribution business did not meet the criteria under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144") for presentation as discontinued operations since the business was not considered an asset group.

Level 3 recognized a gain on the sale of the Vyvx advertising distribution business of \$96 million in 2008. The gain is presented in the consolidated statements of operations as "Gain on Sale of Business Groups."

The carrying amounts of the major classes of assets and liabilities included in the sale of the Vyvx advertising distribution business were as follows (in millions):

| | |
|------------------------------------|-------------|
| Other Current Assets | \$ 1 |
| Property, Plant and Equipment, net | 3 |
| Other Intangibles, net | 22 |
| Accounts Payable | (1) |
| | <u>\$25</u> |

Revenue attributable to the Vyvx advertising distribution business totaled \$15 million in 2008, \$36 million in 2007 and \$35 million in 2006. The financial results, assets and liabilities of the Vyvx advertising distribution business are included in the Communications operating segment through the date of sale.

(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 options, stock based compensation awards and other dilutive securities. No such items were included in the computation of diluted loss per share in 2008, 2007 or 2006 because the Company incurred a loss from continuing operations in each of these periods and the effect of inclusion would have been anti-dilutive.

The effect of approximately 489 million, 315 million and 481 million shares issuable pursuant to the various series of convertible notes outstanding at December 31, 2008, 2007 and 2006, 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 57 million, 55 million and 54 million stock options, outperform stock options, restricted stock units and warrants outstanding at December 31, 2008, 2007 and 2006, respectively, have not been included in the computation of diluted loss per share because their inclusion would have been anti-dilutive to the computation.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Property, Plant and Equipment

The components of the Company's property, plant and equipment as of December 31, 2008 and 2007 are as follows (in millions):

| | Cost | Accumulated Depreciation | Book Value |
|--|-----------------|-----------------------------|----------------|
| December 31, 2008 | | | |
| Land | \$ 169 | \$ — | \$ 169 |
| Land Improvements | 68 | (35) | 33 |
| Facility and Leasehold Improvements: | | | |
| Communications | 1,856 | (682) | 1,174 |
| Coal Mining | 151 | (150) | 1 |
| Network Infrastructure | 5,568 | (1,967) | 3,601 |
| Operating Equipment: | | | |
| Communications | 3,738 | (2,615) | 1,123 |
| Coal Mining | 72 | (65) | 7 |
| Furniture, Fixtures and Office Equipment | 139 | (121) | 18 |
| Other | 24 | (22) | 2 |
| Construction-in-Progress | 31 | — | 31 |
| | <u>\$11,816</u> | <u>\$ (5,657)</u> | <u>\$6,159</u> |
| December 31, 2007 | | | |
| Land | \$ 174 | \$ — | \$ 174 |
| Land Improvements | 60 | (32) | 28 |
| Facility and Leasehold Improvements: | | | |
| Communications | 1,856 | (589) | 1,267 |
| Coal Mining | 153 | (151) | 2 |
| Network Infrastructure | 5,591 | (1,705) | 3,886 |
| Operating Equipment: | | | |
| Communications | 3,455 | (2,267) | 1,188 |
| Coal Mining | 72 | (64) | 8 |
| Furniture, Fixtures and Office Equipment | 141 | (117) | 24 |
| Other | 27 | (24) | 3 |
| Construction-in-Progress | 89 | — | 89 |
| | <u>\$11,618</u> | <u>\$ (4,949)</u> | <u>\$6,669</u> |

Land primarily represents owned assets of the communications business, including land improvements. Capitalized business support systems and network construction costs that have not been placed in service have been classified as construction-in-progress.

Depreciation expense was \$832 million in 2008, \$838 million in 2007 and \$652 million in 2006.

In 2006, Level 3 determined that the period it expected to use its existing fiber and certain equipment was longer than the remaining useful lives as originally estimated. As a result, the Company extended the depreciable lives of its existing fiber from 7 years to 12 years, its existing transmission

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Property, Plant and Equipment (Continued)

equipment from 5 years to 7 years and its existing IP equipment from 3 years to 4 years. These changes in estimate were accounted for prospectively, in accordance with SFAS No. 154, and reduced depreciation expense, loss from continuing operations and net loss by approximately \$80 million, or \$0.08 per share, for the year ended December 31, 2006.

(5) Asset Retirement Obligations

The Company's asset retirement obligations consist of legal requirements to remove certain of its network infrastructure at the expiration of the underlying right-of-way ("ROW") term, restoration requirements for leased facilities and reclamation requirements in the coal mining business to remediate previously mined properties. The Company recognizes its estimate of the fair value of its asset retirement obligations in the period incurred in other long-term liabilities. The fair value of the asset retirement obligation is also capitalized as property, plant and equipment and then amortized over the estimated remaining useful life of the associated asset.

As a result of indicators suggesting that the estimated cash flows underlying the Company's ROW asset retirement obligations were too high, the Company revised its assessment on December 31, 2008. Network infrastructure relocations indicated that the Company is not being required to physically remove its underground network infrastructure at rates consistent with the Company's previous estimates. Other internal and external information corroborated these lower rates. As a result, on December 31, 2008, the Company revised its probability assessment related to its requirement to physically remove its underground network infrastructure at the end of the underlying ROW terms, which caused a significant reduction to the related cash flows that the Company believes will be required to settle its ROW asset retirement obligations. The Company reduced its asset retirement obligation liability accordingly as of December 31, 2008.

As part of the ROW asset retirement obligation change in estimate, the Company determined that certain of its asset retirement obligations for acquired entities should have been higher at the acquisition date. As a result, the Company increased goodwill by approximately \$15 million as of December 31, 2008.

The Company also determined that its estimates of restoration costs for its leased facility asset retirement obligations were too high based on current costs to restore. As a result, on December 31, 2008, the Company reduced its estimates of the cash flows that it believes will be required to settle its leased facility asset retirement obligations at the end of the respective lease terms, which resulted in a reduction to the Company's asset retirement obligation liability.

In the fourth quarter of 2008, the Company was awarded a long-term coal contract, which will extend the life of one of the Company's coal mining operations. As a result of the increase in the estimated life of one of the Company's coal mining operations, the Company revised the timing of its cash flows to remediate the mining site causing a reduction in its asset retirement obligation liability in the fourth quarter of 2008.

As a result of the aforementioned revisions in the estimated amount and timing of cash flows for asset retirement obligations, the Company reduced its asset retirement obligation liability by \$103 million with an offsetting reduction to property, plant and equipment of \$21 million, selling, general and administrative expenses of \$86 million, depreciation and amortization of \$11 million and an increase to goodwill of \$15 million. The Company reduced property, plant and equipment to the extent

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(5) Asset Retirement Obligations (Continued)

of the carrying amount of the related long-lived asset initially recorded when the asset retirement obligation liability was established. The remaining amount of the reduction to the asset retirement obligation was recorded as a reduction to depreciation expense, to the extent of historical depreciation of the related long-lived asset, and selling, general and administrative expense.

Approximately \$71 million and \$61 million of restricted cash and securities were legally restricted to settle the Company's coal mining reclamation liabilities at December 31, 2008 and 2007, respectively, and are recorded in non-current, restricted cash and securities on the consolidated balance sheets.

The following table provides asset retirement obligation activity for the years ended December 31, 2008 and 2007 (in millions):

| | <u>December 31,</u> | |
|--|---------------------|--------------|
| | <u>2008</u> | <u>2007</u> |
| Asset retirement obligation at January 1 | \$ 231 | \$202 |
| Liabilities incurred | 2 | 12 |
| Accretion expense | 25 | 21 |
| Liabilities settled | (4) | (4) |
| Revision in estimated cash flows | (103) | — |
| Asset retirement obligation at December 31 | <u>\$ 151</u> | <u>\$231</u> |

(6) Goodwill

The changes in the carrying amount of goodwill during the year ended December 31, 2008 are as follows (in millions):

| | <u>Communications</u> | <u>Coal</u> | <u>Total</u> |
|--|-----------------------|---------------------------------|----------------|
| | <u>Segment</u> | <u>Mining</u> <u>Segment</u> | |
| Balance as of December 31, 2007 | \$ 1,421 | \$ — | \$1,421 |
| Goodwill adjustments | 12 | — | 12 |
| Effect of foreign currency rate change | (1) | — | (1) |
| Balance as of December 31, 2008 | <u>\$ 1,432</u> | <u>\$ —</u> | <u>\$1,432</u> |

The goodwill adjustments primarily relate to asset retirement obligation revisions. The Company revised its estimate of the amount of its original estimate of undiscounted cash flows related to certain ROW asset retirement obligations at December 31, 2008. As part of the ROW asset retirement obligation change in estimate, the Company determined that certain of its asset retirement obligations for acquired entities should have been higher at the acquisition date. As a result, the Company increased goodwill by approximately \$15 million as of December 31, 2008.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(7) Acquired Intangible Assets

Identifiable acquisition-related intangible assets as of December 31, 2008 and December 31, 2007 were as follows (in millions):

| | Gross Carrying | Accumulated | |
|--------------------------------------|-------------------|-----------------|--------------|
| | Amount | Amortization | Net |
| December 31, 2008 | | | |
| Finite-Lived Intangible Assets: | | | |
| Customer Contracts and Relationships | \$ 743 | \$ (325) | \$418 |
| Patents and Developed Technology | 141 | (52) | 89 |
| | <u>884</u> | <u>(377)</u> | <u>507</u> |
| Indefinite-Lived Intangible Assets: | | | |
| Vyvx Trade Name | 32 | — | 32 |
| Wireless Licenses | 20 | — | 20 |
| | <u>\$ 936</u> | <u>\$ (377)</u> | <u>\$559</u> |
| December 31, 2007 | | | |
| Finite-Lived Intangible Assets: | | | |
| Customer Contracts and Relationships | \$ 772 | \$ (248) | \$524 |
| Patents and Developed Technology | 141 | (37) | 104 |
| | <u>913</u> | <u>(285)</u> | <u>628</u> |
| Indefinite-Lived Intangible Assets: | | | |
| Vyvx Trade Name | 32 | — | 32 |
| Wireless Licenses | 20 | — | 20 |
| | <u>\$ 965</u> | <u>\$ (285)</u> | <u>\$680</u> |

Acquired finite-lived intangible asset amortization expense was \$99 million in 2008, \$104 million in 2007 and \$78 million 2006.

During 2007, the Company changed the estimated useful lives of certain of its customer-related intangible assets that were established in periods prior to 2007, which resulted in a net increase in amortization expense of approximately \$9 million for the year ended December 31, 2007, or less than a \$0.01 per basic and diluted share.

The weighted average useful lives of the Company's acquired finite-lived intangible assets was 7.6 years for customer contracts and relationships and 9.0 years for patents and developed technology.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(7) Acquired Intangible Assets (Continued)

As of December 31, 2008, estimated amortization expense for the Company's finite-lived acquisition-related intangible assets over the next five years and thereafter is as follows (in millions):

| | |
|------------|--------------|
| 2009 | \$ 93 |
| 2010 | 92 |
| 2011 | 91 |
| 2012 | 69 |
| 2013 | 51 |
| Thereafter | 111 |
| | <u>\$507</u> |

(8) Restructuring and Impairment Charges

Changing economic and business conditions as well as organizational structure optimization efforts have caused the Company to initiate various workforce reductions resulting in involuntary employee terminations. The Company has also initiated multiple workforce reductions resulting from the integration of acquired companies. Restructuring charges totaled \$25 million in 2008, \$11 million in 2007 and \$5 million in 2006.

During the fourth quarter of 2008, the Company initiated a workforce reduction of approximately 400 employees, or 7% of the Company's total employee base, and incurred a restructuring charge of \$12 million, all of which related to the communications business. The workforce reductions relate to multiple levels within the organization and across multiple locations within North America. The terms of the workforce reduction, including the involuntary termination benefits to be received by affected employees, were communicated by the Company in the fourth quarter of 2008. The Company expects to conclude this workforce reduction in the first quarter of 2009. As of December 31, 2008, none of the \$12 million of involuntary termination benefits was paid and are recorded in accrued payroll and employee benefits on the consolidated balance sheets.

All of the activities related to the Company's prior restructurings were completed as of December 31, 2008.

Impairment charges classified within restructuring and impairment charges on the consolidated statements of operations totaled zero in 2008, \$1 million in 2007 and \$8 million in 2006. In 2006, the Company recognized \$4 million of non-cash impairment charges as a result of the decision to terminate projects for certain voice services and certain information technology projects in the Communications business which had been previously capitalized. These projects had identifiable costs which the Company was able to separate for impairment. The costs incurred for these projects, including capitalized labor, were impaired as the carrying value of these projects were no longer expected to provide future benefit to the Company. In addition, the Company recognized \$4 million of non-cash impairment charges primarily related to excess land of the communications business held for sale in Germany in 2006. This charge resulted from the difference between the recorded carrying value and the estimated market value of the land. During the third quarter of 2007, the Company reclassified the excess land in Germany as property, plant and equipment due to the fact the land had not been sold and was no longer being actively marketed for sale.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(8) Restructuring and Impairment Charges (Continued)

The Company also has accrued contract termination costs of \$49 million as of December 31, 2008, for facility lease costs, primarily in North America, that the Company continues to incur without economic benefit. Accrued contract termination costs are recorded in other liabilities (current and non-current) in the consolidated balance sheets. The Company expects to pay the majority of these costs through 2018. The Company incurred charges of approximately \$11 million in 2008 as the Company ceased using additional facilities and as a result of revisions to the estimated cash flows for certain facility subleases. The Company did not incur any such charges in 2007 or 2006. The Company records charges for contract termination costs within selling, general and administrative expenses in the consolidated statements of operations.

(9) Fair Value

SFAS No. 157 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 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

SFAS No. 157 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. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. SFAS No. 157 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. As of December 31, 2008, the Company did not have any Level 1 assets or liabilities that are measured at fair value on a recurring basis.

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 2 liabilities that are measured at fair value on a recurring basis include the Company's interest rate swap agreements and other derivative contracts.

The interest rate swaps are priced using discounted cash flow techniques that use observable market inputs, such as LIBOR-based yield curves, forward rates, and credit ratings. The embedded derivative contracts are priced using inputs that are observable in the market, such as the Company's current and historical stock prices, risk-free interest rates, credit ratings and other contractual terms of certain of the Company's convertible debt.

Level 3 —Unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities. The Company does not have any SFAS No. 157 Level 3 assets or liabilities that are measured at fair value on a recurring basis.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(9) Fair Value (Continued)*Assets and Liabilities Measured at Fair Value on a Recurring Basis*

Assets and liabilities measured at fair value on a recurring basis consisted of the following types of instruments as of December 31, 2008 (in millions):

| | Significant Other Observable Inputs (Level 2) |
|--|---|
| Interest Rate Swap Liabilities (included in other non-current liabilities) | \$ 97 |
| Embedded Derivative Contracts (included in other non-current liabilities) | 13 |
| Total Liabilities Measured at Fair Value | \$ 110 |

(10) Financial Instruments*Available for Sale Investments*

The Company did not have any material available-for-sale investments as of December 31, 2008.

At December 31, 2007, marketable securities totaling \$9 million consisted of an investment in the common stock of Infinera Corporation ("Infinera"). The fair value of the Infinera investment as of December 31, 2007 was \$9 million. For the year ended December 31, 2007, an unrealized gain of \$7 million was recorded on the investment in Infinera and is included in other comprehensive income (loss).

In 2007, the Company sold approximately 80% of its investment in Infinera, received proceeds of \$45 million and recognized a gain on the sale of \$37 million. In 2008, the Company sold the remainder of its investment in Infinera, received proceeds of approximately \$4 million and recognized a gain on the sale of \$2 million.

The cost of the equity securities used in computing the unrealized and realized gains is determined by specific identification. Fair values are estimated based on quoted market prices for the securities.

The Company recognized gains of \$2 million from the sale of marketable equity securities in 2006.

Restricted Cash and Securities

Restricted cash and securities consists primarily of cash and investments that serve to collateralize outstanding letters of credit, long-term debt and certain performance and operating obligations of the Company, as well as cash and investments restricted to fund certain reclamation liabilities of the Company. Restricted cash and securities are recorded in other assets (current or non-current) in the consolidated balance sheets depending on the duration of the restriction and the purpose for which the restriction exists.

The cost and fair value of restricted cash and securities totaled \$130 million at December 31, 2008 and \$127 million at December 31, 2007.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(10) Financial Instruments (Continued)

Cash Flow Hedges

The Company has floating rate long-term debt (see Note 11). These obligations expose 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. On March 13, 2007, Level 3 Financing Inc., the Company's wholly owned subsidiary, 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 transactions were effective beginning April 13, 2007 and mature on January 13, 2014. Under the terms of the interest rate swap transactions, 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. The Company has designated the interest rate swap agreements as a cash flow hedge on the interest payments for \$1 billion of floating rate debt. The Company evaluates the effectiveness of the hedge on a quarterly basis. The Company measures effectiveness by offsetting the change in the variable portion of the interest rate swaps with the changes in interest expense paid due to fluctuations in the LIBOR-based interest rate. The Company recognizes any ineffective portion of the hedge in the consolidated statements of operations. Hedge ineffectiveness for the Company's cash flow hedges was not material in any period presented.

The fair value of the interest rate swap agreements was a liability of \$97 million as of December 31, 2008 and a liability of \$37 million as of December 31, 2007. Unrealized losses of \$60 million in 2008 and \$37 million in 2007 were recorded on the interest rate swap agreements and are included in other comprehensive income (loss). The change in the fair value of the interest rate swap agreements is reflected in other comprehensive income (loss) due to the fact that the interest rate swap agreements are designated as an effective cash flow hedge of \$1 billion notional amount of the Company's floating rate debt.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt

As of December 31, 2008 and 2007, long-term debt was as follows (in millions):

| <u>(dollars in millions)</u> | <u>2008</u> | <u>2007</u> |
|--|----------------|----------------|
| Senior Secured Term Loan due 2014 | \$1,400 | \$1,400 |
| Senior Notes due 2008 (11.0%) | — | 20 |
| Senior Euro Notes due 2008 (10.75%) | — | 5 |
| Senior Notes due 2010 (11.5%) | 13 | 13 |
| Fair value adjustment on Senior Notes due 2010 | — | (1) |
| Senior Notes due 2011 (10.75%) | 3 | 3 |
| Floating Rate Senior Notes due 2011 (9.459% as of December 31, 2008) | 6 | 6 |
| Issue discount on Senior Notes due 2011 | — | — |
| Senior Notes due 2013 (12.25%) | 550 | 550 |
| Issue discount on Senior Notes due 2013 | (2) | (2) |
| Senior Notes due 2014 (9.25%) | 1,250 | 1,250 |
| Issue premium on Senior Notes due 2014 | 9 | 10 |
| Floating Rate Senior Notes due 2015 (6.845% as of December 31, 2008) | 300 | 300 |
| Senior Notes due 2017 (8.75%) | 700 | 700 |
| Convertible Senior Notes due 2010 (2.875%) | 192 | 374 |
| Convertible Senior Notes due 2011 (5.25%) | 330 | 345 |
| Convertible Senior Notes due 2011 (10.0%) | 228 | 275 |
| Convertible Senior Notes due 2012 (3.5%) | 326 | 335 |
| Convertible Senior Notes due 2013 (15.0%) | 400 | — |
| Convertible Senior Discount Notes due 2013 (9.0%) | 295 | 295 |
| Convertible Subordinated Notes due 2009 (6.0%) | 181 | 362 |
| Convertible Subordinated Notes due 2010 (6.0%) | 308 | 514 |
| Debt discount due to embedded derivative contracts | (13) | — |
| Commercial Mortgage due 2010 (6.86%) | 69 | 69 |
| Capital leases | 35 | 41 |
| | <u>6,580</u> | <u>6,864</u> |
| Less current portion | (186) | (32) |
| | <u>\$6,394</u> | <u>\$6,832</u> |

The estimated fair value of the Company's long-term debt approximated \$4.0 billion at December 31, 2008 and \$6.3 billion at December 31, 2007. The fair values of the Company's long-term debt were estimated using the December 31, 2008 and December 31, 2007 average of the bid and ask trading quotes. The Commercial Mortgage does not trade. The fair value of this instrument is assumed to approximate its carrying value as of December 31, 2008 and December 31, 2007. The 9% Convertible Senior Discount Notes due 2013, the 10% Convertible Senior Notes due 2011, and the 15% Convertible Senior Notes due 2013 are not traded in an active market. The fair value of these notes were calculated using a Black-Scholes valuation model to value the equity portion of the security and market yields on other Level 3 traded debt of similar characteristics and discounted cash flows to value the debt portion of the security. The 11.5% Senior Notes due 2010, Floating Rate Notes due 2011 and the 10.75% Senior Notes due 2011 are not actively traded debt instruments. The estimated fair value of these debt instruments was derived using market yields on other Level 3 traded debt of similar characteristics and discounted cash flows.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

2008 Debt Issuances

In December 2008, the Company issued \$400 million aggregate principal amount of its 15% Convertible Senior Notes due 2013 and received gross proceeds of \$400 million. Accrued but unpaid debt issuance costs are expected to be approximately \$3 million. The proceeds from this issuance were primarily used to repurchase, through tender offers, a portion of the Company's 6% Convertible Subordinated Notes due 2009, 6% Convertible Subordinated Notes due 2010 and 2.875% Convertible Senior Notes due 2010. See a detailed description of the notes below.

2008 Debt Repurchases

In September 2008, in various transactions, the Company repurchased \$39 million aggregate principal amount of its 6% Convertible Subordinated Notes due 2009 at discounts to the principal amount and recognized a net gain on extinguishment of debt of \$1 million. Unamortized debt issuance costs totaled less than \$1 million and accrued interest paid at the time of repurchase totaled less than \$1 million.

In September 2008, the Company repurchased \$32 million aggregate principal amount of its 6% Convertible Subordinated Notes due 2010 at a discount to the principal amount and recognized a net gain on extinguishment of debt of \$2 million. Unamortized debt issuance costs totaled less than \$1 million and accrued interest paid at the time of repurchase totaled \$1 million.

In December 2008, in connection with the issuance of the 15% Convertible Senior Notes due 2013, the Company repurchased using \$336 million in cash, through tender offers \$460 million aggregate principal amount of various issues of its convertible debt securities at discounts to par and recognized a gain on the extinguishment of debt of approximately \$122 million. The gain consisted of a \$124 million cash gain, which was partially offset by \$2 million in unamortized debt issuance costs. Accrued interest paid at the time of repurchase totaled \$7 million.

The December 2008 debt repurchases consisted of the following:

- \$163 million of 2.875% Convertible Senior Notes due 2010;
- \$173 million of 6% Convertible Subordinated Notes due 2010; and
- \$124 million of 6% Convertible Subordinated Notes due 2009.

2008 Debt for Equity Exchanges

On multiple dates in October 2008, the Company entered into exchange agreements with holders of various issues of its convertible debt and issued approximately 48 million shares of Level 3 common stock in exchange for approximately \$108 million aggregate principal amount of its convertible debt securities. The shares of the Company's common stock are exempt from registration pursuant to Section 3(a)(9) under the Securities Act of 1933, as amended. These transactions were considered to be induced conversions in accordance with SFAS No. 84 "Induced Conversions of Convertible Debt—An Amendment of APB Opinion No. 26" ("SFAS No. 84") and as a result, the Company recorded a non-cash loss in the fourth quarter of 2008 on the exchange of the \$108 million aggregate principal amount of convertible debt securities of approximately \$44 million, consisting of \$43 million of debt conversion expense and \$1 million of previously capitalized debt issuance costs. The loss was recorded in gain (loss) on extinguishment of debt in the consolidated statements of operations.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

The fourth quarter 2008 exchange transactions consisted of the following:

- \$18 million of 6% Convertible Subordinated Notes due 2009;
- \$47 million of 10% Convertible Senior Notes due 2011;
- \$19 million of 2.875% Convertible Senior Notes due 2010;
- \$15 million of 5.25% Convertible Senior Notes due 2011; and
- \$9 million of 3.5% Convertible Senior Notes due 2012.

2008 Debt Repayments

During March 2008, Level 3 Communications, Inc. repaid the remaining \$20 million of outstanding 11% Senior Notes due 2008 and \$6 million (€4 million) of outstanding 10.75% Senior Euro Notes due 2008. The Company also made capital lease and commercial mortgage payments of approximately \$6 million in 2008.

2007 Debt for Equity Exchanges

In January 2007, in two separate transactions, Level 3 completed the exchange of \$605 million in aggregate principal amount of its 10% Convertible Senior Notes due 2011 for a total of 197 million shares of Level 3's common stock. The shares of the Company's common stock are exempt from registration pursuant to Section 3(a)(9) under the Securities Act of 1933, as amended. The Company recognized a \$177 million loss on extinguishment of debt for the exchanges. Included in the loss was approximately \$1 million of unamortized debt issuance costs.

2007 Redemptions and Repurchases

In March 2007, the Company redeemed using cash the entire \$722 million of outstanding principal amount of the following debt issuances and recognized a loss on extinguishment of debt totaling \$54 million on the redemption transactions.

- Redeemed \$488 million of outstanding 12.875% Senior Notes due 2010 at a price equal to 102.146% of the principal amount and recognized a \$12 million loss on extinguishment of debt consisting of a \$10 million cash loss and \$2 million in unamortized debt issuance costs. Accrued interest paid at the time of redemption totaled less than \$1 million.
- Redeemed \$96 million of outstanding 11.25% Senior Notes due 2010 at a price equal to 101.875% of the principal amount and recognized a \$3 million loss on extinguishment of debt consisting of a \$2 million cash loss and \$1 million in unamortized debt issuance costs. Accrued interest paid at the time of redemption totaled less than \$1 million.
- Redeemed \$138 million (€104 million) of outstanding 11.25% Senior Euro Notes due 2010 at a price equal to €101.875 per €1,000 of principal amount and recognized a \$39 million loss on extinguishment of debt consisting of a \$38 million cash loss and \$1 million in unamortized debt issuance costs. Accrued interest paid at the time of redemption totaled less than \$1 million (less than €1 million).

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

In March 2007, the respective issuers repurchased using cash, through tender offers, \$941 million of the outstanding principal amounts of the following debt issuances and recognized a loss on extinguishment of debt totaling \$186 million on the repurchase transactions.

- Repurchased \$144 million of its outstanding Floating Rate Senior Notes due 2011 at a price equal to \$1,080 per \$1,000 principal amount of the notes, which included \$1,050 as the tender offer consideration and \$30 as a consent payment, and recognized an \$18 million loss on extinguishment of debt consisting of a \$12 million cash loss and \$6 million in unamortized debt issuance costs and unamortized discount. Accrued interest paid at the time of repurchase totaled \$8 million.
- Repurchased \$59 million of its outstanding 11% Senior Notes due 2008 at a price equal to \$1,054.28 per \$1,000 principal amount of the notes, which included \$1,024.28 as the tender offer consideration and \$30 as a consent payment, and recognized a \$3 million loss on extinguishment of debt consisting of a \$3 million cash loss and less than \$1 million in unamortized debt issuance costs. Accrued interest paid at the time of repurchase totaled \$3 million.
- Repurchased \$677 million of its outstanding 11.5% Senior Notes due 2010 at a price equal to \$1,115.26 per \$1,000 principal amount of the notes, which included \$1,085.26 as the tender offer consideration and \$30 as a consent payment, and recognized a \$141 million loss on extinguishment of debt consisting of a \$78 million cash loss and \$63 million in unamortized debt issuance costs and unamortized discount. Accrued interest paid at the time of repurchase totaled \$3 million.
- Repurchased \$61 million (€46 million) of its outstanding 10.75% Senior Euro Notes due 2008 at a price equal to €1,061.45 per €1,000 of principal amount of the notes, which included €1,031.45 as the tender offer consideration and €30 as a consent payment, and recognized a \$24 million loss on extinguishment of debt consisting of a \$24 million cash loss and less than \$1 million in unamortized debt issuance costs. Accrued interest paid at the time of repurchase totaled \$3 million (€2 million).

In connection with the tender offers completed in the first quarter of 2007, Level 3 and Level 3 Financing, Inc. ("Level 3 Financing"), a wholly owned subsidiary of the Company, obtained consents to certain proposed amendments to the respective indentures governing the notes that are subject to the tender offer transactions described above to eliminate substantially all of the covenants, amend certain repurchase rights, certain discharge rights and certain events of default and related provisions contained in those indentures.

On February 23, 2007, Level 3 Financing completed a consent solicitation with respect to certain amendments to the indenture governing Level 3 Financing's outstanding 12.25% Senior Notes due 2013 that allowed for the incurrence of debt based upon a multiple of cash flow available for fixed charges on a "pro forma" basis giving effect to any acquisition, merger or consolidation completed prior to February 1, 2007. Additional debt as permitted under the amended indenture was incurred in March 2007. In connection with the consent solicitation, the Company paid consent fees totaling approximately \$2 million which were capitalized as additional debt issuance costs and will be amortized over the remaining life of the related debt issuances using the effective interest method.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

2007 Debt Refinancings

In March 2007, Level 3 Financing refinanced its senior secured credit agreement and received net proceeds of \$1.382 billion. The proceeds from this transaction were used to repay the existing \$730 million Senior Secured Term Loan due 2011 and other debt. The effect of this transaction was to increase the amount of senior secured debt from \$730 million to \$1.4 billion, reduce the interest rate on that debt from the London Interbank Offering Rate ("LIBOR") plus 3.00% to LIBOR plus 2.25% and extend the final maturity from 2011 to 2014. The Company recognized a \$10 million loss on this transaction related to unamortized debt issuance costs. See a detailed description of the Senior Secured Term Loan due 2014 below.

Senior Secured Term Loan due 2014

On March 13, 2007, Level 3, as guarantor, Level 3 Financing, as borrower, Merrill Lynch Capital Corporation, as administrative agent and collateral agent, and certain other agents and certain lenders entered into a Credit Agreement, pursuant to which the lenders extended a \$1.4 billion senior secured term loan ("Senior Secured Term Loan due 2014") to Level 3 Financing. The term loan matures on March 13, 2014 and has an interest rate of LIBOR plus an applicable margin of 2.25% per annum and is payable in cash at the end of each LIBOR period elected in arrears, beginning July 13, 2007, provided that in the case of a six month interest period, interim interest payments are required at the end of the first three months. The borrower has the option of electing one, two, three or six month LIBOR at the end of each interest rate period and may elect different options with respect to different portions of the affected borrowing. The interest rate on \$1.0 billion of the Senior Secured Term Loan due 2014 resets quarterly and was 7.0% as of December 31, 2008. The interest rate on the remaining \$400 million of the Senior Secured Term Loan due 2014 currently is reset monthly and was 7.0% as of December 31, 2008. As of December 31, 2007, the interest rate on the entire \$1.4 billion of the Senior Secured Term Loan due 2014 was 7.49%

Level 3 Financing's obligations under this term loan are, subject to certain exceptions, secured by certain assets of the Company and certain of the Company's material domestic subsidiaries that are engaged in the telecommunications business. The Company and these subsidiaries have also guaranteed the obligations of Level 3 Financing under the Senior Secured Term Loan due 2014. During the second quarter of 2007, Level 3 Communications, LLC and its material domestic subsidiaries obtained all material governmental authorizations and consents required in order for them to pledge certain of their assets and guarantee the Senior Secured Term Loan due 2014. The guarantee was entered into by Level 3 Communications, LLC and its material domestic subsidiaries on June 28, 2007.

The Senior Secured Term Loan due 2014 includes certain negative covenants which restrict the ability of the Company, Level 3 Financing and any restricted subsidiary to engage in certain activities. The Senior Secured Term Loan due 2014 also contains certain events of default. It does not require the Company or Level 3 Financing to maintain specific financial ratios or other financial metrics.

Level 3 used a portion of the original net proceeds after transaction costs to repay Level 3 Financing's \$730 million Senior Secured Term Loan due 2011 under that certain credit agreement dated June 27, 2006. In addition, Level 3 used a portion of the net proceeds to fund the purchase of certain of its existing debt securities.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

Debt issuance costs of \$18 million were capitalized and are being amortized to interest expense over the term of the Senior Secured Term Loan due 2014 using the effective interest method. As a result of amortization, the capitalized debt issuance costs have been reduced to \$14 million at December 31, 2008.

11.5% Senior Notes Due 2010

In January 2006, Level 3 Communications, Inc. issued \$692 million aggregate principal amount of its 11.5% Senior Notes due 2010. The fair value of the 11.5% Senior Notes due 2010 was approximately \$73 million less than the face amount of the debt. The accretion of the \$73 million discount is being reflected as interest expense in using the effective interest method. The 11.5% Senior Notes due 2010 were recorded at their fair value on the transaction date and accrete to their face value at maturity.

The 11.5% Senior Notes are senior unsecured obligations of the Company, ranking equal in right of payment to all other senior unsecured obligations of the Company. The 11.5% Senior Notes due 2010 mature on March 1, 2010, and bear interest at a rate per annum equal to 11.5%. Interest on the notes is payable on March 1 and September 1 of each year, beginning on September 1, 2006. The Company may redeem some or all of the 11.5% Senior Notes due 2010 at any time on or after March 1, 2009, at 100% of their principal amount plus accrued interest.

In March 2007, the Company repurchased \$677 million of its outstanding 11.5% Senior Notes due 2010 at a price equal to \$1,115.26 per \$1,000 principal amount of the notes, which included \$1,085.26 as the tender offer consideration and \$30 as a consent payment, and recognized a \$141 million loss on extinguishment of debt consisting of a \$78 million cash loss and \$63 million in unamortized debt issuance costs and unamortized discount. Accrued interest paid at the time of repurchase totaled \$3 million. As of December 31, 2008, a total of \$13 million aggregate principal amount remains outstanding.

Debt issuance costs of \$11 million were originally capitalized and were being amortized to interest expense over the term of the 11.5% Senior Notes due 2010. As a result of amortization and debt repurchases, the capitalized debt issuance costs have been reduced to less than \$1 million at December 31, 2008.

10.75% Senior Notes due 2011

In October 2003, Level 3 Financing received \$486 million of net proceeds from a private placement offering of \$500 million aggregate principal amount of its 10.75% Senior Notes due 2011 ("10.75% Senior Notes"). As of December 31, 2008, a total of \$497 million aggregate principal amount of the 10.75% Senior Notes had been redeemed. Interest on the notes accrues at 10.75% per year and is payable in arrears on April 15 and October 15 each year in cash. These notes are guaranteed by Level 3 Communications, LLC and Level 3 Communications, Inc. (See Note 16).

The 10.75% Senior Notes are subject to redemption at the option of Level 3 Financing, in whole or in part, at any time or from time to time, plus accrued and unpaid interest thereon to the

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

redemption date, if redeemed during the twelve months beginning October 15, of the years indicated below:

| <u>Year</u> | <u>Redemption Price</u> |
|---------------------|-------------------------|
| 2008 | 102.688% |
| 2009 and thereafter | 100.000% |

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

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

Debt issuance costs of \$14 million were originally capitalized and are being amortized to interest expense over the term of the 10.75% Senior Notes. As a result of amortization and repurchases, the capitalized debt issuance costs have been reduced to less than \$1 million at December 31, 2008.

Floating Rate Senior Notes due 2011

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

In March 2007, the Company repurchased \$144 million of its outstanding Floating Rate Senior Notes due 2011 at a price equal to \$1,080 per \$1,000 principal amount of the notes, which included \$1,050 as the tender offer consideration and \$30 as a consent payment, and recognized an \$18 million loss on extinguishment of debt consisting of a \$12 million cash loss and \$6 million in unamortized debt issuance costs and unamortized discount. Accrued interest paid at the time of repurchase totaled \$8 million.

The Floating Rate Senior Notes due 2011 rank equal in right of payment with all other senior unsecured obligations of Level 3 Financing and have an initial interest rate equal to the six month London Interbank Offered Rate ("LIBOR"), plus 6.375%, which will be reset semi-annually. Interest on the notes is payable on March 15 and September 15 of each year, beginning on September 15, 2006. The interest rate was 9.46% at December 31, 2008. The Floating Rate Senior Notes due 2011 were priced at 96.782% of par and will mature on March 15, 2011. The discount, after the debt repurchase is less than \$1 million and is reflected as a reduction in long-term debt and is being amortized as interest expense over the term of the Floating Rate Senior Notes due 2011 using the effective interest method. These notes are guaranteed by Level 3 Communications, Inc. and Level 3 Communications, LLC (See Note 16).

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

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

| <u>Year</u> | <u>Redemption Price</u> |
|-------------|-------------------------|
| 2008 | 102.0% |
| 2009 | 101.0% |
| 2010 | 100.0% |

Debt issuance costs of \$3 million were capitalized and are being amortized over the term of the Floating Rate Senior Notes due 2011 using the effective interest method. As a result of amortization and the debt repurchase, the capitalized debt issuance costs have been reduced to less than \$1 million at December 31, 2008.

12.25% Senior Notes due 2013

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

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

The 12.25% Senior Notes due 2013 are senior unsecured obligations of Level 3 Financing, ranking equal in right of payment with all other senior unsecured obligations of Level 3 Financing. These notes are guaranteed by Level 3 Communications, Inc. and Level 3 Communications, LLC (See Note 16). The notes will mature on March 15, 2013. Interest on the notes accrues at 12.25% per year and is payable on March 15 and September 15 of each year, beginning on September 15, 2006. The \$250 million of 12.25% Senior Notes due 2013 issued on March 14, 2006 were priced at 96.618% of par. The \$300 million of 12.25% Senior Notes due 2013 issued on April 6, 2006 were priced at 102% of par. The resulting net discount for the two issuances of approximately \$2 million is reflected as a reduction in long-term debt and is being amortized as interest expense over the remaining term of the 12.25% Senior Notes due 2013 using the effective interest method.

The 12.25% Senior Notes due 2013 are subject to redemption at the option of Level 3 Financing in whole or in part, at any time or from time to time, on or after March 15, 2010 at the redemption prices (expressed as a percentage of principal amount) set forth below, plus accrued and unpaid

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

interest thereon to the redemption date, if redeemed during the twelve months beginning March 15, of the years indicated below:

| <u>Year</u> | <u>Redemption Price</u> |
|-------------|-------------------------|
| 2010 | 106.125% |
| 2011 | 103.063% |
| 2012 | 100.000% |

The 12.25% Senior Notes due 2013 contain certain covenants, which among other things, limit additional indebtedness, dividend payments, certain investments and transactions with affiliates.

Debt issuance costs of approximately \$11 million were capitalized and are being amortized over the term of the 12.25% Senior Notes due 2013. As a result of amortization, the capitalized debt issuance costs have been reduced to \$10 million at December 31, 2008.

9.25% Senior Notes Due 2014

On October 30, 2006, Level 3 Communications, Inc., as guarantor and Level 3 Financing, Inc. as borrower, received \$588 million of net proceeds after transaction costs, from a private offering of \$600 million aggregate principal amount of its 9.25% Senior Notes due 2014 ("9.25% Senior Notes Due 2014"). On December 13, 2006, Level 3 Communications, Inc., as guarantor and Level 3 Financing, Inc. as borrower, received \$661 million of net proceeds after transaction costs and accrued interest, for a second offering of \$650 million aggregate principal amount of 9.25% Senior Notes due 2014. These notes together with the \$600 million aggregate principal amount of 9.25% Senior Notes due 2014 issued on October 30, 2006 were issued under the same indenture and will be treated as a single series of notes. The Company received total net proceeds of \$1.239 billion (excluding prepaid interest).

The 9.25% Senior Notes due 2014 are senior unsecured obligations of Level 3 Financing, ranking equal in right of payment with all other senior unsecured obligations of Level 3 Financing. These notes are guaranteed by Level 3 Communications, Inc. (See Note 16). The notes will mature on November 1, 2014. Interest on the 9.25% Senior Notes Due 2014 accrues at 9.25% interest per year and is payable semi-annually in cash on May 1 and November 1 beginning May 1, 2007. The \$600 million of 9.25% Senior Notes due 2014 issued on October 30, 2006 were priced at par. The \$650 million of 9.25% Senior Notes due 2014 issued on December 13, 2006 were priced at 101.75% of par plus accrued interest from October 30, 2006, representing an effective yield of 8.86% to the purchasers of these senior notes. The resulting premium of the two issuances of approximately \$11 million is reflected as an increase to long-term debt and is being amortized as a reduction to interest expense over the remaining term of the 9.25% Senior Notes due 2014 using the effective interest method. As of December 31, 2008, the premium remaining was approximately \$9 million.

The 9.25% Senior Notes Due 2014 are subject to redemption at the option of Level 3 Financing in whole or in part, at any time or from time to time, on or after November 1, 2010 at the redemption prices (expressed as a percentage of principal amount) set forth below, plus accrued and unpaid

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

interest thereon to the redemption date, if redeemed during the twelve months beginning November 1, of the years indicated below:

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

At any time or from time to time on or prior to November 1, 2009, Level 3 Financing may redeem up to 35% of the original aggregate principal amount of the 9.25% Senior Notes Due 2014 at a redemption price equal to 109.25% of the principal amount of those notes so redeemed, plus accrued and unpaid interest thereon (if any) to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), with the net cash proceeds contributed to the capital of Level 3 Financing of one or more private placements to persons other than affiliates of Level 3 or underwritten public offerings of common stock of Level 3 resulting, in each case, in gross proceeds of at least \$100 million in the aggregate; provided, however, that at least 65% of the original aggregate principal amount of the 9.25% Senior Notes Due 2014 would remain outstanding immediately after giving effect to such redemption. Any such redemption shall be made within 90 days of such private placement or public offering upon not less than 30 nor more than 60 days' prior notice.

The 9.25% Senior Notes due 2014 contain certain covenants, which among other things, limit additional indebtedness, dividend payments, certain investments and transactions with affiliates.

Debt issuance costs of approximately \$23 million were capitalized and are being amortized over the term of the 9.25% senior Notes Due 2014. As a result of amortization, the capitalized debt issuance costs have been reduced to \$18 million at December 31, 2008.

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

On February 14, 2007, Level 3 Financing received \$982 million of net proceeds after transaction costs, from a private offering of \$700 million aggregate principal amount of its 8.75% Senior Notes due 2017 (the "8.75% Senior Notes") and \$300 million aggregate principal amount of its Floating Rate Senior Notes due 2015 (the "2015 Floating Rate Senior Notes"). The 8.75% Senior Notes and the 2015 Floating Rate Senior Notes are senior unsecured obligations of Level 3 Financing, ranking equal in right of payment with all other senior unsecured obligations of Level 3 Financing. Level 3 Communications, Inc. and Level 3 Communications, LLC have guaranteed the 8.75% Senior Notes and the 2015 Floating Rate Senior Notes (See Note 16). Interest on the 8.75% Senior Notes accrues at 8.75% interest per year and is payable semi-annually in cash on February 15th and August 15th beginning August 15, 2007. The principal amount of the 8.75% Senior Notes will be due on February 15, 2017. Interest on the 2015 Floating Rate Senior Notes accrues at LIBOR plus 3.75% per annum, reset semi-annually. The interest rate was 6.85% at December 31, 2008. Interest on the 2015 Floating Rate Senior notes is payable semi-annually in cash on February 15th and August 15th beginning August 15, 2007. The principal amount of the 2015 Floating Rate Senior Notes will be due on February 15, 2015.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

At any time prior to February 15, 2012, Level 3 Financing may redeem all or a part of the 8.75% Senior Notes upon not less than 30 nor more than 60 days' prior notice, at a redemption price equal to 100% of the principal amount of the 8.75% Senior Notes so redeemed plus the 8.75% Applicable Premium as of, and 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 respect to the 8.75% Senior Notes, "8.75% Applicable Premium" means on any redemption date, the greater of (1) 1.0% of the principal amount of such 8.75% Senior Notes and (2) the excess, if any, of (a) the present value at such redemption date of (i) 104.375% of the principal amount of such 8.75% Senior Notes plus (ii) all required interest payments due on such 8.75% Senior Notes through February 15, 2012 (excluding accrued but unpaid interest to the redemption date), computed using a discount rate equal to the Treasury Rate (as defined in the indenture governing the 8.75% Senior Notes) as of such redemption date plus 50 basis points, over (b) the principal amount of such 8.75% Senior Notes.

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

| <u>Year</u> | <u>Redemption Price</u> |
|-------------|-------------------------|
| 2012 | 104.375% |
| 2013 | 102.917% |
| 2014 | 101.458% |
| 2015 | 100.000% |

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

At any time prior to February 15, 2009, Level 3 Financing may redeem all or a part of the Floating Rate Senior Notes, upon not less than 30 nor more than 60 days' prior notice, at a redemption price equal to 100% of the principal amount of the Floating Rate Senior Notes so redeemed plus the Applicable Premium as of, and accrued and unpaid interest thereon (if any) to, the redemption date

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

(subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date).

With respect to the Floating Rate Senior Notes, "Applicable Premium" means, on any redemption date, the greater of (1) 1.0% of the principal amount of such Floating Rate Senior Notes and (2) the excess, if any, of (a) the present value at such redemption date of (i) the redemption price of 102% of the principal amount of such Floating Rate Senior Notes, plus (ii) all required interest payments due on such Floating Rate Senior Notes through February 15, 2009 (excluding accrued but unpaid interest to the redemption date), such interest payments to be determined in accordance with the indenture governing the Floating Rate Senior Notes assuming that LIBOR in effect on the date of the applicable redemption notice would be the applicable LIBOR in effect through February 15, 2009, computed using a discount rate equal to the Treasury Rate (as defined in the indenture governing the Floating Rate Senior Notes) as of such redemption date plus 50 basis points, over (b) the principal amount of such Floating Rate Senior Notes.

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

| <u>Year</u> | <u>Redemption Price</u> |
|-------------|-------------------------|
| 2009 | 102.0% |
| 2010 | 101.0% |
| 2011 | 100.0% |

At any time or from time to time on or prior to February 15, 2009, Level 3 Financing may redeem up to 35% of the original aggregate principal amount of the Floating Rate Senior Notes at a redemption price equal to 100.0% of the principal amount of the Floating Rate Senior Notes so redeemed, plus a premium equal to the interest rate on the Floating Rate Senior Notes applicable on the date that notice of the redemption is given, plus accrued and unpaid interest thereon (if any) to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), with the net cash proceeds contributed to the capital of Level 3 Financing of one or more private placements to persons other than affiliates of Level 3 or underwritten public offerings of common stock of Level 3 resulting, in each case, in gross proceeds of at least \$100 million in the aggregate; provided, however, that at least 65% of the original aggregate principal amount of the Floating Rate Senior Notes would remain outstanding immediately after giving effect to such redemption. Any such redemption shall be made within 90 days of such private placement or public offering upon not less than 30 nor more than 60 days' prior notice.

The 8.75% Senior Notes and the 2015 Floating Rate Senior Notes contain certain covenants, which among other things, limit additional indebtedness, dividend payments, certain investments and transactions with affiliates.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

Debt issuance costs of approximately \$16 million were capitalized and are being amortized over the term of the 8.75% Senior Notes due 2017. As a result of amortization, the capitalized debt issuance costs have been reduced to approximately \$15 million at December 31, 2008.

Debt issuance costs of approximately \$6 million were capitalized and are being amortized over the term of the Floating Rate Senior Notes due 2015. As a result of amortization, the capitalized debt issuance costs have been reduced to approximately \$5 million at December 31, 2008.

2.875% Convertible Senior Notes due 2010

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

On multiple dates in October 2008, the Company completed the exchange of \$19 million in aggregate principal amount of its 2.875% Convertible Senior Notes for a total of 7 million shares of Level 3's common stock. The shares of the Company's common stock issued pursuant to these exchanges were exempt from registration pursuant to Section 3(a)(9) under the Securities Act of 1933, as amended. These transactions were considered to be induced conversions in accordance with SFAS No. 84 and as a result, the Company recorded a non-cash loss in the fourth quarter of 2008 on the exchange of the 2.875% Convertible Senior Notes of \$8 million, consisting of approximately \$8 million of debt conversion expense and less than \$1 million of previously capitalized debt issuance costs. The loss was recorded in gain (loss) on extinguishment of debt in the consolidated statements of operations.

In December 2008, the Company repurchased using \$101 million in cash, through tender offers, \$163 million aggregate principal amount of its 2.875% Convertible Senior Notes at a price equal to \$620 per \$1,000 principal amount of the notes and recognized a gain on the extinguishment of debt of approximately \$61 million. The gain consisted of a \$62 million cash gain, which was partially offset by \$1 million in unamortized debt issuance costs. Accrued interest paid at the time of repurchase totaled \$2 million. The gain was recorded in gain (loss) on extinguishment of debt in the consolidated statements of operations.

The remaining 2.875% Convertible Senior Notes are convertible into shares of the Company's common stock at a conversion rate of \$7.18 per share, subject to certain adjustments. At any time and from time to time, the Company, at its option, may redeem for cash all or a portion of the notes. The Company may exercise this option only if the current market price for Level 3's common stock for at least 20 trading days within any 30 consecutive trading day period exceeds prices ranging from 160% of the conversion price on July 15, 2008 decreasing to 150% of the conversion price on or after July 15, 2009. The Company would also be obligated to pay the holders of the redeemed notes a cash amount equal to the present value of all remaining scheduled interest payments.

Debt issuance costs of \$13 million were originally capitalized and are being amortized to interest expense over the term of the 2.875% Convertible Senior Notes. As a result of amortization, exchanges

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

and repurchases the capitalized debt issuance costs have been reduced to approximately \$2 million at December 31, 2008.

5.25% Convertible Senior Notes due 2011

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

In October 2008, the Company completed the exchange of \$15 million in aggregate principal amount of its 5.25% Convertible Senior Notes for a total of 5 million shares of Level 3's common stock. The shares of the Company's common stock issued pursuant to this exchange were exempt from registration pursuant to Section 3(a)(9) under the Securities Act of 1933, as amended. This transaction was considered to be an induced conversion in accordance with SFAS No. 84 and as a result, the Company recorded a non-cash loss in the fourth quarter of 2008 on the exchange of the 5.25% Convertible Senior Notes of \$3 million, consisting of approximately \$3 million of debt conversion expense and less than \$1 million of previously capitalized debt issuance costs. The loss was recorded in gain (loss) on extinguishment of debt in the consolidated statements of operations.

The remaining 5.25% Convertible Senior Notes are convertible, at the option of the holders, into shares of the Company's common stock at a conversion rate of \$3.98 per share, subject to certain adjustments. Upon conversion, the Company will have the right to deliver cash in lieu of shares of its common stock, or a combination of cash and shares of common stock. In addition, holders of the 5.25% Convertible Senior Notes will have the right to require the Company to repurchase the notes upon the occurrence of a change in control, as defined, at a price of 100% of the principal amount plus accrued interest and a make whole premium. As of December 31, 2008, the make whole premium privileges on the 5.25% Convertible Senior Notes had lapsed.

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

| <u>Year</u> | <u>Redemption Price</u> |
|---------------------|-----------------------------|
| 2008 | 102.250% |
| 2009 | 101.500% |
| 2010 and thereafter | 100.750% |

Debt issuance costs of \$11 million were originally capitalized and are being amortized to interest expense over the term of the 5.25% Convertible Senior Notes. As a result of amortization and exchanges, the remaining unamortized debt issuance costs were \$4 million at December 31, 2008.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

10% Convertible Senior Notes due 2011

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

In January 2007, in two separate transactions, Level 3 completed the exchange of \$605 million in aggregate principal amount of its 10% Convertible Senior Notes due 2011 for a total of 197 million shares of Level 3's common stock. The shares of the Company's common stock issued pursuant to these announced exchanges are exempt from registration pursuant to Section 3(a)(9) under the Securities Act of 1933, as amended. The Company recognized a \$177 million loss on extinguishment of debt for the exchanges. Included in the loss was approximately \$1 million of unamortized debt issuance costs.

In October 2008, the Company completed the exchange of \$47 million in aggregate principal amount of its 10% Convertible Senior Notes for a total of 22 million shares of Level 3's common stock. The shares of the Company's common stock issued pursuant to this exchange was exempt from registration pursuant to Section 3(a)(9) under the Securities Act of 1933, as amended. This transaction was considered to be an induced conversion in accordance with SFAS No. 84 and as a result, the Company recorded a non-cash loss in the fourth quarter of 2008 on the exchange of the 10% Convertible Senior Notes of \$15 million, consisting of approximately \$15 million of debt conversion expense and less than \$1 million of previously capitalized debt issuance costs. The loss was recorded in gain (loss) on extinguishment of debt in the consolidated statements of operations.

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

On or after May 1, 2009, Level 3, at its option, may redeem for cash all or a portion of the notes. The 10% Convertible Senior Notes are subject to redemption at the option of Level 3, in whole or in part, at any time or from time to time, on not more than sixty nor less than thirty days' notice, on or after May 1, 2009, plus accrued and unpaid interest thereon to the redemption date, if redeemed during the twelve months beginning May 1, of the years indicated below:

| <u>Year</u> | <u>Redemption Price</u> |
|---------------------|-------------------------|
| 2009 | 103.330% |
| 2010 and thereafter | 101.670% |

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

Debt issuance costs of \$3 million were originally capitalized and are being amortized to interest expense over the term of the 10% Convertible Senior Notes. As a result of amortization and exchanges, the capitalized debt issuance costs have been reduced to less than \$1 million at December 31, 2008.

3.5% Convertible Senior Notes due 2012

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

In October 2008, the Company completed the exchange of \$9 million in aggregate principal amount of its 3.5% Convertible Senior Notes for a total of 3 million shares of Level 3's common stock. The shares of the Company's common stock issued pursuant to this exchange was exempt from registration pursuant to Section 3(a)(9) under the Securities Act of 1933, as amended. This transaction was considered to be an induced conversion in accordance with SFAS No. 84 and as a result, the Company recorded a non-cash loss in the fourth quarter of 2008 on the exchange of the 3.5% Convertible Senior Notes of \$2 million, consisting of approximately \$2 million of debt conversion expense and less than \$1 million of previously capitalized debt issuance costs. The loss was recorded in gain (loss) on extinguishment of debt in the consolidated statements of operations.

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

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

| <u>Year</u> | <u>Redemption Price</u> |
|-------------|-------------------------|
| 2010 | 101.17% |
| 2011 | 100.58% |

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

Debt issuance costs of \$9 million were originally capitalized and are being amortized to interest expense over the term of the 3.5% Convertible Senior Notes. As a result of amortization and the exchange, the capitalized debt issuance costs have been reduced to approximately \$6 million at December 31, 2008.

15% Convertible Senior Notes Due 2013

On December 24, 2008 the Company received gross proceeds of \$373.8 million and on December 31, 2008 the Company received gross proceeds of \$26.2 million from the issuance of its \$400 million 15% Convertible Senior Notes due 2013 ("15% Convertible Senior Notes"). Accrued but unpaid debt issuance costs are expected to be approximately \$3 million and are being amortized to interest expense over the term of the 15% Convertible Senior Notes. The proceeds from this issuance were primarily used to repurchase, through tender offers, a portion of the Company's 6% Convertible Subordinated Notes due 2009, 6% Convertible Subordinated Notes due 2010 and 2.875% Convertible Senior Notes due 2010. The 15% Convertible Senior Notes were priced at 100% of the principal amount. The 15% Convertible Senior Notes are unsecured and unsubordinated obligations and will rank equally with all the Company's existing and future unsecured and unsubordinated indebtedness. The 15% Convertible Senior Notes will mature on January 15, 2013. Interest on the notes will accrue from the date of original issuance at a rate of 15% per year and will be payable on January 15 and July 15 of each year, beginning on January 15, 2009. The 15% Convertible Senior Notes contain limited covenants which restrict additional liens on assets of the Company.

The 15% Convertible Senior Notes are convertible by holders into shares of the Company's common stock at an initial conversion price of \$1.80 per share (which is equivalent to a conversion rate of 555.5556 shares of common stock per \$1,000 principal amount of the 15% Convertible Senior Notes), subject to adjustment upon certain events, at any time before the close of business on January 15, 2013. If at any time following the date of original issuance of the 15% Convertible Senior Notes and prior to the close of business on January 15, 2013 the closing per share sale price of the Company's common stock exceeds 222.2% of the conversion price then in effect for at least 20 trading days within any 30 consecutive trading day period, the 15% Convertible Senior Notes will automatically convert into shares of Level 3 common stock, plus accrued and unpaid interest (if any) to, but excluding the automatic conversion date, which date will be designated by the Company following such automatic conversion event.

Holders of the 15% Convertible Senior Notes may require the Company to repurchase all or any part of their notes upon the occurrence of a designated event at a price equal to 100% of the principal amount of the notes, plus accrued and unpaid interest to, but excluding, the repurchase date, if any.

In addition, if a holder elects to convert its 15% Convertible Senior Notes in connection with certain changes in control, the Company could be required to pay a make-whole premium by increasing the number of shares deliverable upon conversion of such notes. Any make whole premium will have the effect of increasing the number of shares due to holders of the 15% Convertible Senior Notes upon conversion.

9% Convertible Senior Discount Notes due 2013

In October 2003, Level 3 Communications, Inc. issued \$295 million aggregate principal amount at maturity of 9% Convertible Senior Discount Notes due 2013. Interest on the 9% Convertible Senior

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

Discount Notes accretes at a rate of 9% per annum, compounded semiannually, to an aggregate principal amount of \$295 million by October 15, 2007. Cash interest did not accrue on the 9% Convertible Senior Discount Notes prior to October 15, 2007. Commencing October 15, 2007, interest on the 9% Convertible Senior Discount Notes accrues at the rate of 9% per annum and is payable in cash semiannually in arrears. Accreted interest expense of \$20 million for the year ended December 31, 2007 on the 9% Convertible Senior Discount Notes due 2013 was added to long-term debt.

The 9% Convertible Senior Discount Notes are convertible into shares of the Company's common stock at a conversion rate of \$9.99 per share, subject to certain adjustments. On or after October 15, 2008, the Company, at its option, may redeem for cash all or a portion of the notes. The Company may exercise this option only if the current market price for at least 20 trading days within any 30 consecutive trading day period exceeds 140% of the conversion price on October 15, 2008. This amount will be decreased to 130% and 120% on October 15, 2008 and 2010, respectively, if the initial holders sell greater than 33.33% of the notes. The Company is also obligated to pay the holders of the redeemed notes a cash amount equal to the present value of all remaining scheduled interest payments.

The 9% Convertible Senior Discount Notes are subject to conversion into common stock at the option of the holder, in whole or in part, at any time or from time to time at a conversion rate of 100.09 shares per \$1,000 of face value of the debt plus accrued and unpaid interest thereon to the conversion date.

These notes are senior unsecured obligations of Level 3 Communications, Inc., ranking *pari passu* with all existing and future senior unsecured indebtedness of Level 3 Communications, Inc.

6% Convertible Subordinated Notes due 2009

In September 1999, the Company received \$798 million of proceeds, after transaction costs, from an offering of \$823 million aggregate principal amount of its 6% Convertible Subordinated Notes Due 2009 ("Subordinated Notes 2009"). The Subordinated Notes 2009 are unsecured and subordinated to all existing and future senior indebtedness of the Company. Interest on the Subordinated Notes 2009 accrues at 6% per year and is payable each year in cash on March 15 and September 15. The principal amount of the Subordinated Notes 2009 will be due on September 15, 2009.

In September 2008, in various transactions, the Company repurchased \$39 million aggregate principal amount of its Subordinated Notes 2009 at discounts to the principal amount and recognized a net gain on extinguishment of debt of \$1 million. Unamortized debt issuance costs totaled less than \$1 million and accrued interest paid at the time of repurchase totaled less than \$1 million.

In October 2008, the Company completed the exchange of \$18 million in aggregate principal amount of its Subordinated Notes 2009 for a total of 10 million shares of Level 3's common stock. The shares of the Company's common stock issued pursuant to these exchanges were exempt from registration pursuant to Section 3(a)(9) under the Securities Act of 1933, as amended. These transactions were considered to be induced conversions in accordance with SFAS No. 84 and as a result, the Company recorded a non-cash loss in the fourth quarter of 2008 on the exchange of the Subordinated Notes 2009 of \$14 million, consisting of approximately \$14 million of debt conversion expense and less than \$1 million of previously capitalized debt issuance costs. The loss was recorded in gain (loss) on extinguishment of debt in the consolidated statements of operations.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

In December 2008, the Company repurchased using \$114 million in cash, through tender offers, \$124 million aggregate principal amount of Subordinated Notes 2009 at a price equal to \$920 per \$1,000 principal amount of the notes and recognized a gain on the extinguishment of debt of approximately \$9 million. The gain consisted of a \$10 million cash gain, which was partially offset by \$1 million in unamortized debt issuance costs. Accrued interest paid at the time of repurchase totaled \$2 million. The gain was recorded in gain (loss) on extinguishment of debt in the consolidated statements of operations.

The remaining Subordinated Notes 2009 may be converted into shares of common stock of the Company at any time prior to maturity, unless previously redeemed, repurchased or the Company has caused the conversion rights to expire. The conversion rate is 15.3401 shares per each \$1,000 principal amount of Subordinated Notes 2009, subject to adjustment in certain circumstances. On or after September 15, 2002, the Company, at its option, may cause the conversion rights to expire. The Company may exercise this option only if the current market price exceeds approximately \$91.27 (which represents 140% of the conversion price) for 20 trading days within any period of 30 consecutive trading days including the last day of that period.

Debt issuance costs of \$25 million were originally capitalized and are being amortized to interest expense over the term of the Subordinated Notes 2009. As a result of amortization, exchanges and repurchases the capitalized debt issuance costs have been reduced to \$1 million at December 31, 2008.

6% Convertible Subordinated Notes due 2010

In February 2000, Level 3 Communications, Inc. received \$836 million of net proceeds, after transaction costs, from a public offering of \$863 million aggregate principal amount of its 6% Convertible Subordinated Notes due 2010 ("Subordinated Notes 2010"). The Subordinated Notes 2010 are unsecured and subordinated to all existing and future senior indebtedness of the Company. Interest on the Subordinated Notes 2010 accrues at 6% per year and is payable semi-annually in cash on March 15 and September 15 beginning September 15, 2000. The principal amount of the Subordinated Notes 2010 will be due on March 15, 2010.

In December 2008, in connection with the issuance of the \$400 million of 15% Convertible Senior Notes due 2013, the Company repurchased using \$121 million in cash, through tender offers, \$173 million aggregate principal amount of Subordinated Notes 2010 at a price equal to \$700 per \$1,000 principal amount of the notes and recognized a gain on the extinguishment of debt of approximately \$51 million. The gain consisted of a \$52 million cash gain, which was partially offset by \$1 million in unamortized debt issuance costs. Accrued interest paid at the time of repurchase totaled \$3 million. The gain was recorded in gain (loss) on extinguishment of debt in the consolidated statements of operations.

In September 2008, the Company repurchased \$32 million aggregate principal amount of Subordinated Notes 2010 at a discount to the principal amount and recognized a net gain on extinguishment of debt of \$2 million. Unamortized debt issuance costs totaled less than \$1 million and accrued interest paid at the time of repurchase totaled \$1 million.

The remaining Subordinated Notes 2010 may be converted into shares of common stock of Level 3 Communications, Inc. at any time prior to the close of business on the business day immediately preceding maturity, unless previously redeemed, repurchased or Level 3 Communications, Inc. has

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

caused the conversion rights to expire. The conversion rate is 7.416 shares per each \$1,000 principal amount of Subordinated Notes 2010, subject to adjustment in certain events.

On or after March 18, 2003, the Company, at its option, may cause the conversion rights to expire. The Company may exercise this option only if the current market price exceeds approximately \$188.78 (which represents 140% of the conversion price) for at least 20 trading days within any period of 30 consecutive trading days, including the last trading day of that period.

Debt issuance costs of \$27 million were originally capitalized and are being amortized to interest expense over the term of the Subordinated Notes. As a result of amortization and debt repurchases, the capitalized debt issuance costs have been reduced to \$1 million at December 31, 2008.

Commercial Mortgage

In the third quarter of 2005, the HQ Realty, Inc., a wholly owned subsidiary of the Company, completed a refinancing of the mortgage on the Company's corporate headquarters. On September 27, 2005, HQ Realty, Inc. entered into a \$70 million loan at an initial fixed rate of 6.86% through 2010, the anticipated repayment date as defined in the loan agreement ("Commercial Mortgage"). The term of the Commercial Mortgage may be extended to a final maturity date of October 1, 2015 at the election of HQ Realty, Inc. If the term is extended, after 2010 through maturity in 2015, the interest rate will adjust to the greater of 9.86% or the five year U.S. Treasury rate plus 300 basis points. HQ Realty, Inc. received \$66 million of net proceeds after transaction costs and has deposited \$1 million into restricted cash accounts as of December 31, 2008, for future facility improvements and property taxes. HQ Realty, Inc. was required to make interest only payments in the first year and began making monthly principal payments in the second year based on a 30-year amortization schedule.

Debt issuance costs of \$1 million were capitalized and are being amortized as interest expense over the term of the Commercial Mortgage. As a result of amortization, the capitalized debt issuance costs have been reduced to less than \$1 million at December 31, 2008.

The assets of HQ Realty, Inc. are not available to satisfy any third party obligations other than those of HQ Realty, Inc. In addition, the assets of the Company and its subsidiaries other than HQ Realty, Inc. are not available to satisfy the obligations of HQ Realty, Inc.

Capital Leases

The Company leases certain dark fiber facilities and metro fiber under noncancelable IRU agreements that are accounted for as capital leases. All of these capital leases were assumed by the Company through its previous acquisitions. Interest rates on capital leases approximate 8% on average as of December 31, 2008. Depreciation expense related to assets under capital leases is included in depreciation and amortization expense.

Covenant Compliance

At December 31, 2008 and 2007, the Company was in compliance with the covenants on all outstanding debt issuances.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Long-Term Debt (Continued)

Long-Term Debt Maturities:

Aggregate future maturities of long-term debt and capital leases (excluding issue discounts, premiums and fair value adjustments) were as follows as of December 31, 2008 (in millions):

| | |
|------------|----------------|
| 2009 | \$ 186 |
| 2010 | 583 |
| 2011 | 569 |
| 2012 | 328 |
| 2013 | 1,247 |
| Thereafter | 3,673 |
| | <u>\$6,586</u> |

(12) Employee Benefit Plans

The Company records non-cash compensation expense for its outperform stock appreciation rights that it refers to as Outperform Stock Options ("OSO"), restricted stock units and shares, 401(k) matching contributions and discretionary 401(k) contributions. Total non-cash compensation expense related to these equity awards was \$78 million in 2008, \$122 million in 2007 and \$84 million in 2006. Included in discontinued operations for 2006 is non-cash compensation of \$2 million.

The following table summarizes non-cash compensation expense and capitalized non-cash compensation for each of the three years ended December 31, 2008 (in millions):

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|----------------------------------|-------------|--------------|-------------|
| OSO | \$13 | \$ 35 | \$38 |
| Restricted Stock | 36 | 42 | 20 |
| 401(k) Match Expense | 30 | 30 | 18 |
| 401(k) Discretionary Grant Plan | — | 16 | 12 |
| | <u>79</u> | <u>123</u> | <u>88</u> |
| Capitalized Noncash Compensation | (1) | (1) | (2) |
| | <u>78</u> | <u>122</u> | <u>86</u> |
| Discontinued Operations | — | — | (2) |
| | <u>\$78</u> | <u>\$122</u> | <u>\$84</u> |

OSO units and restricted stock units and shares are granted under the Company's 1995 Stock Plan, as amended, which term extends through September 25, 2010. The Company's 1995 Stock Plan, as amended, provides for accelerated vesting of stock awards upon retirement if an employee meets certain age and years of service requirements and certain other requirements. Under SFAS No. 123R, if an employee meets the age and years of service requirements under the accelerated vesting provision, the award would be expensed at grant or expensed over the period from the grant date to the date the employee meets the requirements, even if the employee has not actually retired. The Company recognized non-cash compensation expense for employees that met the age and years of service requirements for accelerated vesting at retirement of \$7 million in 2008, \$11 million in 2007 and zero in 2006.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(12) Employee Benefit Plans (Continued)

Outperform Stock Options

During the second quarter of 2006, the October 2005 and January 2006 grants of Outperform Stock Option ("OSO") units were revalued using May 15, 2006 as the grant date, as there had not been stockholder approval of those awards prior to that date, which was deemed necessary for determination of the grant date for those awards under SFAS No. 123R, and resulted in an additional \$6 million in non-cash compensation expense.

The Company's OSO program was designed so that the Company's stockholders would receive a market return on their investment before OSO holders receive any return on their options. The Company believes that the OSO program directly aligns management's and stockholders' interests by basing stock option value on the Company's ability to outperform the market in general, as measured by the Standard & Poor's ("S&P") 500 Index. Participants in the OSO program do not realize any value from awards unless the Company's common stock price outperforms the S&P 500® Index during the life of the grant. When the stock price gain is greater than the corresponding gain on the S&P 500® Index (or less than the corresponding loss on the S&P 500® Index for grants awarded before September 30, 2005), the value received for awards under the OSO plan is based on a formula involving a multiplier related to the level by which the Company's common stock outperforms the S&P 500® Index. To the extent that Level 3's common stock outperforms the S&P 500 Index, the value of OSO units to a holder may exceed the value of nonqualified stock options.

The initial strike price, as determined on the day prior to the OSO grant date, is adjusted over time (the "Adjusted Strike Price"), until the exercise date. The adjustment is an amount equal to the percentage appreciation or depreciation in the value of the S&P 500® Index from the date of grant to the date of exercise. The value of the OSO increases for increasing levels of outperformance. OSO units have a multiplier range from zero to four depending upon the performance of Level 3 common stock relative to the S&P 500® Index as shown in the following table.

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

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

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

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(12) Employee Benefit Plans (Continued)

Prior to March 31, 2007, OSO awards vested over 2 years and had a 4-year life. Fifty percent of the awards vested at the end of the first year after grant, with the remaining 50% vested over the second year (12.5% per quarter). As part of a comprehensive review of its long-term compensation program completed in the first quarter of 2007, beginning with awards made on or after April 1, 2007, OSO units are awarded monthly to employees in mid-management level and higher positions, have a three year life, vest 100% and fully settle on the third anniversary of the date of the award and are valued as of the first day of each month. Recipients have no discretion on the timing to exercise OSO units granted on or after April 1, 2007, thus the expected life of all such OSO units is three years.

As of December 31, 2008, there was \$20 million of unamortized compensation expense related to granted OSO units. The weighted average period over which this cost will be recognized is 1.94 years.

The fair value of the OSO units granted is calculated by applying a modified Black-Scholes model with the assumptions identified below. The Company utilized a modified Black-Scholes model due to the additional variables required to calculate the effect of the success multiplier of the OSO program. The Company believes that given the relative short life of the options and the other variables used in the model, the modified Black-Scholes model provides a reasonable estimate of the fair value of the OSO units at the time of grant.

| | <u>Year Ended December 31,</u> | | |
|---|--------------------------------|-------------|-------------|
| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
| S&P 500 Expected Dividend Yield Rate | 2.00% | 1.78% | 1.78% |
| Expected Life | 3 years | 3 years | 3.4 years |
| S&P 500 Expected Volatility Rate | 13% | 12% | 12% |
| Level 3 Common Stock Expected Volatility Rate | 56% | 55% | 55% |
| Expected S&P 500 Correlation Factor | .32 | .28 | .28 |
| Calculated Theoretical Value | 147% | 146% | 153% |
| Estimated Forfeiture Rate | 11.87% | 11.88% | 10.19% |

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

The expected life data was stratified based on levels of responsibility within the Company. The theoretical value used in 2006 was determined using the weighted average exercise behavior for these groups of employees. As described above, recipients have no discretion on the timing to exercise OSO units granted on or after April 1, 2007, thus the expected life of all such OSO units is three years. Volatility assumptions were derived using historical data as well as current market data.

The fair value for OSO units awarded to participants during the years ended December 31, 2008, 2007 and 2006 was approximately \$18 million, \$32 million and \$50 million, respectively.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(12) Employee Benefit Plans (Continued)

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

| | Units | Initial Strike Price Per Unit | Weighted Average Initial Strike Price | Aggregate Intrinsic Value (in millions) | Weighted Average Remaining Contractual Term |
|---------------------------------|-------------|-------------------------------------|--|--|---|
| Balance December 31, 2005 | 14,245,976 | \$2.03 - \$6.66 | \$ 3.34 | \$ 9.3 | 2.34 years |
| Options granted | 8,092,915 | 2.87 - 5.39 | 4.49 | | |
| Options cancelled | (1,101,849) | 2.03 - 6.66 | 3.71 | | |
| Options expired | (3,010,367) | 2.03 - 6.66 | 3.62 | | |
| Options exercised | (2,941,180) | 2.03 - 4.44 | 2.97 | | |
| Balance December 31, 2006 | 15,285,495 | \$2.03 - \$6.66 | 3.93 | 82.7 | 2.54 years |
| Options granted | 4,818,069 | 3.03 - 6.10 | 5.25 | | |
| Options cancelled | (631,603) | 2.03 - 6.66 | 5.08 | | |
| Options expired | (1,767,687) | 2.03 - 6.66 | 5.37 | | |
| Options exercised | (1,999,717) | 2.03 - 5.39 | 2.87 | | |
| Balance December 31, 2007 | 15,704,557 | \$2.03 - \$6.10 | 4.27 | 2.4 | 2.04 years |
| Options granted | 4,592,809 | 0.94 - 3.44 | 2.70 | | |
| Options cancelled | (1,552,070) | 1.05 - 6.10 | 4.65 | | |
| Options expired | (2,228,545) | 2.03 - 6.10 | 3.97 | | |
| Options exercised | (709,483) | 2.03 - 3.39 | 2.42 | | |
| Balance December 31, 2008 | 15,807,268 | \$0.94 - \$6.10 | \$ 3.90 | \$ — | 1.56 years |
| Options exercisable ("vested"): | | | | | |
| December 31, 2006 | 7,903,200 | \$2.03 - \$6.66 | \$ 3.48 | | |
| December 31, 2007 | 9,821,827 | \$2.03 - \$5.70 | \$ 3.72 | | |
| December 31, 2008 | 7,962,066 | \$2.03 - \$5.39 | \$ 3.95 | \$ — | 1.11 years |

| Range of Exercise Prices | OSO units Outstanding at December 31, 2008 | | | OSO units Exercisable at December 31, 2008 | |
|--------------------------|---|--|--|---|--|
| | Number Outstanding | Weighted Average Remaining Life (years) | Weighted Average Initial Strike Price | Number Exercisable | Weighted Average Initial Strike Price |
| \$0.94 - \$1.05 | 741,335 | 2.87 | \$ 1.00 | — | \$ — |
| 2.03 - 3.04 | 5,203,042 | 1.46 | 2.58 | 2,836,847 | 2.47 |
| 3.36 - 4.65 | 4,216,088 | 1.59 | 3.85 | 2,200,792 | 4.08 |
| 5.18 - 6.10 | 5,646,803 | 1.45 | 5.53 | 2,924,427 | 5.29 |
| | 15,807,268 | 1.56 | \$ 3.90 | 7,962,066 | \$ 3.95 |

In the table above, the weighted average initial strike price represents the values used to calculate the theoretical value of OSO units on the grant date and the intrinsic value represents the value of OSO units that have outperformed the S&P 500® Index as of December 31, 2008.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(12) Employee Benefit Plans (Continued)

The total realized value of OSO units exercised was \$2 million, \$19 million and \$20 million for the years ended December 31, 2008, 2007 and 2006, respectively. The Company issued approximately 466,000, 3.2 million and 3.8 million shares of Level 3 common stock upon the exercise of OSO units for the years ended December 31, 2008, 2007 and 2006, respectively. The number of shares of Level 3 stock issued upon exercise of an OSO unit varies based upon the relative performance of Level 3's stock price and the S&P 500® Index between the initial grant date and exercise date of the OSO unit.

As of December 31, 2008, based on the Level 3 common stock price and post-multiplier values, the Company was not obligated to issue any shares for vested and exercisable OSO units as the Company's common stock price did not outperform the S&P 500® Index.

Restricted Stock and Units

Restricted stock units and shares are granted to the recipients at no cost. Restrictions on transfer lapse over one to four year periods. The fair value of restricted stock units and shares awarded totaled \$43 million, \$68 million and \$27 million, for the years ended December 31, 2008, 2007 and 2006, respectively. The fair value of these awards was calculated using the value of the Level 3 common stock on the grant date and are being amortized over the periods in which the restrictions lapse. As of December 31, 2008, unamortized compensation cost related to nonvested restricted stock and restricted stock units was \$34 million and the weighted average period over which this cost will be recognized is 2.66 years.

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

| | Number | Weighted Average Grant Date Fair Value |
|--------------------------------|-------------------|--|
| Nonvested at December 31, 2005 | 23,376,843 | \$ 2.06 |
| Stock and units granted | 5,874,765 | 4.65 |
| Lapse of restrictions | (7,225,744) | 2.13 |
| Stock and units forfeited | (2,575,137) | 2.45 |
| Nonvested at December 31, 2006 | 19,450,727 | 2.76 |
| Stock and units granted | 11,992,520 | 5.67 |
| Lapse of restrictions | (6,997,946) | 2.71 |
| Stock and units forfeited | (2,173,989) | 4.20 |
| Nonvested at December 31, 2007 | 22,271,312 | 4.20 |
| Stock and units granted | 17,627,904 | 2.43 |
| Lapse of restrictions | (9,701,473) | 3.57 |
| Stock and units forfeited | (4,063,944) | 4.08 |
| Nonvested at December 31, 2008 | <u>26,133,799</u> | <u>\$ 3.26</u> |

The total fair value of restricted stock and restricted stock units whose restrictions lapsed in the years ended December 31, 2008, 2007 and 2006 was \$35 million, \$19 million and \$15 million, respectively.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(12) Employee Benefit Plans (Continued)

Warrants

As of December 31, 2008, there were approximately 15.3 million warrants outstanding ranging in exercise price from \$4.00 to \$29.00, all of which were fully vested and for which compensation expense had been fully recognized in the consolidated statements of operations. The weighted average exercise price of these warrants was \$7.22 as of December 31, 2008.

In connection with the acquisition of Broadwing, approximately 4 million previously issued Broadwing warrants were converted into warrants to purchase approximately 5 million shares of Level 3 common stock at a weighted average exercise price of \$5.76 per share of Level 3 common stock. In 2007, approximately 3 million of the Broadwing warrants were exercised to purchase approximately 4 million shares of Level 3 common stock and resulted in proceeds to the Company totaling approximately \$23 million. As of December 31, 2007 and 2008, warrants to purchase approximately 1 million shares of Level 3 common stock remained outstanding. The weighted average exercise price of these warrants was \$5.38 as of December 31, 2008.

401(k) Plan

The Company and its subsidiaries offer their qualified employees the opportunity to participate in a defined contribution retirement plan qualifying under the provisions of Section 401(k) of the Internal Revenue Code ("401(k) Plan"). Each employee is eligible to contribute, on a tax deferred basis, a portion of annual earnings generally not to exceed \$15,500 in 2008. The Company matches 100% of employee contributions up to 7% of eligible earnings or applicable regulatory limits. Effective March 6, 2009, the Company is reducing its match to 100% of employee contributions up to 3% of eligible earnings or applicable regulatory limits.

The Company's matching contributions are made with Level 3 common stock based on the closing stock price on each pay date. The Company's matching contributions are made through units in the Level 3 Stock Fund, which represent shares of Level 3 common stock. The Level 3 Stock Fund is the mechanism that is used for Level 3 to make employer matching and other contributions to employees through the Level 3 401(k) plan. Employees are not able to purchase units in the Level 3 Stock Fund. Employees are able to diversify the Company's matching contribution as soon as it is made, even if they are not fully vested. The Company's matching contributions will vest ratably over the first three years of service or over such shorter period until the employee has completed three years of service at such time the employee is then 100% vested in all Company matching contributions, including future contributions. The Company made 401(k) Plan matching contributions of \$30 million, \$30 million and \$18 million for the years ended December 31, 2008, 2007 and 2006, respectively. The Company's matching contributions are recorded as non-cash compensation and included in selling, general and administrative expenses.

The Company made a discretionary contribution to the 401(k) plan in Level 3 common stock for the years ended December 31, 2007 and 2006 equal to three percent of eligible employees' earnings each year. The 2007 and 2006 deposits were made into the employees' 401(k) accounts during the first quarter of the subsequent year. Level 3 recorded an expense of \$16 million in 2007 and \$11 million in 2006 for the discretionary contribution. The Company did not make a discretionary contribution to the 401(k) plan for the year ended December 31, 2008.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(13) Income Taxes

An analysis of the income tax benefit (provision) attributable to loss from continuing operations before income taxes for each of the years in the three year period ended December 31, 2008 follows:

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---|-----------------------|--------------|---------------|
| | (dollars in millions) | | |
| Current: | | | |
| United States federal | \$ 1 | \$— | \$— |
| State | (7) | (3) | — |
| Foreign | — | 2 | (2) |
| | <u>(6)</u> | <u>(1)</u> | <u>(2)</u> |
| Deferred, net of changes in valuation allowances: | | | |
| United States federal | — | — | — |
| State | — | 23 | — |
| Foreign | — | — | — |
| Income tax benefit (provision) | <u>\$ (6)</u> | <u>\$ 22</u> | <u>\$ (2)</u> |

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

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---------------|-----------------------|------------------|----------------|
| | (dollars in millions) | | |
| United States | \$(188) | \$(1,016) | \$(710) |
| Foreign | (96) | (120) | (78) |
| | <u>\$(284)</u> | <u>\$(1,136)</u> | <u>\$(788)</u> |

A reconciliation of the actual income tax benefit (provision) and the tax computed by applying the U.S. federal rate (35%) to the loss from continuing operations before income taxes for each of the three years ended December 31, 2008 follows:

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---|-----------------------|--------------|---------------|
| | (dollars in millions) | | |
| Computed tax benefit at statutory rate | \$100 | \$ 397 | \$ 276 |
| State income tax benefit | 9 | 39 | 26 |
| Stock option plan exercises | (4) | 8 | 3 |
| Disallowance of losses on extinguishments of debt | (15) | (62) | (3) |
| Other, net | (3) | (9) | — |
| Change in valuation allowance | (93) | (351) | (304) |
| Income tax benefit (provision) | <u>\$ (6)</u> | <u>\$ 22</u> | <u>\$ (2)</u> |

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(13) Income Taxes (Continued)

The components of the net deferred tax assets (liabilities) as of December 31, 2008 and 2007 were as follows:

| | <u>2008</u> | <u>2007</u> |
|---|------------------------------|--------------|
| | <u>(dollars in millions)</u> | |
| Deferred Tax Assets: | | |
| Fixed assets and intangible assets | \$ 171 | \$ 59 |
| Accrued payroll and related benefits | 80 | 41 |
| State tax credit carry forwards | 23 | 23 |
| Investment in securities | — | 25 |
| Investment in joint ventures | 82 | 94 |
| Unutilized tax net operating loss carry forwards | 1,790 | 3,690 |
| Accrued liabilities and deferred revenue | — | 11 |
| Other assets or liabilities | — | 6 |
| Total Deferred Tax Assets | <u>2,146</u> | <u>3,949</u> |
| Deferred Tax Liabilities: | | |
| Accrued liabilities and deferred revenue | (69) | — |
| Total Deferred Tax Liabilities | <u>(69)</u> | <u>—</u> |
| Net Deferred Tax Assets before valuation allowance | 2,077 | 3,949 |
| Valuation Allowance | (2,054) | (3,926) |
| Net Non-Current Deferred Tax Asset after Valuation Allowance | <u>\$ 23</u> | <u>\$ 23</u> |

As of December 31, 2008, the Company had net operating loss carry forwards of approximately \$4.7 billion for federal income tax purposes. Under the rules prescribed by U.S. Internal Revenue Code ("IRC") Section 382 and applicable regulations, if certain transactions occur with respect to an entity's capital stock that result in a cumulative ownership shift of more than 50 percentage points by 5-percent stockholders over a testing period, annual limitations are imposed with respect to the entity's ability to utilize its net operating loss carry forwards and certain current deductions against any taxable income the entity achieves in future periods. The Company had entered into transactions over the testing period resulting in significant cumulative shifts in the ownership of its capital stock which alone would not have resulted in an ownership change under IRC Section 382. However, when the Company's actions are coupled with the trading activity in the Company's common stock throughout 2008 by third-party market participants, the Company believes that in 2008 the Company experienced a cumulative ownership change of more than 50 percentage points by 5-percent stockholders during the applicable testing period. Prior to the ownership change, the Company had net operating loss carry forwards of \$9.7 billion. The Company believes that the limitation of its net operating loss carry forwards will not have a near term effect on its consolidated results of operations and financial position. Additional transactions could cause the Company to incur a subsequent 50 percentage point ownership change by 5-percent stockholders and, if the Company triggers the above-noted IRC imposed limitations, could further limit it from fully utilizing the remaining net operating loss carry forwards and certain current deductions to reduce income taxes.

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(13) Income Taxes (Continued)

planning strategies in making this assessment. A valuation allowance has been recorded against deferred tax assets, as the Company has concluded that under relevant accounting standards it is not more likely than not that the deferred tax assets are realizable.

The valuation allowance for deferred tax assets was approximately \$2.0 billion as of December 31, 2008 and approximately \$3.9 billion as of December 31, 2007. The net change in the valuation allowance for the year ended December 31, 2008 was approximately \$1.9 billion. A significant portion of the change in valuation allowance is attributable to the IRC Section 382 limitation. This limitation reduced the deferred tax asset for unutilized net operating loss carry forwards and associated valuation allowance, by approximately \$2.1 billion during 2008. This reduction in valuation allowance was partially offset by the valuation allowance recorded for additional deferred tax assets, for the portion of the 2008 net operating losses not subject to the IRC Section 382 limitation, and other changes in deferred tax assets.

The U.S. federal tax loss carry forwards expire through 2028 and are subject to examination by the tax authorities until three years after the carry forwards are utilized. The U.S. federal tax loss carry forwards expire as follows (dollars in millions):

| <u>Expiring December 31</u> | <u>Amount</u> |
|-----------------------------|----------------|
| 2024 | \$ 536 |
| 2025 | 1,175 |
| 2026 | 987 |
| 2027 | 1,539 |
| 2028 | 438 |
| | <u>\$4,675</u> |

The Company has approximately \$95 million of tax loss carry forwards for controlled foreign corporations at December 31, 2008, the majority of which have no expiration period. In addition, the Company has approximately \$128 million of state tax loss carry forwards with various expiration periods through 2028.

The majority of the Company's foreign assets and operations are owned by entities that have elected to be treated for U.S. tax purposes as unincorporated branches of a U.S. holding company and, as a result, the taxable income or loss and other tax attributes of such entities are included in the Company's U.S. federal consolidated income tax return. However, the Company has some foreign subsidiaries that have not so elected and therefore are treated for U.S. tax purposes as controlled foreign corporations. With respect to such controlled foreign corporations, as of December 31, 2008, the Company has no plans to repatriate undistributed earnings of such controlled foreign corporations as any earnings are deemed necessary to fund ongoing European operations and planned expansion. Undistributed earnings of such controlled foreign corporations that are permanently invested and for which no deferred taxes have been provided are immaterial as of December 31, 2008 and 2007.

The Company adopted the provisions of FIN No. 48 on January 1, 2007. The adoption of FIN No. 48 did not affect the Company's liability for uncertain tax positions. The Company's liability for uncertain tax positions totaled \$16 million at December 31, 2008 and \$18 million at December 31, 2007. These amounts also include the related accrued interest and penalties associated with the uncertain tax positions if applicable. The Company does not expect the liability for uncertain tax

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(13) Income Taxes (Continued)

positions will change significantly during the twelve months ended December 31, 2009; however, actual changes in the liability for uncertain tax positions could be different than currently expected. A rollforward of the liability for uncertain tax positions follows:

| <u>(dollars in millions)</u> | <u>Amount</u> |
|---|---------------|
| Balance as of December 31, 2007 | \$ 18 |
| Gross increases—tax positions prior to 2008 | 3 |
| Gross increases—during 2008 | 1 |
| Gross decreases—tax positions prior to 2008 | (6) |
| Balance as of December 31, 2008 | <u>\$ 16</u> |

The Company, or at least one of its subsidiaries, files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2003. The Internal Revenue Service and state and local taxing authorities reserve the right to audit any period where net operating loss carry forwards are available. During the third quarter of 2008, the Company and the Internal Revenue Service settled an income tax audit for years 1999 through 2001 in addition to 1996 interest issues resulting in a refund of \$1 million to the Company. In addition, the Internal Revenue Service completed an examination of certain adjustments to the Company's U.S. income tax returns for 2002 resulting from final resolution of the 1999 through 2001 audit. The Company is currently under audit by taxing authorities in the United Kingdom for tax years 2002 through 2004 and in France for tax years 2005 through 2006.

The Company recognizes accrued interest and penalties related to uncertain tax positions in income tax expense in its consolidated statements of operations. The Company's liability for uncertain tax positions includes approximately \$10 million of accrued interest and penalties at December 31, 2008.

(14) Segment Information

SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information" defines operating segments as components of an enterprise for which separate financial information is available and which is evaluated regularly by the Company's chief operating decision maker, or decision making group, in deciding how to allocate resources and assess performance. Operating segments are managed separately and represent separate strategic business units that offer different products and serve different markets. The Company's current reportable segments include: communications and coal mining (see Note 1). Other primarily includes corporate assets and overhead not attributable to a specific segment. In the third quarter of 2006, the Company exited the information services business as a result of the sale of Software Spectrum.

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

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(14) Segment Information (Continued)

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

Adjusted EBITDA excludes non-cash impairment charges and non-cash stock compensation expense because of the non-cash nature of these items. Adjusted EBITDA also excludes interest income, interest expense, income taxes and gain (loss) on extinguishment of debt 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 should be evaluated through cash flow measures. Adjusted EBITDA excludes the gain on sale of business groups and 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 taxes, depreciation and amortization, non-cash impairment charges, non-cash stock compensation expense, gain (loss) on early extinguishment of debt, the gain on sale of business groups 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 data presented in the following tables includes information for the years ended December 31, 2008, 2007 and 2006 for all statement of operations and cash flow information presented, and as of December 31, 2008 and 2007 for all balance sheet information presented. Information related to the acquired businesses is included from their respective acquisition dates. Revenue and the related expenses are attributed to countries based on where services are provided.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(14) Segment Information (Continued)

Segment information for the Company's Communications and Coal Mining businesses is summarized as follows (in millions):

| | Year Ended December 31, | | |
|---|----------------------------|-----------------|----------------|
| | 2008 | 2007 | 2006 |
| <i>Revenue from external customers:</i> | | | |
| Communications | \$4,226 | \$ 4,199 | \$3,311 |
| Coal Mining | 75 | 70 | 67 |
| | <u>\$4,301</u> | <u>\$ 4,269</u> | <u>\$3,378</u> |
| <i>Adjusted EBITDA:</i> | | | |
| Communications | \$1,039 | \$ 823 | \$ 677 |
| Coal Mining | \$ 5 | \$ 5 | \$ 8 |
| Other | \$ (4) | \$ (4) | \$ (3) |
| <i>Capital expenditures:</i> | | | |
| Communications | \$ 446 | \$ 631 | \$ 391 |
| Coal Mining | 3 | 2 | 1 |
| | <u>\$ 449</u> | <u>\$ 633</u> | <u>\$ 392</u> |
| <i>Depreciation and amortization:</i> | | | |
| Communications | \$ 929 | \$ 935 | \$ 729 |
| Coal Mining | 2 | 7 | 1 |
| | <u>\$ 931</u> | <u>\$ 942</u> | <u>\$ 730</u> |
| <i>Total assets:</i> | | | |
| Communications | \$9,509 | \$10,128 | \$9,849 |
| Coal Mining | 121 | 115 | 127 |
| Other | 8 | 11 | 18 |
| | <u>\$9,638</u> | <u>\$10,254</u> | <u>\$9,994</u> |

The following is a summary of geographical information (in millions):

| | Year Ended December 31, | | |
|---|----------------------------|----------------|----------------|
| | 2008 | 2007 | 2006 |
| <i>Revenue from external customers:</i> | | | |
| North America | \$3,975 | \$4,011 | \$3,188 |
| Europe | 326 | 258 | 190 |
| | <u>\$4,301</u> | <u>\$4,269</u> | <u>\$3,378</u> |
| <i>Long-lived assets:</i> | | | |
| North America | \$6,244 | \$6,790 | \$6,450 |
| Europe | 718 | 818 | 747 |
| | <u>\$6,962</u> | <u>\$7,608</u> | <u>\$7,197</u> |

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(14) Segment Information (Continued)

The majority of North American revenue consists of services delivered within the United States. The majority of European revenue consists of services delivered within the United Kingdom, France and Germany. Revenue from transoceanic services is allocated to Europe.

The Company includes all non-current assets, except for goodwill, in its long-lived assets.

Communications revenue consists of:

- 1) Core Communications Services, which includes Core Network Services and Wholesale Voice Services;
 - Core Network Services includes revenue from transport and infrastructure, IP and data services, local and enterprise voice services and Level 3 Vyvx broadcast services.
 - Wholesale Voice Services includes revenue from long distance voice services, including domestic voice termination, international voice termination and toll free services.
- 2) Other Communications Services includes revenue from managed modem and its related reciprocal compensation services and SBC Contract Services, which includes revenue from the SBC Master Services Agreement, which was obtained in the acquisition of WilTel.

| | Core Communications Services | Other Communications Services | Total |
|-------------------------------|------------------------------------|-------------------------------------|----------------|
| | (in millions) | | |
| Communications Revenue | | | |
| 2008 | | | |
| North America | \$ 3,534 | \$ 366 | \$3,900 |
| Europe | 326 | — | 326 |
| | <u>\$ 3,860</u> | <u>\$ 366</u> | <u>\$4,226</u> |
| 2007 | | | |
| North America | \$ 3,366 | \$ 575 | \$3,941 |
| Europe | 256 | 2 | 258 |
| | <u>\$ 3,622</u> | <u>\$ 577</u> | <u>\$4,199</u> |
| 2006 | | | |
| North America | \$ 1,787 | \$ 1,334 | \$3,121 |
| Europe | 186 | 4 | 190 |
| | <u>\$ 1,973</u> | <u>\$ 1,338</u> | <u>\$3,311</u> |

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(14) Segment Information (Continued)

The following information provides a reconciliation of Net Income (Loss) to Adjusted EBITDA by reportable segment, as defined by the Company, for the years ended December 31, 2008, 2007 and 2006 (in millions):

2008

| | Communications | Coal Mining | Other |
|---------------------------------------|-----------------|----------------|---------------|
| Net Income (Loss) | \$ (294) | \$ 3 | \$ 1 |
| Income Tax Provision (Benefit) | 4 | — | 2 |
| Total Other (Income) Expense | 322 | — | (7) |
| Depreciation and Amortization Expense | 929 | 2 | — |
| Non-Cash Compensation Expense | 78 | — | — |
| Adjusted EBITDA | <u>\$ 1,039</u> | <u>\$ 5</u> | <u>\$ (4)</u> |

2007

| | Communications | Coal Mining | Other |
|---------------------------------------|----------------|----------------|---------------|
| Net Income (Loss) | \$ (1,113) | \$ (3) | \$ 2 |
| Income Tax Provision (Benefit) | (17) | 1 | (6) |
| Total Other (Income) Expense | 895 | — | — |
| Non-Cash Impairment Charge | 1 | — | — |
| Depreciation and Amortization Expense | 935 | 7 | — |
| Non-Cash Compensation Expense | 122 | — | — |
| Adjusted EBITDA | <u>\$ 823</u> | <u>\$ 5</u> | <u>\$ (4)</u> |

2006

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

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(15) Commitments, Contingencies and Other Items

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

The Company and its subsidiaries have negotiated a proposed nationwide class settlement affecting persons who own or owned land next to or near railroad rights of way. The United States District Court for the District of Massachusetts in *Kingsborough v. Sprint Communications Co. L.P.* has granted preliminary approval of the proposed settlement which, if finally approved, will resolve all of the pending actions. The proposed settlement will provide cash payments to class members based on various factors that include:

- the length of the right of way where the cable is installed;
- the state where the property is located; and
- how the railroad obtained its property rights.

The proposed settlement will also provide the Company and its subsidiaries with a permanent telecommunications easement, which gives them certain rights over the railroad right of way.

It is still too early for the Company to reach a conclusion as to the ultimate outcome of the proposed settlement of these actions. However, management believes that the Company and its subsidiaries have substantial defenses to the claims asserted in all of these actions (and any similar claims which may be named in the future), and intends to defend them vigorously if a satisfactory form of settlement is not ultimately approved. Additionally, management believes that any resulting liabilities for these actions, beyond amounts reserved, will not materially affect the Company's financial condition or future results of operations, but could affect future cash flows.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(15) Commitments, Contingencies and Other Items (Continued)

In February 2009, Level 3 Communications, Inc., certain of its current officers and a former officer were named as defendants in purported class action lawsuits filed in the United States District Court for the District of Colorado, which have been consolidated as *In re Level 3 Communications, Inc. Securities Litigation (Civil Case No. 09-cv-00200-PAB-CBS)*. The Plaintiffs in each complaint allege, in general, that throughout the purported class period of February 8, 2007 to October 23, 2007, the defendants failed to disclose material adverse facts about the Company's business and operations. Specifically, defendants failed to disclose or indicate the following: (1) that the Company's efforts to integrate the numerous acquired companies were not going well; (2) that, specifically, the Company was experiencing an increase in service activation times, which was negatively impacting the Company's service installation intervals and the rate of its revenue growth; (3) that the Company was also experiencing challenges in its service management processes that were resulting in longer response times to resolve customer's network service issues; (4) that steps taken by the Company to remedy the problems were not working and actually, further complicating the issues and making them worse; (5) that, as a result of the above, the Company did not have adequate provisioning capability to convert its increasing sales, or signed orders, into revenue generating service; (6) that the Company lacked adequate internal controls; and (7) that, as a result of the above, the statements made by the defendants during the purported class period lacked a reasonable basis. The complaints seek damages based on purported violations of Section 10(b) of the Securities Exchange Act of 1934, Securities and Exchange Commission Rule 10b-5 promulgated thereunder and Section 20(a) of the Securities Exchange Act of 1934.

It is too early for the Company to reach a conclusion as to the ultimate outcome of these actions. However, management believes that the Company has substantial defenses to the claims asserted in all of these actions (and any similar claims which may be named in the future), and intends to defend these actions vigorously.

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

Letters of Credit

It is customary in Level 3's industries 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 December 31, 2008 and 2007, Level 3 had outstanding letters of credit of approximately \$30 million and \$36 million, respectively, which are collateralized by cash, which is reflected on the consolidated balance sheet as restricted cash. The Company does not believe it is practicable to estimate the fair value of the letters of credit and does not believe exposure to loss is likely nor material.

Operating Leases

The Company is leasing rights-of-way, facilities and other assets under various operating leases which, in addition to rental payments, may require payments for insurance, maintenance, property taxes and other executory costs related to the lease. Certain leases provide for adjustments in lease cost based upon adjustments in various price indexes and increases in the landlord's management costs.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(15) Commitments, Contingencies and Other Items (Continued)

The right-of-way agreements have various expiration dates through 2060. Payments under these right-of-way agreements were \$112 million in 2008, \$106 million in 2007 and \$75 million in 2006.

The Company has obligations under non-cancelable operating leases for certain colocation and office facilities, including lease obligations for which facility related restructuring charges have been recorded. The lease agreements have various expiration dates through 2099. Rent expense, including common area maintenance, under non-cancelable lease agreements was \$193 million in 2008, \$190 million in 2007 and \$132 million in 2006.

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

Future minimum payments for the next five years under network and related right-of-way agreements and non-cancelable operating leases for facilities consist of the following as of December 31, 2008 (in millions):

| | Right-of-Way | | |
|--------------|-----------------|---------------|----------------|
| | Agreements | Facilities | Total |
| 2009 | \$ 110 | \$ 153 | \$ 263 |
| 2010 | 91 | 138 | 229 |
| 2011 | 83 | 121 | 204 |
| 2012 | 80 | 112 | 192 |
| 2013 | 78 | 97 | 175 |
| Thereafter | 733 | 261 | 994 |
| Total | \$ 1,175 | \$ 882 | \$2,057 |

Certain right of way agreements include provisions for increases in payments in future periods based on the rate of inflation as measured by various price indexes. The Company has not included estimates for these increases in future periods in the amounts included above.

Certain non-cancelable right of way agreements provide for automatic renewal on a periodic basis. Payments due under these agreements with automatic renewal options have been included in the table above for a period of 17 years from January 1, 2009, which approximates the economic remaining useful life of the Company's conduit. In addition, certain other right of way agreements are cancellable or can be terminated under certain conditions by the Company. The Company includes the payments under such cancelable right of way agreements in the table above for a period of 1 year from January 1, 2009, if the Company does not consider it likely that it will cancel the right of way agreement within the next year.

(16) Condensed Consolidating Financial Information

As discussed in Note 11, Level 3 Financing has issued senior notes as described below:

- In October 2003, Level 3 Financing issued \$500 million of 10.75% Senior Notes due 2011. The 10.75% Senior Notes were registered with the Securities and Exchange Commission in 2005. The Company repurchased \$497 million of the 10.75% notes in 2006.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(16) Condensed Consolidating Financial Information (Continued)

- In March 2006, Level 3 Financing issued \$150 million of Floating Rate Senior Notes due 2011 and \$250 million of 12.25% Senior Notes due 2013. The Company repurchased \$144 million of the Floating Rate Senior Notes due 2011 in 2007.
- In April 2006, Level 3 Financing issued an additional \$300 million of 12.25% Senior Notes due 2013.
- In October 2006, Level 3 Financing issued \$600 million of 9.25% Senior Notes due 2014 and in December 2006 issued an additional \$650 million of 9.25% Senior Notes due 2014.
- In February 2007, Level 3 Financing issued \$700 million of 8.75% Senior Notes due 2017 and \$300 million of Floating Rate Senior Notes due 2015.

The notes discussed above 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 addition, Level 3 Financing's 12.25% Senior Notes due 2013, Floating Rate Senior Notes due 2011 and 9.25% Senior Notes due 2014 are jointly and severally and fully and unconditionally guaranteed by Broadwing Financial Services, Inc., a wholly owned subsidiary of Level 3 Communications, Inc. As a result of this guarantee, the Company has included Broadwing Financial Services, Inc. in the condensed consolidating financial information below for the periods subsequent to the acquisition of Broadwing on January 3, 2007.

In conjunction with the registration of the 10.75% Senior Notes, Floating Rate Senior Notes due 2011, 12.25% Senior Notes due 2013, 9.25% Senior Notes due 2014, 8.75% Senior Notes due 2017 and Floating Rate Senior Notes due 2015 the accompanying condensed consolidating financial information has been prepared and presented pursuant to SEC Regulation S-X Rule 3-10 "Financial statements of guarantors and affiliates whose securities collateralize an issue registered or being registered." The operating activities of the separate legal entities included in the Company's consolidated financial statements are interdependent. The accompanying condensed consolidating financial information presents the results of operations, financial position and cash flows of each legal entity and, on an aggregate basis, the other non-guarantor subsidiaries based on amounts incurred by such entities, and are not intended to present the operating results of those legal entities on a stand-alone basis.

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.

The Condensed Consolidating Balance Sheet as of December 31, 2007 has been reclassified within the Level 3 Financing Inc. entity and Other Subsidiaries, to reflect the transfer between entities of the \$37 million interest rate swap liability and to reclassify the liability from Other Assets, net to Other Liabilities. These changes did not have any effect on the Level 3 Consolidated Balance Sheet as of December 31, 2007 or affect the financial results for the year ended December 31, 2007.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(16) Condensed Consolidating Financial Information (Continued)

Condensed Consolidating Statements of Operations
For the year ended December 31, 2008

| | Level 3 Communications, Inc. | Level 3 Financing, Inc. | Level 3 Communications, LLC | Broadwing Financial Services, Inc. | Other Subsidiaries | Eliminations | Total |
|---|------------------------------------|-------------------------------|-----------------------------------|---|-----------------------|--------------|----------|
| | (dollars in millions) | | | | | | |
| Revenue | \$ — | \$ — | \$ 1,720 | \$ — | \$ 2,795 | \$ (214) | \$4,301 |
| Costs and Expenses: | | | | | | | |
| Cost of Revenue | — | — | 684 | — | 1,328 | (203) | 1,809 |
| Depreciation and Amortization | — | — | 362 | — | 569 | — | 931 |
| Selling, General and Administrative | 1 | — | 1,243 | — | 272 | (11) | 1,505 |
| Restructuring and Impairment Charges | — | — | 25 | — | — | — | 25 |
| Total Costs and Expenses | 1 | — | 2,314 | — | 2,169 | (214) | 4,270 |
| Operating Income (Loss) | (1) | — | (594) | — | 626 | — | 31 |
| Other Income (Expense): | | | | | | | |
| Interest Income | — | 1 | 10 | — | 4 | — | 15 |
| Interest Expense | (155) | (369) | — | (2) | (8) | — | (534) |
| Interest Income (Expense) Affiliates, net | 787 | 1,103 | (1,951) | — | 61 | — | — |
| Equity in Net Earnings (Losses) of Subsidiaries | (998) | (1,733) | 527 | — | — | 2,204 | — |
| Other Income (Expense), net | 77 | — | 7 | — | (120) | — | 204 |
| Other Income (Expense) | (289) | (998) | (1,407) | (2) | (177) | 2,204 | (315) |
| Income (Loss) from Operations | (290) | (998) | (2,001) | (2) | 803 | 2,204 | (284) |
| Income Tax Benefit (Expense) | — | — | (5) | — | (1) | — | (6) |
| Net Income (Loss) | \$ (290) | \$ (998) | \$ (2,006) | \$ (2) | \$ 802 | \$ 2,204 | \$ (290) |

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(16) Condensed Consolidating Financial Information (Continued)

Condensed Consolidating Statements of Operations
For the year ended December 31, 2007

| | Level 3 Communications, Inc. | Level 3 Financing, Inc. | Level 3 Communications, LLC | Broadwing Financial Services, Inc. | Other Subsidiaries | Eliminations | Total |
|---|------------------------------------|-------------------------------|-----------------------------------|---|-----------------------|--------------|------------|
| | (dollars in millions) | | | | | | |
| Revenue | \$ — | \$ — | \$ 1,439 | \$ 27 | \$ 2,994 | \$ (191) | \$ 4,269 |
| Costs and Expenses: | | | | | | | |
| Cost of Revenue | — | — | 553 | — | 1,434 | (154) | 1,833 |
| Depreciation and Amortization | — | — | 345 | — | 597 | — | 942 |
| Selling, General and Administrative | 3 | — | 1,251 | 27 | 479 | (37) | 1,723 |
| Restructuring and Impairment Charges | — | — | 12 | — | — | — | 12 |
| Total Costs and Expenses | 3 | — | 2,161 | 27 | 2,510 | (191) | 4,510 |
| Operating Income (Loss) | (3) | — | (722) | — | 484 | — | (241) |
| Other Income (Expense): | | | | | | | |
| Interest Income | 2 | 1 | 43 | — | 8 | — | 54 |
| Interest Expense | (202) | (365) | (1) | (1) | (8) | — | (577) |
| Interest Income (Expense) Affiliates, net | 781 | 976 | (1,818) | — | 61 | — | — |
| Equity in Net Earnings (Losses) of Subsidiaries | (1,329) | (1,934) | 444 | — | — | 2,819 | — |
| Other Income (Expense) | (363) | (29) | 7 | — | 13 | — | (372) |
| Other Income (Expense) | (1,111) | (1,351) | (1,325) | (1) | 74 | 2,819 | (895) |
| Income (Loss) from Operations | (1,114) | (1,351) | (2,047) | (1) | 558 | 2,819 | (1,136) |
| Income Tax Benefit | — | 22 | — | — | — | — | 22 |
| Net Income (Loss) | \$ (1,114) | \$ (1,329) | \$ (2,047) | \$ (1) | \$ 558 | \$ 2,819 | \$ (1,114) |

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(16) Condensed Consolidating Financial Information (Continued)

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

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

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(16) Condensed Consolidating Financial Information (Continued)

Condensed Consolidating Balance Sheets
December 31, 2008

| | Level 3 Communications, Inc. | Level 3 Financing, Inc. | Level 3 Communications, LLC | Broadwing Financial Services, Inc. | Other Subsidiaries | Eliminations | Total |
|---|------------------------------------|-------------------------------|-----------------------------------|---|-----------------------|--------------|---------|
| | (dollars in millions) | | | | | | |
| Assets | | | | | | | |
| Current Assets: | | | | | | | |
| Cash and cash equivalents | \$ 67 | \$ 10 | \$ 555 | \$ — | \$ 136 | \$ — | \$ 768 |
| Restricted cash and securities | — | — | 1 | — | 2 | — | 3 |
| Accounts Receivable, net | — | — | 73 | — | 317 | — | 390 |
| Due from (to) affiliates | 11,148 | 9,306 | (22,122) | 17 | 1,651 | — | — |
| Other | 6 | 9 | 36 | — | 32 | — | 83 |
| Total Current Assets | 11,221 | 9,325 | (21,457) | 17 | 2,138 | — | 1,244 |
| Property, Plant and Equipment, net | — | — | 3,150 | — | 3,009 | — | 6,159 |
| Restricted Cash and Securities | 18 | — | 25 | — | 84 | — | 127 |
| Goodwill and Other Intangibles, net | — | — | 540 | — | 1,451 | — | 1,991 |
| Investment in Subsidiaries | (8,043) | (13,041) | 3,484 | — | — | 17,600 | — |
| Other Assets, net | 11 | 76 | 15 | — | 15 | — | 117 |
| Total Assets | \$ 3,207 | \$ (3,640) | \$ (14,243) | \$ 17 | \$ 6,697 | \$ 17,600 | \$9,638 |
| Liabilities and Stockholders' Equity (Deficit) | | | | | | | |
| Current Liabilities: | | | | | | | |
| Accounts payable | \$ 3 | \$ — | \$ 147 | \$ — | \$ 215 | \$ — | \$ 365 |
| Current portion of long-term debt | 181 | — | 1 | 1 | 3 | — | 186 |
| Accrued payroll and employee benefits | — | — | 97 | — | 8 | — | 105 |
| Accrued interest | 24 | 93 | — | — | — | — | 117 |
| Current portion of deferred revenue | — | — | 96 | — | 72 | — | 168 |
| Other | — | 1 | 59 | — | 51 | — | 111 |
| Total Current Liabilities | 208 | 94 | 400 | 1 | 349 | — | 1,052 |
| Long-Term Debt, less current portion | 2,079 | 4,216 | 7 | 19 | 73 | — | 6,394 |
| Deferred Revenue, less current portion | — | — | 630 | — | 89 | — | 719 |
| Other Liabilities | 44 | 97 | 284 | — | 172 | — | 597 |
| Stockholders' Equity (Deficit) | 876 | (8,047) | (15,564) | (3) | 6,014 | 17,600 | 876 |
| Total Liabilities and Stockholders' Equity (Deficit) | \$ 3,207 | \$ (3,640) | \$ (14,243) | \$ 17 | \$ 6,697 | \$ 17,600 | \$9,638 |

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(16) Condensed Consolidating Financial Information (Continued)

Condensed Consolidating Balance Sheets
December 31, 2007

| | Level 3 Communications, Inc. | Level 3 Financing, Inc. | Level 3 Communications, LLC | Broadwing Financial Services, Inc. | Other Subsidiaries | Eliminations | Total |
|---|------------------------------------|-------------------------------|-----------------------------------|---|-----------------------|------------------|-----------------|
| | (dollars in millions) | | | | | | |
| Assets | | | | | | | |
| Current Assets: | | | | | | | |
| Cash and cash equivalents | \$ — | \$ 27 | \$ 588 | \$ — | \$ 99 | \$ — | \$ 714 |
| Marketable securities | 8 | — | — | — | 1 | — | 9 |
| Restricted cash and securities | — | — | 7 | — | 3 | — | 10 |
| Accounts receivable, net | — | — | 80 | — | 324 | — | 404 |
| Due from (to) affiliates | 10,575 | 8,549 | (20,897) | 20 | 1,753 | — | — |
| Other | 7 | 8 | 32 | — | 41 | — | 88 |
| Total Current Assets | 10,590 | 8,584 | (20,190) | 20 | 2,221 | — | 1,225 |
| Property, Plant and Equipment, net | — | — | 3,256 | — | 3,413 | — | 6,669 |
| Restricted Cash and Securities | 18 | — | 24 | — | 75 | — | 117 |
| Goodwill and Other Intangibles, net | — | — | 151 | — | 1,950 | — | 2,101 |
| Investment in Subsidiaries | (6,951) | (11,270) | 4,481 | — | — | 13,740 | — |
| Other Assets, net | 16 | 84 | 17 | — | 25 | — | 142 |
| Total Assets | \$ 3,673 | \$ (2,602) | \$ (12,261) | \$ 20 | \$ 7,684 | \$ 13,740 | \$10,254 |
| Liabilities and Stockholders' Equity (Deficit) | | | | | | | |
| Current Liabilities: | | | | | | | |
| Accounts payable | \$ — | \$ — | \$ 170 | \$ — | \$ 226 | \$ — | \$ 396 |
| Current portion of long-term debt | 25 | — | — | 1 | 6 | — | 32 |
| Accrued payroll and employee benefits | — | — | 88 | — | 9 | — | 97 |
| Accrued interest | 33 | 95 | — | — | — | — | 128 |
| Deferred revenue | — | — | 91 | — | 84 | — | 175 |
| Other | — | — | 47 | — | 97 | — | 144 |
| Total Current Liabilities | 58 | 95 | 396 | 1 | 422 | — | 972 |
| Long-Term Debt, less current portion | 2,511 | 4,217 | — | 20 | 84 | — | 6,832 |
| Deferred Revenue | — | — | 644 | — | 119 | — | 763 |
| Other Liabilities | 34 | 37 | 208 | — | 338 | — | 617 |
| Stockholders' Equity (Deficit) | 1,070 | (6,951) | (13,509) | (1) | 6,721 | 13,740 | 1,070 |
| Total Liabilities and Stockholders' Equity (Deficit) | \$ 3,673 | \$ (2,602) | \$ (12,261) | \$ 20 | \$ 7,684 | \$ 13,740 | \$10,254 |

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(16) Condensed Consolidating Financial Information (Continued)

Condensed Consolidating Statements of Cash Flows
For the year ended December 31, 2008

| | Level 3 Communications, Inc. | Level 3 Financing, Inc. | Level 3 Communications, LLC (dollars in millions) | Broadwing Financial Services, Inc. | Other Subsidiaries | Eliminations | Total |
|--|------------------------------------|-------------------------------|--|---|-----------------------|--------------|--------|
| Net Cash Provided by (Used in) Operating Activities | \$ (149) | \$ (377) | \$ (159) | \$ (1) | \$ 1,099 | \$ — | \$ 413 |
| Cash Flows from Investing Activities: | | | | | | | |
| Capital expenditures | — | — | (160) | — | (289) | — | (449) |
| Proceeds from sale of business group, net | — | — | — | — | 124 | — | 124 |
| (Increase) decrease in restricted cash and securities, net | — | — | 3 | — | (8) | — | (5) |
| Proceeds from sale of property, plant and equipment and other assets | — | — | 1 | — | 2 | — | 3 |
| Other | — | — | 2 | — | 4 | — | 6 |
| Net Cash Used in Investing Activities | — | — | (154) | — | (167) | — | (321) |
| Cash Flows from Financing Activities: | | | | | | | |
| Long-term debt borrowings | 400 | — | — | — | — | — | 400 |
| Payments on and repurchases of long-term debt | (431) | — | — | (1) | (4) | — | (436) |
| Increase (decrease) due from affiliates, net | 245 | 360 | 282 | 2 | (889) | — | — |
| Other | 2 | — | — | — | — | — | 2 |
| Net Cash Provided by (Used in) Financing Activities | 216 | 360 | 282 | 1 | (893) | — | (34) |
| Effect of Exchange Rates on Cash and Cash Equivalents | — | — | (2) | — | (2) | — | (4) |
| Net Change in Cash and Cash Equivalents | 67 | (17) | (33) | — | 37 | — | 54 |
| Cash and Cash Equivalents at Beginning of Period | — | 27 | 588 | — | 99 | — | 714 |
| Cash and Cash Equivalents at End of Period | \$ 67 | \$ 10 | \$ 555 | \$ — | \$ 136 | \$ — | \$ 768 |

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(16) Condensed Consolidating Financial Information (Continued)

Condensed Consolidating Statements of Cash Flows
For the year ended December 31, 2007

| | Level 3 Communications, Inc. | Level 3 Financing, Inc. | Level 3 Communications, LLC | Broadwing Financial Services, Inc. | Other Subsidiaries | Eliminations | Total |
|--|------------------------------------|-------------------------------|-----------------------------------|---|-----------------------|--------------|---------|
| | (dollars in millions) | | | | | | |
| Net Cash Provided by (Used in) Operating Activities | \$ (229) | \$ (306) | \$ (146) | \$ (15) | \$ 927 | \$ — | \$ 231 |
| Cash Flows from Investing Activities: | | | | | | | |
| Proceeds from sale and maturity of marketable securities | 280 | — | — | — | 53 | — | 333 |
| Decrease in restricted cash and securities, net | — | — | 1 | — | 11 | — | 12 |
| Capital expenditures | — | — | (271) | — | (362) | — | (633) |
| Acquisitions, net of cash acquired and investments | — | — | (893) | — | 217 | — | (676) |
| Proceeds from sale of discontinued operations | — | (2) | — | — | — | — | (2) |
| Proceeds from sale of property, plant and equipment and other assets | — | — | 2 | — | 3 | — | 5 |
| Net Cash Provided by (Used in) Investing Activities | 280 | (2) | (1,161) | — | (78) | — | (961) |
| Cash Flows from Financing Activities: | | | | | | | |
| Long-term debt borrowings, net of issuance costs | — | 2,349 | — | — | — | — | 2,349 |
| Payments on and repurchases of long-term debt, including current portion and refinancing costs | (1,619) | (887) | — | (1) | (111) | — | (2,618) |
| Proceeds from warrants and stock-based equity plans | 26 | — | — | — | — | — | 26 |
| Increase (decrease) due from affiliates, net | 1,527 | (1,139) | 300 | 16 | (704) | — | — |
| Net Cash Provided by (Used in) Financing Activities | (66) | 323 | 300 | 15 | (815) | — | (243) |
| Effect of Exchange Rates on Cash and Cash Equivalents | — | — | 3 | — | 3 | — | 6 |
| Net Change in Cash and Cash Equivalents | (15) | 15 | (1,004) | — | 37 | — | (967) |
| Cash and Cash Equivalents at Beginning of the Year | 15 | 12 | 1,592 | — | 62 | — | 1,681 |
| Cash and Cash Equivalents at End of the Year | \$ — | \$ 27 | \$ 588 | \$ — | \$ 99 | \$ — | \$ 714 |

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(16) Condensed Consolidating Financial Information (Continued)

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

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

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(22) Unaudited Quarterly Financial Data

| | Three Months Ended | | | | | | | |
|----------------------------|---|-----------|-----------|-----------|---------------|-----------|--------------|-----------|
| | March 31, | | June 30, | | September 30, | | December 31, | |
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| | (dollars in millions except per share data) | | | | | | | |
| Revenue | \$1,092 | \$1,056 | \$1,090 | \$1,052 | \$1,070 | \$1,061 | \$1,049 | \$1,100 |
| Operating Income (Loss) | (52) | (75) | (3) | (79) | 4 | (58) | 82 | (29) |
| Net Income (Loss) | (181) | (647) | (33) | (202) | (120) | (174) | 44 | (91) |
| Earnings (Loss) per Share: | | | | | | | | |
| Basic | \$ (0.12) | \$ (0.44) | \$ (0.02) | \$ (0.13) | \$ (0.08) | \$ (0.11) | \$ 0.03 | \$ (0.06) |
| Diluted | \$ (0.12) | \$ (0.44) | \$ (0.02) | \$ (0.13) | \$ (0.08) | \$ (0.11) | \$ (0.03) | \$ (0.06) |

Earnings (loss) per share for each quarter is computed using the weighted-average number of shares outstanding during that quarter, while earnings (loss) per share for the year is computed using the weighted-average number of shares outstanding during the year. Thus, the sum of the earnings (loss) per share for each of the four quarters may not equal the earnings (loss) per share for the year.

In the second quarter of 2008, the Company completed the sale of its Vyvx advertising distribution business to DG FastChannel, Inc. and a recognized a gain of \$96 million.

In the fourth quarter of 2008, the Company recognized a \$12 million restructuring charge, \$44 million of induced debt conversion expenses attributable to the exchange of certain of the Company's convertible debt securities, and a gain on the early extinguishment of debt of \$125 million as a result of certain debt repurchases. The Company also revised its estimates of the amounts and timing of its original estimate of undiscounted cash flows related to certain future asset retirement obligations and reduced selling, general and administrative expenses by \$86 million and depreciation and amortization by \$11 million.

In the first quarter of 2007, the Company purchased Broadwing and the CDN Business. The Company also recognized a \$427 million net loss on the extinguishment of various debt instruments in several transactions.

In the third quarter of 2007, the Company purchased Servecast Limited.

In the fourth quarter of 2007, the Company recognized a \$37 million gain related to the partial sale of its investment in Infinera stock and recognized a tax benefit of \$23 million related to certain changes in state income tax law that primarily occurred in the second quarter of 2007.

SEPARATION AGREEMENT AND GENERAL RELEASE

This Separation Agreement and General Release ("Agreement") is entered into by and between John N. Hobbs ("EMPLOYEE") and LEVEL 3 COMMUNICATIONS, LLC, its parent and affiliated companies ("COMPANY"). In the event that the EMPLOYEE signs and does not revoke this Agreement, the Agreement shall become effective and enforceable on the expiration date of the seven day revocation period referenced in paragraph 14 (the "Effective Date").

In connection with certain organizational changes, COMPANY and EMPLOYEE have determined that it is in their mutual best interests to end their employment relationship. Because COMPANY wants to recognize the service of EMPLOYEE and because EMPLOYEE and COMPANY wish to end the relationship without any disputes or differences following execution of this Agreement, and in consideration for the mutual promises contained herein, EMPLOYEE and COMPANY agree as follows:

1. EMPLOYEE'S employment with and position as an officer of the COMPANY will be terminated effective December 31, 2008. EMPLOYEE shall execute the Resignation attached hereto as Exhibit "A".
2. If EMPLOYEE signs and does not revoke this Agreement, subject to the terms of this Agreement, on the Effective Date, COMPANY will pay to EMPLOYEE, in all cases less withholding for federal and state taxes and less appropriate payroll deductions: the amount of Five Hundred Thousand Dollars (\$500,000.00). Such payment shall be made in a lump sum distribution as soon as administratively feasible after the effective date of this Agreement (as set forth in Paragraph 14(d)) but in no event later than April 1, 2009. In addition, if EMPLOYEE elects such coverage, COMPANY will provide to EMPLOYEE COBRA benefit continuation coverage for one month. The costs associated with these additional benefits shall be deemed separation pay that COMPANY has offered to EMPLOYEE freely and without obligation and in consideration for this Agreement.
3. As additional consideration for this Agreement, subject to the terms of this Agreement, if EMPLOYEE signs and does not revoke this Agreement, upon the Effective Date, EMPLOYEE will be entitled to the following:
 - 3.1 Outperform Stock Options ("OSOs"). EMPLOYEE and COMPANY are parties to an Outperform Stock Option Master Award Agreement ("OSO Master Award Agreement"), which incorporates and is governed by the Level 3 Communications, Inc. 1995 Stock Plan, as amended and restated (the "Stock Plan"). Notwithstanding the terms of the OSO Master Award Agreement, EMPLOYEE'S fully vested OSO's shall, consistent with the terms of the OSO Master Award Agreement, be exercisable for a period of one year following EMPLOYEE'S termination date. No OSOs shall be exercisable beyond the date upon which they expire under the terms of the applicable OSO Master Award Agreement. In addition, EMPLOYEE expressly recognizes and agrees, notwithstanding the terms of the OSO Master Award Agreement, that with respect to any OSO award where the period in which to exercise has been modified herein, the Adjusted Initial Price may never be below the Initial Price as set forth in the Outperform Stock Option Award Letter of the corresponding OSO(s). Any OSO awards that are not vested prior to the termination date shall be forfeited.
 - 3.2 Restricted Stock Units ("RSUs"). EMPLOYEE and COMPANY are parties to an Amended Master Deferred Issuance Stock Agreement, which incorporates and is governed by the Stock Plan. Consistent with the above-referenced Amended Master Deferred Issuance Stock Agreement, EMPLOYEE has been awarded RSUs, and as of December 31, 2008, 602,898 RSUs have restrictions that have not lapsed. Notwithstanding the terms of the Amended

Master Deferred Issuance Stock Agreement, the restrictions on 477,898 RSUs shall all lapse on December 31, 2008.

- 3.3 EMPLOYEE shall receive the full amount of any discretionary bonus awarded to EMPLOYEE for calendar year 2008, as such bonus amount is determined in the sole discretion of the Level 3 Communications, Inc.'s Compensation Committee, taking into account the COMPANY'S performance, the EMPLOYEE's performance, and other such factors as the Compensation Committee deems appropriate. EMPLOYEE agrees that any discretionary bonus amount determined by the Compensation Committee for calendar year 2008 shall only be paid to EMPLOYEE as a severance benefit. Such bonus payment, if any, shall be made in a lump sum distribution as soon as administratively feasible, but in no event later than May 1, 2009.
- 3.4 COMPANY reserves the right to make, and the EMPLOYEE hereby consents to, any amendments to the Plan, the EMPLOYEE'S Amended Master Issuance Deferred Stock Agreement, RSU Award Letters, OSO Master Award Agreements, and Outperform Stock Option Award letters, as COMPANY deems necessary to comply with the provisions of Section 409A of the Internal Revenue Code of 1986, and the applicable rules and regulations thereunder.
- 3.5 Except as provided here in, EMPLOYEE will not be entitled to any additional awards or vesting in any of the COMPANY'S stock plans, stock option plans, or other benefit plans. *In addition, nothing in the Agreement is intended to nor shall modify the actual expiration date of any award of OSOs.*
4. Notwithstanding any provision in this Agreement to the contrary, any payment or delivery of securities otherwise required to be made hereunder to EMPLOYEE, at any date as a result of the termination of EMPLOYEE'S employment (other than any payment made in reliance upon Treas. Reg. Section 1.409A-1(b)(9) (Separation Pay Plans) or Treas. Reg. Section 409A-1(b)(4) (Short-Term Deferrals)) shall be delayed for such period of time as may be necessary to meet the requirements of Section 409A(a)(2)(B)(i) of the Internal Revenue Code of 1986, as amended (the "Code"). On the earliest date on which such payments or deliveries can be made without violating the requirements of Section 409A(a) (2)(B)(i) of the Code, there shall be paid or delivered to EMPLOYEE, in a single cash lump sum or delivery, as the case may be, an amount equal to the aggregate amount of all payments or deliveries delayed pursuant to the preceding sentence.
5. Except as provided herein, this Agreement shall expressly and unconditionally supersede and render void any and all claims, rights, title or interest in or with respect to any employee compensation, commission payments, or benefit to which EMPLOYEE may have been entitled by virtue of his employment with COMPANY, excluding claims relating to social security, workers' compensation or unemployment insurance benefits.
6. Release and Covenant Not To Sue. In exchange for the benefits offered herein, EMPLOYEE hereby releases and discharges COMPANY, its directors, officers, employees, agents or successors and assigns, of and from any demands or claims, of whatever kind or nature, whether known or unknown, arising out of his employment or separation from employment with COMPANY, except for the unwaivable claims referred to above and any indemnification rights available in the Certificate of Incorporation or by-laws at the time of an indemnification claim, if any. EMPLOYEE waives these claims on behalf of himself and on behalf of his heirs, assigns, and anyone who may or does make a claim in his behalf. The claims waived and discharged include, but are not limited to: claims of breach of express or implied contract, promissory estoppel, detrimental reliance, wrongful discharge, infliction of emotional distress, claims under the Employee Retirement Income Security Act of 1974 or the Family and Medical Leave Act of 1993, the WARN Act, or claims of discrimination under the Title VII of the Civil Rights Act of 1964, as

amended, the Age Discrimination in Employment Act of 1967, as amended, the Americans with Disabilities Act of 1990, the Sarbanes Oxley Act of 2002, the Internal Revenue Code, or any other local, state or federal law or regulation, as of the date of this Agreement. EMPLOYEE specifically agrees and covenants not to sue COMPANY, its predecessors, successors and assigns, as well as past and present officers, directors, and employees for any of the above mentioned claims, or any other claim related to his employment and EMPLOYEE represents and warrants that he has not filed any such claim to date.

7. Non Disparagement; Cooperation. EMPLOYEE will engage in no conduct and make no statements that are derogatory about or detrimental to COMPANY or any of its officers or employees. COMPANY, through any of its leadership at the level of Group Vice President and above, will engage in no conduct and make no statements that are derogatory about or detrimental to EMPLOYEE. EMPLOYEE further agrees to continue to cooperate with the COMPANY and its representatives in all pending and future claims and litigation against the COMPANY for which he may have information and knowledge, and further agrees to cooperate with COMPANY with respect to wrapping up matters where he was involved, including necessary debriefings.
8. Company Information, Property and Intellectual Property.

EMPLOYEE affirms that

- (a) s/he has turned over to his/her manager any information in his/her custody that is (i) considered a COMPANY record; (ii) subject to a legal hold; or (iii) otherwise critical to the conduct of Level 3 business; and that he/she has not deleted, removed or altered and will not delete or otherwise remove or alter any data or configuration from any COMPANY equipment or system without prior written approval from his/her direct supervisor; and
 - (b) with the exception of the COMPANY issued personal computer ("COMPANY Computer") s/he has returned or will promptly return to COMPANY all COMPANY equipment, Confidential Information, and other materials and that s/he will not at any time, except as authorized by the Chief Executive Officer of COMPANY, for his/her own benefit or the benefit of any other person or entity, disclose or cause to be disclosed any information, materials, systems, procedures, processes, manuals, forms, customer or employee lists, business plans or other trade secrets or confidential information regarding COMPANY. Prior to his Termination Date, EMPLOYEE will make the COMPANY Computer available to allow COMPANY to remove all COMPANY information it deems necessary. EMPLOYEE shall not be allowed to take ownership of the COMPANY Computer unless and until he has allowed COMPANY access as set forth herein. EMPLOYEE further acknowledges and agrees that s/he continues to be bound by the COMPANY'S Intellectual Property and Confidential Information policies, previously acknowledged by EMPLOYEE, copies of which are attached hereto as Exhibit "B".
9. No Solicitation/No Competition. EMPLOYEE agrees, for a period of 12 months beyond EMPLOYEE'S termination date set forth in paragraph 1 above, that he will not: (a) directly or indirectly solicit the services of, induce away from employment with, or hire any employee of COMPANY or its affiliates during their employment with COMPANY; (b) solicit from any corporation, firm, or organization that is a customer of COMPANY any business, service, or product that the COMPANY is providing said customer; (c) induce or attempt to induce any customer, supplier, licensee or other business relation of the COMPANY to cease doing business with the COMPANY or interfere with the relationship between any such customer, supplier, licensee or business relation and COMPANY; or (d) directly or indirectly engage in, own, manage, be employed by, assist, loan money to, or promote business for any person or entity who or which is engaged in the same business as COMPANY, offers for sale the same products or services as the COMPANY, or otherwise is a competitor of COMPANY, without the express written consent of

the Chief Executive Officer of the COMPANY. Section 9(d) shall be limited to: (i) companies that include within their corporate structure competitive local exchange carrier(s) and/or incumbent local exchange carrier(s), which with affiliates have, for their most recent fiscal year, annual consolidated total communications revenue equal to or greater than \$1 Billion; or (ii) providers of content delivery network services which with affiliates have, for their most recent fiscal year, consolidated total content delivery network revenues greater than \$50 million; or (iii) international communication services providers which with affiliates have a presence in the United States and, with affiliates, have, for their most recent fiscal year, annual consolidated total revenue equal to or greater than \$1Billion; or (iv) XO Holdings, Inc., Global Crossing Ltd., Qwest Communications International Inc., AT&T Inc., Sprint Nextel Corporation, Time Warner Telecom Inc., Verizon Communications Inc., Limelight Networks, Inc., Akamai Technologies Inc., PAETEC Holding Corp., Reliance Communications Venture Limited, including in each case their affiliates, successors and assigns.

10. Remedies. EMPLOYEE agrees further that if he breaches or otherwise acts inconsistent with the provisions of Paragraphs 6, 7, 8 or 9, COMPANY'S obligations under the provisions of Paragraphs 2 and 3 are terminated, and COMPANY may bring an action in a court of competent jurisdiction and recover as liquidated damages pursuant to the terms of Paragraph 2 and 3 of this Agreement, its costs and attorney's fees and any other available remedy. EMPLOYEE also expressly acknowledges that any breach or threatened breach of Paragraphs 8 or 9 might cause irreparable injury to the COMPANY and that money damages may not provide an adequate remedy at law for such injury. To the extent there is litigation involving this Agreement, the party who substantially prevails shall be entitled to their fees and expenses.
11. Non-Admission. This Agreement will not in any way be construed as an admission by COMPANY of a violation of any federal, state or local law or ordinance, or any enforceable right of EMPLOYEE, and COMPANY specifically denies any wrongdoing on its part, or on the part of its directors, employees or agents.
12. Headings. The headings of the sections herein are included solely for convenience of reference and, whether included or not, shall not control the meaning or interpretation of any of the provisions of this Agreement.
13. Review and Acknowledgment. This Separation Agreement and General Release sets forth the entire agreement between EMPLOYEE and COMPANY and may not be modified or canceled in any manner except in writing and signed by both parties. EMPLOYEE hereby acknowledges that COMPANY has made no representations or promises to me other than those contained in this Agreement. If any provision of this Agreement is found to be unenforceable, that provision will be enforced to the greatest extent permitted by law and all other provisions will remain fully enforceable.

This Agreement will be governed by Colorado law. Any action to enforce the terms of this Separation Agreement and General Release will be brought exclusively in state or federal court located in the City and County of Denver, Colorado and EMPLOYEE and COMPANY consent to personal jurisdiction and venue in those courts.

14. ***EMPLOYEE acknowledges that he has read and understands the following notifications:***
 - (a) ***EMPLOYEE is advised to and understands his opportunity to consult with an attorney regarding the Agreement before executing it;***
 - (b) ***EMPLOYEE acknowledges that he executes this Agreement having been advised and understands that it releases any and all claims under the Age Discrimination in Employment Act of 1967;***

- (c) *EMPLOYEE acknowledges that he was provided this Agreement on December 31, 2008 and that he has up to forty-five (45) days in which to consider and accept this Agreement;*
- (d) *EMPLOYEE may revoke this Agreement at any time within seven (7) days following execution of this Agreement by delivering written notice of such revocation to Thomas C. Stortz, Executive Vice President, 1025 Eldorado Boulevard, Broomfield, Colorado 80021, and that this Agreement will not become effective or enforceable until the expiration of this seven (7) day revocation period;*
- (e) *by entering into this Agreement, EMPLOYEE has read and understands the terms of this Agreement, that his signature below is truly voluntary, and that he has entered into this Agreement knowingly and willfully.*

DATED this 31st day of December, 2008

EMPLOYEE

/s/ John N. Hobbs

John N. Hobbs

COMPANY

/s/ Thomas C. Stortz

By: Thomas C. Stortz
Title: EVP

QuickLinks

[Exhibit 10.33](#)

[SEPARATION AGREEMENT AND GENERAL RELEASE](#)

CONSULTING AGREEMENT

This CONSULTING AGREEMENT (" *Agreement* ") is made as of the 31st day of December, 2008 (the " *Effective Date* ") by and between **LEVEL 3 COMMUNICATIONS, LLC** , a Delaware limited liability company (" *Company* "), whose address is 1025 Eldorado Boulevard, Broomfield, CO 80021 and **HOBBS MANAGEMENT, LLC** , a limited liability company (" *Consultant* "), whose address is 1845 Sugarloaf Club Drive, Duluth, GA, 30097. Company and Consultant hereby agree as follows:

1. **Services** . During the term of this Agreement, Consultant agrees to perform the following work and services: operations analysis and support, capital raising support, regulatory and government affairs support, market positioning and strategy, customer targeting, sales, mergers and acquisitions support, and any other activities related to his prior responsibilities with Company, requested by a President, Chief Operating Officer, or Chief Executive Officer, to be performed at such locations as are designated by Company ("Services"). The Services to be provided by Consultant to Company shall be performed by John N. Hobbs. Consultant shall be available to provide Company the Services under this Agreement for such time as reasonably requested by Company. As used in this Agreement, references to Consultant shall include all of Consultant's managers, officers, members and employees.
2. **Representations** . Consultant represents and warrants that the execution of this Agreement and the performance of Consultant's obligations hereunder shall not violate the terms of any other agreement or any rule, law, order or consent decree by which Consultant or John N. Hobbs is bound.
3. **Term** . Unless earlier terminated, the term of this Agreement shall be from the Effective Date to June 30, 2009, unless earlier terminated as provided herein.
4. **Consideration** . In consideration for Consultant's full and timely performance of the Services, Company shall pay Consultant the sum of Fifty Thousand Dollars (\$50,000.00) per month, payable in arrears on the 1st day following each month of this Agreement.
5. **Expenses and Administrative Support** . Subject to the Company's travel and expense reimbursement policies, the Company shall reimburse Consultant for Consultant's reasonable expenses incurred in performing the Services. Company will provide Consultant with administrative support, to the extent it is necessary for the performance of Services. In addition, Consultant shall be allowed to continue the use of Company's computer during the term of this Agreement, but will not have access to Company's computer network. All expenses to be reimbursed shall be submitted directly to Thomas C. Stortz for payment.
6. **Independent Contractor** . Consultant and Company, expressly intending that no employment, partnership, or joint venture relationship is created by this Agreement, hereby agree as follows:
 - A. Consultant shall act at all times as an independent contractor hereunder and is not an employee, partner, or co-venturer of, or in any other relationship with Company. The manner in which Consultant's services are rendered shall be within Consultant's sole control and discretion.
 - B. Neither Consultant nor anyone employed by or acting for or on behalf of Consultant shall ever be construed as an employee of Company and Company shall not be liable for employment or withholding taxes or any benefits respecting Consultant or any employee of Consultant.
 - C. Consultant shall determine when, where and how Consultant shall perform the Services.

- D.** Consultant shall take all steps to ensure that Consultant and Consultant's employees (if any) are treated as independent contractors of Company.
- E.** Consultant expressly acknowledges and agrees that except to the extent expressly provided in Sections 5 and 6 above, neither Consultant nor anyone employed by or acting for or on behalf of Consultant shall receive or be entitled to any consideration, compensation or benefits of any kind from Company, including without limitation, pension, stock options, profit sharing or similar plans or benefits, or accident, health, medical, life or disability insurance benefits or coverages.
- F.** To the extent permitted by law, Consultant, for Consultant and for anyone claiming through Consultant, waives any and all rights to any consideration, compensation or benefits, except as expressly provided for herein.
- 7. *Indemnity* .** Consultant shall indemnify and hold harmless Company and its officers, directors, agents and employees, from and against any and all claims, demands, causes of action, losses, damages, costs and expenses (including reasonable attorneys' fees) arising out of or relating to Consultant's execution of this Agreement, Consultant's performance of the Services, a breach of the Consultant's representations contained in this Agreement or any claim for withholding or other taxes that might arise or be imposed due to this Agreement or the performance of the Services, except to the extent such claim, demand, cause of action, loss, damage, cost and expense is caused solely by the negligent acts or failures to act of Company, its officers, directors, agents and employees, in which case Company shall indemnify and hold Consultant harmless from any and all claims, demands, causes of action, losses, damages, costs and expenses (including reasonable attorney fees) to the extent and in the same proportion as said loss or damage was caused by Company's (or its officers, directors, agents and employees') negligent acts or failures to act.
- 8. *Confidential Information*.** All information and materials disclosed during the performance of this Agreement shall be subject to the Non-Disclosure Agreement dated December 15, 2008, executed by John N. Hobbs and the Company, which is incorporated herein and is considered a material part of this Agreement.
- 9. *Confidentiality of Agreement*.** The terms of this Agreement, and the proposal of and discussions relating to this Agreement, are and shall remain confidential as between the parties, unless, and to the extent, disclosure is required by law or to secure advice from a legal or tax advisor.
- 10. *Standard of Conduct*.** In rendering Services under this Agreement, Consultant shall conform to high professional standards of work and business ethics.
- 11. *Public Relations*.** This Agreement shall not be construed as granting to Consultant any right to use any of Company or its affiliates' trademarks, service marks or trade names, or otherwise refer to Company in any marketing, promotional or advertising materials or activities. Without limiting the generality of the forgoing, Consultant shall not disclose (i) the terms and conditions of this Agreement, or (ii) the existence of the project or any contractual relationship between Company and Consultant, except as is reasonably necessary to perform the Services, or (iii) issue any publication or press release relating directly or indirectly to (i) or (ii) above; without Company's prior written consent.
- 12. *No-Solicitation / No Competition*.** Consultant agrees, that for a period of 12 months from the Effective Date, it, or any of its employees, including John N. Hobbs as well as the Consultant's officers, directors, and managers, will not: (a) directly or indirectly, solicit the services of, induce away from employment with, or hire any employee of Company or its affiliates during their employment with Company and for a period of six months after they are no longer employed by Company, without Company's prior written consent; (b) solicit, directly or indirectly, for himself or on behalf of a third party any corporation, firm, or organization that is a customer of Company

any business, service or product that the Company is providing said customer; (c) without the express written consent of the Chief Executive Officer of the Company, which consent will not be unreasonably withheld, directly or indirectly engage in, own, manage, be employed by, assist, loan money to, or promote any business, for any person or entity; or (d) directly or indirectly engage in, own, manage, be employed by, assist, loan money to, or promote any business, for any person or entity who or which is engaged in the same business of Company, offers for sale the same products or services of the Company, or otherwise is a Competitor of Company. Section 12(d) shall be limited to: (i) companies that include within their corporate structure competitive local exchange carrier(s) and/or incumbent local exchange carrier(s), which with affiliates have, for their most recent fiscal year, annual consolidated total communications revenue equal to or greater than \$1 Billion; or (ii) providers of content delivery network services which with affiliates have, for their most recent fiscal year, consolidated total content delivery network revenues greater than \$50 million; or (iii) international communication services providers which with affiliates have a presence in the United States and, with affiliates, have, for their most recent fiscal year, annual consolidated total revenue equal to or greater than \$1 Billion; or (iv) XO Holdings, Inc., Global Crossing Ltd., Qwest Communications International Inc., AT&T Inc., Sprint Nextel Corporation, Time Warner Telecom Inc., Verizon Communications Inc., Limelight Networks, Inc., Akamai Technologies Inc., PAETEC Holding Corp., Reliance Communications Venture Limited, including in each case their affiliates, successors and assigns.

- 13. *Conceptions.*** Consultant acknowledges that Company is engaged in a continuous program of research, development and marketing in connection with its business and that, in the performance of the Services, Consultant may participate in and support such activities. To the extent that Consultant participates in or supports such activities on behalf of Company, Consultant hereby agrees to promptly disclose exclusively to Company all improvements, original works of authorship, process, computer programs, ideas, discoveries, techniques, data bases and trade secrets ("*Conceptions*"), whether or not patentable or copyrightable, that are made, conceived, first reduced to practice or created by Consultant, either alone or jointly with others. Consultant further agrees that all Conceptions that (a) are developed using equipment, supplies, facilities or trade secrets of Company, or (b) result from or are any way connected with the Services performed by Consultant, or (c) relate to the business or the actual or anticipated research or development of Company, including any "moral" rights under any copyright or other similar law, shall be the sole and exclusive property of, and are hereby automatically assigned to, Company. Consultant agrees to assist Company in obtaining and enforcing all rights and other legal protections for the Proprietary Information and the Conceptions and to execute any and all documents that Company may reasonably request in connection therewith. Consultant's agreement set forth in the preceding sentence shall continue throughout the period of five (5) years following the termination or expiration of this Agreement; however, Company agrees to pay Consultant reasonable consideration for time actually spent and sufficiently documented by Consultant for such assistance during such five (5) year period.
- 14. *Termination.*** To the extent the Company, through its Compensation Committee Chairman, provides a consent pursuant to Section 12 (c), the Company's payment obligations under this Agreement shall cease as of the date of such consent.

Company may terminate this Agreement for "cause". For purposes of this Agreement "cause" shall mean the Company's good faith determination that the Consultant or Consultant's employees has committed any of the following in breach of this Agreement: (1) failure to provide Services; (2) conduct that is materially injurious to Company or any of its affiliates; (3) fraud, theft or embezzlement or any other material act of dishonesty with respect to Company or its affiliates; (4) willful use or imparting of any confidential or proprietary information of Company or an affiliate; (5) a felony or crime involving moral turpitude; or (6) Consultant's employment with or

performance of any work or services on behalf of any other company, person, or other entity, including any self-employment.. In the event that Company reasonably believes, in good faith, that Consultant has breached the Agreement, Company shall provide Consultant prior written notice of such alleged breach (the "Alleged Breach Notice"), which notice shall identify with reasonable particularity the basis for such belief, along with the provision of the Agreement that Company alleges has been breached. If Consultant disagrees with Company's belief as set forth in the Alleged Breach Notice, Consultant and the Chairman of the Compensation Committee, on Company's behalf, shall attempt in good faith to resolve the dispute within fourteen (14) business days of Consultant's receipt of the Alleged Breach Notice. If Consultant and Company are unable to definitively resolve the dispute and Company, in good faith, maintains its position that Consultant has breached the Agreement, Company shall promptly send a second notice to Consultant (the "Notice of Breach"). If Consultant does not cure such alleged breach within five (5) business days of receipt of the Notice of Breach, Company may take any action at law or in equity that it may otherwise have against Consultant, including terminating the Agreement, and paying to Consultant the pro-rata amount due for Services performed as of the date of termination. Except for such payment, Company's payment obligations under this Agreement shall cease.

If this Agreement is terminated, the provisions of Sections 2, 6, 7, 8, 9, 11, 12 (but not Section 12(c)), 13, 17, 18, 19, 20, and 21 shall survive and be enforceable by either party to this Agreement.

15. *Assignment.* Neither this Agreement nor any rights or obligations created hereby may be assigned by either party and any attempt to do so shall be void, provided, however, Company may freely assign this Agreement to Company affiliates and subsidiaries and in connection with a change in control of Company.

16. *Notice.*

A. Whenever under the provisions of this Agreement it shall be necessary or desirable for one party to serve any notice, request, demand, report or other communication on another party, the same shall be in writing and shall be served (i) personally; (ii) by independent, reputable, overnight commercial carrier; or (iii) by electronic transmission where the sender is able to obtain verification of receipt and review, and where the electronic transmission is immediately followed by service of the original of the subject item in the manner provided in clause (i), or (ii) hereof; addressed as follows:

If to Company: Level 3 Communications, LLC
Attn: Chief Legal Officer
1025 Eldorado Blvd.
Broomfield, CO 80021
Facsimile (720) 888-5127

If to Consultant: Hobbs Management, LLC
Attn: John N. Hobbs
1845 Sugarloaf Club Drive
Duluth, GA 30097

B. Any party may, from time to time, by notice in writing served upon the other party as aforesaid, designate an additional and/or a different mailing address or an additional and/or a different person to whom all such notices, requests, demands, reports and communications are thereafter to be addressed. Any notice, request, demand, report or other communication served personally shall be deemed delivered upon receipt, if received by independent courier shall be deemed delivered on the date of receipt as shown by the addressee's registry or

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Exhibit 10.34

CONSULTING AGREEMENT

LEVEL 3 COMMUNICATIONS, INC.
STATEMENT REGARDING COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES AND
PREFERRED STOCK DIVIDENDS

| | Fiscal Year Ended | | | | |
|---|-----------------------|-------------------------|-----------------------|-----------------------|-----------------------|
| | 2008 | 2007 | 2006 | 2005 | 2004 |
| Loss from Continuing Operations Before Income Taxes | \$(284) | \$(1,136) | \$(788) | \$(702) | \$(477) |
| Interest on Debt, Net of Capitalized Interest | 534 | 577 | 648 | 530 | 485 |
| Amortization of Capitalized Interest | 48 | 68 | 68 | 68 | 68 |
| Interest Expense Portion of Rental Expense | 68 | 63 | 44 | 25 | 29 |
| Earnings (Losses) Available for Fixed Charges | <u>\$ 366</u> | <u>\$ (428)</u> | <u>\$ (28)</u> | <u>\$ (79)</u> | <u>\$ 105</u> |
| Interest on Debt | <u>\$ 534</u> | <u>\$ 577</u> | <u>\$ 648</u> | <u>\$ 530</u> | <u>\$ 485</u> |
| Preferred Dividends | — | — | — | — | — |
| Interest Expense Portion of Rental Expense | 68 | 63 | 44 | 25 | 29 |
| Total Fixed Charges | <u>\$ 602</u> | <u>\$ 640</u> | <u>\$ 692</u> | <u>\$ 555</u> | <u>\$ 514</u> |
| Ratio of Earnings to Fixed Charges | — | — | — | — | — |
| Deficiency | <u><u>\$(236)</u></u> | <u><u>\$(1,068)</u></u> | <u><u>\$(720)</u></u> | <u><u>\$(634)</u></u> | <u><u>\$(409)</u></u> |

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LEVEL 3 COMMUNICATIONS, INC. STATEMENT REGARDING COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES AND PREFERRED STOCK DIVIDENDS

[QuickLinks](#) -- Click here to rapidly navigate through this document

Exhibit 21

Significant Subsidiaries As of and for the Fiscal Year ending December 31, 2008

Level 3 Communications, Inc.
Level 3 Financing, Inc.
Level 3 Communications, LLC
Broadwing, LLC
Broadwing Communications Holdings, LLC
Broadwing Communications, LLC
TelCove Operations, LLC
WilTel Communications Group, LLC
WilTel Communications, LLC
Vyvx, LLC
BTE Equipment, LLC
Level 3 International, Inc.
Level 3 Holdings, B.V.
Level 3 Communications Limited (UK)
Level 3 Communications GmbH (Germany)
Level 3 Holdings, Inc.
KCP, Inc.

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[Significant Subsidiaries As of and for the Fiscal Year ending December 31, 2008](#)

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Level 3 Communications, Inc.:

We consent to the incorporation by reference in the registration statements (Nos. 333-53914, 333-91899, 333-68887, 333-71713, 333-115062, 333-125262, 333-130710, 333-132695, 333-134668, 333-136413, 333-139836, 333-139838, 333-153644, 333-154976, and 333-156709) on Form S-3 and the registration statements (Nos. 333-79533, 333-42465, 333-68447, 333-58691, 333-52697, 333-115472, and 333-115751) on Form S-8 of Level 3 Communications, Inc. of our reports dated February 27, 2009, with respect to the consolidated balance sheets of Level 3 Communications, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of operations, cash flows, changes in stockholders' equity (deficit) and comprehensive loss for each of the years in the three-year period ended December 31, 2008, and the effectiveness of internal control over financial reporting as of December 31, 2008, which reports appear in the December 31, 2008 annual report on Form 10-K of Level 3 Communications, Inc.

/s/ KPMG LLP

Denver, Colorado
February 27, 2009

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[Consent of Independent Registered Public Accounting Firm](#)

CERTIFICATIONS*

I, James Q. Crowe, certify that:

1. I have reviewed this annual report on Form 10-K of Level 3 Communications, Inc.;
2. Based on my knowledge, this annual 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: February 27, 2009

/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).

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[CERTIFICATIONS](#)

CERTIFICATIONS*

I, Sunit S. Patel, certify that:

1. I have reviewed this annual report on Form 10-K of Level 3 Communications, Inc.;
2. Based on my knowledge, this annual 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: February 27, 2009

/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).

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[CERTIFICATIONS](#)

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

In connection with the Form 10-K of Level 3 Communications, Inc. (the "Company") for the year ended December 31, 2008 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

James Q. Crowe
Chief Executive Officer
February 27, 2009

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

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

In connection with the Form 10-K of Level 3 Communications, Inc. (the "Company") for the year ended December 31, 2008 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

Sunit S. Patel
Chief Financial Officer
February 27, 2009

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

LEVEL 3 COMMUNICATIONS INC

FORM 10-K (Annual Report)

Filed 02/29/08 for the Period Ending 12/31/07

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

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LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2007

OR

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

For the transition period from _____ to _____

Commission file number: 0-15658

Level 3 Communications, Inc.

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

47-0210602

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

1025 Eldorado Boulevard, Broomfield, Colorado

(Address of principal executive offices)

80021-8869

(Zip code)

(720) 888-1000

(Registrant's telephone number including area code)

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

Common Stock, par value \$.01 per share

The NASDAQ Stock Market LLC

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

None

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition 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 Act). Yes No

As of June 30, 2007 the aggregate market value of common stock held by non-affiliates of the registrant approximated \$6.5 billion based upon the closing price of the common stock as reported on the NASDAQ Global Select Market as of the close of business on that date. Shares of common stock held by each executive officer and director and by each entity that owns 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

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

| Title | Outstanding |
|---|---------------------------------------|
| Common Stock, par value \$.01 per share | 1,545,421,165 as of February 26, 2008 |

DOCUMENTS INCORPORATED BY REFERENCE

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

Portions of the Company's Definitive Proxy Statement for the 2008 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K

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Unless the context otherwise requires, when we use the words "Level 3," "we," "us" or "our company" in this Form 10-K, we are referring to Level 3 Communications, Inc., a Delaware corporation, and its subsidiaries, unless it is clear from the context or expressly stated that these references are only to Level 3 Communications, Inc. In this Form 10-K, we may refer to our former subsidiary Software Spectrum, Inc. and its subsidiaries as "Software Spectrum."

The Level 3 logo and Level 3 are registered service marks of our wholly owned subsidiary, Level 3 Communications, LLC, in the United States and other countries. All rights are reserved. This Form 10-K refers to trade names and trademarks of other companies. The mention of these trade names and trademarks in this Form 10-K is made with due recognition of the rights of these companies and without any intent to misappropriate those names or marks. All other trade names and trademarks appearing in this Form 10-K are the property of their respective owners.

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

This Form 10-K contains forward-looking statements and information that are based on the beliefs of our management as well as assumptions made by and information currently available to us. When we use the words "anticipate", "believe", "plan", "estimate" and "expect" and similar expressions in this Form 10-K, as they relate to us or our management, we are intending to identify forward-looking statements. These statements reflect our current views 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, our actual results may vary materially from those described in this document. These forward-looking statements include, among others, statements concerning:

- our communications business, its advantages and our strategy for continuing to pursue our business;
- anticipated development and launch of new services in our business;
- anticipated dates on which we will begin providing certain services or reach specific milestones in the development and implementation of our business strategy;
- growth of the communications industry;
- expectations as to our future revenue, margins, expenses, cash flows and capital requirements; and
- other statements of expectations, beliefs, future plans and strategies, anticipated developments and other matters that are not historical facts.

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

- integrate strategic acquisitions;
 - increase the volume of traffic on our network;
 - defend our intellectual property and proprietary rights;
 - successfully complete commercial testing of new technology and information systems to support new services;
 - develop new services that meet customer demands and generate acceptable margins;
 - attract and retain qualified management and other personnel; and
-

- meet all of the terms and conditions of our debt obligations.

Except as required by applicable law and regulations, we undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. Further disclosures that we make on related subjects in our additional filings with the SEC or Securities and Exchange Commission should be consulted. For further information regarding the risks and uncertainties that may affect our future results, please review the information set forth below under "ITEM 1A. RISK FACTORS."

Part I

ITEM 1. BUSINESS

Unless the context otherwise requires, when we use the words "Level 3," "we," "us" or "our company" in this Form 10-K, we are referring to Level 3 Communications, Inc., a Delaware corporation, and its subsidiaries, unless it is clear from the context or expressly stated that these references are only to Level 3 Communications, Inc. Throughout this Form 10-K we use various industry terms and abbreviations, which we have defined in the Glossary of Terms at the end of this description of our business.

Through our operating subsidiaries, we engage primarily in the communications business.

We are 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. We have created our communications network generally by constructing our own assets, but also through a combination of purchasing and leasing other companies and facilities. Our network is an advanced, international, facilities based communications network. We designed our network to provide communications services, which employ and take advantage of rapidly improving underlying optical, Internet Protocol, computing and storage technologies.

Market and Technology Opportunity. We believe that ongoing technology advances in both optical and Internet Protocol technologies have been revolutionizing the communications industry. We also believe that these advances have, and will continue to, facilitate decreases in unit costs for communications service providers that are able to most effectively take advantage of these technology advances. Service providers that can effectively take advantage of technology improvements and reduce unit costs will be able to offer lower prices, which, we believe, will stimulate substantial increases in the demand for communications services. We believe there are two primary factors that are continuing to drive this market dynamic:

- *Rapidly Improving Technologies.* Over the past few years, both Internet Protocol or IP and optical based networking technologies have undergone extremely rapid innovation, due, in large part, to market based development of underlying technologies. This rapid technology innovation has resulted in both an improvement in price-performance for optical and Internet Protocol systems, as well as rapid improvement in the functionality and applications supported by these technologies. For example, these improvements are enabling voice over IP services or VoIP that are challenging traditional telephone network or PSTN services. We believe that this rapid innovation will continue well into the future across a number of different aspects of the communications marketplace.
- *High Demand Elasticity.* We believe decreases in communications services costs and prices cause the development of new bandwidth-intensive applications, which, over time, result in even more significant increases in bandwidth demand. In addition, we believe that communications services are direct substitutes for other, existing modes of information distribution from sources such as traditional broadcast entertainment as well as distribution of software, audio and video content using physical media delivered using motor transportation systems. An example of this dynamic is the use of the Internet for the distribution of video entertainment.

We believe that as communications services improve more rapidly than these alternative content distribution systems, significant demand will be generated from these sources of information. We also believe that high elasticity of demand from both these new applications and the substitution for existing distribution systems will continue for the foreseeable future. We believe that while high demand elasticity will be manifested over time, government regulation and communications supply chain inefficiencies may cause realization of demand to be delayed.

We also believe that there are significant implications that result from this market dynamic. These implications include the following:

- *Incorporating Technology Changes.* Given the rapid rate of improvement in optical and Internet Protocol technologies, communications service providers that are most effective at rapidly deploying new services that take advantage of these technologies will have an inherent cost and service advantage over companies that are less effective at deploying new services that use these technologies.
- *Capital Intensity.* The rapid improvements in these technologies and the need to move to new technologies more quickly results in shortened economic lives of underlying assets. To achieve improvements in service capabilities and unit cost reductions, service providers will need to deploy new generations of technology sooner, resulting in a more capital-intensive business model. Those providers with the technical, operational and financial ability to take advantage of the rapid advancements in these technologies are expected to have higher absolute capital requirements, shortened asset lives, rapidly decreasing unit costs and prices, rapidly increasing unit demand and higher cash flows and profits.

Our Communications Business Strategy

We are seeking to capitalize on the opportunities presented by the expanded coverage of our communications network as well as the significant and rapid advancements in optical and Internet Protocol technologies. Key elements of our strategy include:

- *Offer a Comprehensive Range of Communications Services Over Our End-to-End Network.* We provide a comprehensive range of communications services designed to meet the needs of our customers over our network. Beginning in 2006, we expanded our targeted customer base to include enterprise or business customers through the acquisitions we completed during 2006 and early 2007.

Our communications service offerings include:

- Internet Protocol and data services—including (1) Internet access and IP and Ethernet Virtual Private Networks and (2) broadband transport services such as wavelengths, dark fiber and private line services (transoceanic, backhaul, intercity, metro and unprotected private line services);
- content distribution services including caching and video broadcast services;
- colocation services; and
- Softswitch and voice services—including wholesale VoIP component services, enterprise or business voice services, wholesale voice origination and termination services and managed modem for the dial-up access business.

The availability of these services varies by location.

For several years we have been developing services that take advantage of the investment that we have made in our network and that generally target large, existing markets for communications services. We have also expanded our existing markets for communications

services through the acquisitions we completed in 2006 and early 2007 that enabled us to offer services directly to enterprise or business customers. Through these efforts we have increased significantly our addressable market by adding new targeted customers as well as new voice and data services that take advantage of the geographic coverage and cost advantages of our network.

With respect to our wholesale customers, we provide these customers with several options for accessing our intercity network—including our metropolitan networks and colocation facilities. Our metropolitan networks enable us to connect directly to points of high traffic aggregation. These traffic aggregation facilities are typically locations where our customers wish to interconnect with our intercity network. Our metropolitan networks allow us to extend our network services to these aggregation points at low costs. With respect to our enterprise customers, we provide these customers with access to our network either by directly connecting to their location or by serving that location with a connection from another communications services provider. As of December 31, 2007, we have:

- approximately 77,000 intercity route miles in North America and Europe, which we expect to reduce to approximately 48,000 intercity route miles after we complete the integration of acquired companies, connecting 20 countries;
- approximately 125 markets having metropolitan fiber networks containing approximately 27,000 route miles in the United States and Europe; and
- approximately 7,300 traffic aggregation points and buildings in the aggregate.

We believe that providing colocation services in facilities directly connected to our network attracts communications intensive customers by allowing us to offer those customers reduced bandwidth costs, rapid provisioning of additional bandwidth, interconnection with other third party networks and improved network performance.

Additionally, our metropolitan networks allow us to compete for certain local communications traffic, which constitutes a significant percentage of the communications market. As of December 31, 2007, we had secured approximately 6.9 million square feet of space for our Gateway and transmission facilities and other technical space and had completed the build-out of approximately 4.6 million square feet of this space.

- *Provide Low Cost Backbone Services Through An Upgradeable Backbone Network.* Many portions of our originally constructed intercity and metropolitan networks were designed to provide high quality communications services at a lower cost. As we continue to integrate our acquired operations, our network and business processes will seek to enable us to cost effectively deploy future generations of optical and IP networking components (both fiber and transmission electronics and optronics) and thereby expand capacity and reduce unit costs. In addition, our strategy is to maximize the use of open, non-proprietary interfaces in the design of our network software and hardware. This approach is intended to provide us with the ability to purchase the most cost effective network equipment from multiple vendors and allow us to deploy new technology more rapidly and effectively.
- *Target Top Global Bandwidth Customers.* With respect to our wholesale service offerings, our primary distribution strategy is to use a national, direct sales force focused on high bandwidth usage businesses. These businesses include incumbent local exchange carriers, international carriers also known as PTTs, major internet service providers or ISPs, broadband cable television operators, wireless providers, major interexchange carriers, the U.S. government and enhanced service providers. Providing communications services to many of these businesses is at the core of our market enabling strategy. We identify as wholesale customers those customers that purchase significant amounts of capacity to serve the needs of their customers.

- *Further Develop Existing Enterprise Customer Business.* With respect to our business markets customers, our primary distribution strategy is to use a locally based direct sales force to target business customers, state governments, higher education institutions and academic consortia with high demands for mission critical communications services. In this category we also target regional carriers that make communications services buying decisions locally.
- *Develop Market Leading Content Distribution Service Offerings.* At December 31, 2007, we operated one of the largest Internet Protocol backbones in the world. In other words, we operate one of the largest networks over which Internet content is transported from content sources to third party owned access networks connected directly to end users. As a result of this network scale, in early 2007 we embarked on a strategy to refine our capabilities to address the communications needs of those organizations that produce the content that individuals want to view over the Internet. This service offering includes high speed IP services, colocation services and services that cost effectively distribute the content that is produced for consumption over the Internet. We believe that one of the largest sources of future incremental demand for communications services will be derived from customers that are seeking to distribute their feature rich content or video over the Internet. Furthermore, we believe that we are the only services provider with a single source, full portfolio of end-to-end content distribution solutions, and that we are in a unique position to offer a range of building blocks to meet these customers' needs.
- *Expand Metropolitan Network Coverage.* We expect to selectively extend the current reach of our existing metropolitan networks by opportunistically adding additional connections to buildings and other traffic aggregation points from these networks. These connections will enable us to reach additional potential customers and reduce our costs for the termination of our customers' communications traffic on other carriers' networks.
- *Pursue Acquisition Opportunities.* For a number of years, we have engaged in significant acquisition activities. In evaluating potential acquisition opportunities, among other criteria, we evaluate the potential acquisition according to the transaction's ability to generate positive cash flow from high credit quality customers. For these opportunities, we generally look for companies with recurring revenue that comes predominantly from services we already provide, in geographic areas that are already served, with customers that are consistent with our existing customer base. It is this group of acquisitions that generally also provide significant synergy opportunities as a result of overlapping network and service offerings.

As we seek to expand the addressable market for our services, we also evaluate opportunities that would expand our service capabilities. Transactions that would be included in this category would expand the geographic scope of our network or would provide capabilities for additional services or distribution channels. For these opportunities, we generally consider whether the targeted company's distribution strategy is consistent with our strategy and whether management believes that the target's current and/or future revenues can be significantly increased and/or expenses can be significantly reduced as a result of a combination with our operations. Generally these acquisition opportunities will not provide the same level of synergy opportunity that the category of acquisitions describe above provide to us.

- *Develop Advanced Operational Processes and Business Support Systems.* We have developed and continue to develop substantial and scalable operational processes and business support systems specifically designed to enable us to offer services efficiently to our targeted customers. We believe that over time these systems will reduce our operating costs, give our customers direct control over some of the services they buy from us and allow us to grow rapidly while minimizing redesign of our business support systems.

- *Attract and Motivate High Quality Employees.* We have developed programs designed to attract and retain employees with the technical and business skills necessary for our business. The programs include our long term incentive programs.

Our Strengths

We believe that the following strengths will assist us in implementing our strategy:

- *Experienced Management Team.* We have assembled a management team that we believe is well suited for our business objectives and strategy. Our senior management has substantial experience in leading the development, marketing and sale of communications services and in managing, designing and constructing metropolitan, intercity and international networks.
- *A Comprehensive Range of Communications Services.* We provide a comprehensive range of communications services designed to meet the needs of our customers over our network. Beginning in 2006, we expanded our targeted customer base to include enterprise or business customers.

Our communications service offerings include:

- Internet Protocol and data services—including (1) Internet access and IP and Ethernet Virtual Private Networks and (2) broadband transport services such as wavelengths, dark fiber and private line services (transoceanic, backhaul, intercity, metro and unprotected private line services);
- content distribution services including caching and video broadcast services;
- colocation services; and
- Softswitch and voice services—including wholesale VoIP component services, enterprise or business voice services, wholesale voice origination and termination services and managed modem for the dial-up access business.

The availability of these services varies by location.

For several years we have been developing services that take advantage of the investment that we have made in our network and that generally target large, existing markets for communications services. We have also expanded our existing markets for communications services through our acquisitions that enabled us to offer services directly to enterprise or business customers. Through these efforts we have increased significantly our addressable market by adding new targeted customers as well as new voice and data services that take advantage of the geographic coverage and cost advantages of our network.

- *Significant metropolitan network platform.* As of December 31, 2007, we have metropolitan fiber networks in approximately 125 markets in North America and Europe, which contain approximately 26,000 route miles and connect in the aggregate approximately 7,300 traffic aggregation points and buildings. Our metropolitan networks enable us to connect directly to points of high traffic aggregation and customer locations and reduce our costs for the termination of our customers' communications traffic on other carriers' networks.
- *End-to-End Network Platform.* Our strategy has been and continues to be to deploy network infrastructure in major metropolitan areas and to link these networks with significant intercity and trans-oceanic networks in North America and Europe. We believe that the integration of our metropolitan and intercity networks with our colocation facilities will expand the scope and reach of our on-net customer coverage, facilitate the uniform deployment of technological innovations as we manage our future upgrade paths and allow us to grow or scale our service

offerings rapidly. We believe that we are the only international communications service provider with the unique combination of:

- a substantial intercity network;
 - large fiber count metropolitan networks;
 - substantial colocation facilities; and
 - significant content distribution technology and services.
- *Advanced IP Backbone.* We operate one of the largest international IP networks or backbones. Our IP services deliver a broad range of IP transit and network interconnection solutions tailored to meet the varied needs of high bandwidth companies.
 - *Extensive Patent Portfolio.* Through acquisitions and through our own research and development, we have created an extensive patent portfolio, consisting of approximately 880 patents and patent applications filed in the United States and around the world. Our patent portfolio includes patents filed in each of the last three decades covering technologies ranging from data and voice services to content distribution to transmission and networking equipment. Most of our issued patents are not scheduled to expire for more than ten years. We have used our patent portfolio in a number of ways. First, developing or acquiring technologies and receiving the legal right to preclude others from using them may give us a competitive advantage. Second, the breadth and depth of our patent portfolio may deter others, particularly telecommunications operators, from bringing patent infringement claims against us for fear of counter-claim by us. We will continue to file new patent applications as we enhance and develop products and services, we will continue to seek opportunities to expand our patent portfolio through strategic acquisitions and licensing, and we will continue to enforce our patents against infringement by others.
 - *Softswitch based Co-Carrier Network.* Our experience in operating our Softswitch based co-carrier network is combined with a set of infrastructure and other management experiences, which include extensive local interconnection with local exchange carriers, experience in scaling a Softswitch based platform, and an ability to provide seamless interconnection to the traditional telephone network or PSTN. We believe that our extensive co-carrier network and Softswitch infrastructure provides us with a competitive advantage in the emerging voice over IP or VoIP marketplace.
 - *A More Readily Upgradeable Network Infrastructure.* With respect to a substantial portion of our network, the network was designed to take advantage of technological innovations, incorporating many of the features that are not present in older communication networks, and provide us flexibility to take advantage of future developments and innovations. We designed the transmission network to optimize all aspects of fiber and optronics simultaneously as a system to deliver the lowest unit cost to our customers. As fiber and optical transmission technology changes, we expect to realize new unit cost improvements by deploying the most cost efficient technologies in our network. We believe that our network design will enable us to lower costs and prices while enjoying higher margins than our competitors.

Our Communications Services

Customer Focused Organization

Beginning in August 2006, we realigned the customer interacting or customer facing aspects of our communications business into four groups to focus more effectively on the needs of our customers. These four groups are:

- Wholesale Markets Group
- Business Markets Group
- Content Markets Group; and
- Europe

This realignment was implemented to enable those employees in these customer facing roles to develop and deliver high quality communications services that are based on the needs of the customers that the group is seeking to serve. Each of these groups is supported by dedicated employees in sales and segment marketing. Each of the groups is also supported by centralized service or product management and development, general marketing, global network services, engineering, information technology, and corporate functions including legal, finance, strategy and human resources. It is through the Wholesale Markets, Business Markets, Content Markets and Europe groups that we offer a comprehensive range of communications services.

Wholesale Markets Group. The Wholesale Markets Group is focused on delivering communications services to meet the high bandwidth needs of many of the largest global communications services providers on a wholesale basis. The Wholesale Markets Group's customers integrate or package our services into their own products and services to offer voice, video and data services to their end-user customers.

The market segments that the Wholesale Markets Group addresses include:

- domestic and international carriers;
- voice service providers, which include calling card companies, conferencing providers, and contact centers that use VoIP technology to better manage costs and enable advanced applications;
- wireless providers;
- broadband cable television operators;
- system integrators; and
- the U.S. government.

Business Markets Group. The Business Markets Group is focused on delivering communications services to meet the telecommunications needs of: small, medium and large enterprises; regional carriers; higher education institutions and academic consortia; and state and local governments. Local and regional carriers include ISPs, enhanced service providers, application service providers, wireless providers, mobile virtual network operators, VoIP providers as well as datacenters and hosting facilities. The Business Markets Group focuses on providing its targeted customers with the full suite of data, Internet, transport and voice services.

Content Markets Group. As we believe that one of the largest sources of future incremental demand for communications services will be derived from customers that are seeking to distribute their feature rich content or video over the Internet, the Content Markets Group focuses on offering a range

of end-to-end communications services building blocks to meet the content distribution needs of its customers. Customers that the Content Markets Group serves include:

- video distribution companies;
- providers of online gaming and mega-portals;
- software service providers;
- social networking providers; and
- traditional media distribution companies including broadcasters, television networks and sports leagues.

Europe. The Europe group focuses on the communications needs of European customers and the European aspects of customers located outside of Europe. The Europe group target customers are similar to the target customers of the Wholesale Markets Group and the Content Markets Group.

Service Offerings

We offer a comprehensive range of communications services, which currently include the following services. All of these services are available to customers of each of the customer facing groups, however their availability varies by location. The following is an overview description of some of the services that we offer.

- *Network and Internet Services.* We offer both wholesale-oriented communications services to enable large scale networks and high speed access to the Internet as well as similar services designed for the enterprise marketplace. We offer a portfolio of data communications services ranging from basic network infrastructure components such as dark fiber, wavelength, and private line services to higher level routed data services such as Ethernet, Internet Transit and IP VPN. Our Network and Internet Services include the following.
- *Transport Services.* Transport services include wavelengths (Level 3 Intercity Wavelength Services and Level 3 Metro Wavelength Services) and private lines (Level 3 Intercity Private Line Services and Level 3 Metro Services). These services are available across our metropolitan and intercity fiber network. Wavelength services provide unprotected point-to-point connections of a fixed amount of bandwidth with Ethernet or SONET interfaces. Wavelength services are available at 2.5 Gbps and 10 Gbps speeds, which represent the largest capacity of dedicated transport services. This service offering targets customers that require significant amounts of bandwidth, desire more direct control and provide their own network management. Private line services are also point-to-point connections of dedicated bandwidth but usually include SONET or SDH protection to provide resiliency to fiber or equipment outages. Private line services are available in a range of speeds. Level 3 also offers Metro and Intercity Ethernet Private Line Services with Fast-E and Gig-E interfaces. Customers generally use our transport services to create their own SONET/SDH, ATM and IP networks. We typically offer transport services in annual contracts with monthly payments or long-term pre-paid agreements.

Level 3 also provides transport services within our transatlantic cable system connecting North America and Europe as well as via leased bulk capacity on other transoceanic systems. "International Backhaul" transport services, interconnecting cable landing stations and the terrestrial North American and European networks, are also available.

- *High Speed Internet Protocol (IP) Service.* Level 3 operates one of the largest international Internet backbones providing connectivity among customer IP, content and application networks. Built on our own intercity and metropolitan networks in North America and

Europe, we provide customers with high performance, reliability and scalability. Access to the Internet is enabled through interconnection among our customers across our network as well as interconnections with other Internet Service provider "peers."

- *Dedicated Internet Access.* Dedicated Internet Access, or DIA, is Level 3's Enterprise focused Internet access product leveraging the same core Internet backbone as our other Internet Services. Level 3 operates one of the largest international Internet backbones in the world and is regularly considered one of the most connected Internet networks. Level 3's Dedicated Internet Access service provides Internet connectivity over a Tier One Internet backbone through a wide variety of access methods and speeds. The service also includes Domain Name services, primary, secondary and caching and is available as either a stand-alone service or as a complement to our other communications services.
- *VPN Services.* Built on our optical transport and MPLS networks, we offer customers the ability to create private point-to-point, point-to-multipoint, and full-mesh networks based on IP VPN, Virtual Private LAN Service, or VPLS, ATM and Frame Relay technologies. These services allow service providers, corporations, government entities, and distribution businesses to replace multiple networks with a single, cost-effective solution that simplifies the transmission of voice, video, and data over a single or converged network. The service allows the customer to achieve this convergence without sacrificing the quality of service or security levels of traditional dedicated transport offerings. These solutions are used for service provider and corporate data and voice networks, data center networking, disaster recovery and out-of-region or redundant customer connectivity for other service providers.
- *Colocation Service.* We offer high quality, data center space where customers can locate servers, content storage devices and communications network equipment in a safe and secure technical operating environment. At our colocation sites, we offer high-speed, reliable connectivity to our network and to other networks, including metro and intercity networks, the traditional telephone network and the Internet.
- *Dark Fiber Service.* Level 3 Intercity Dark Fiber and Level 3 Metro Dark Fiber provide carriers, service providers, government entities and large enterprises a complete infrastructure when a fiber solution is required based on unique applications, control or scale requirements. The services include fiber, colocation space in our Gateway and in our network facilities, power and physical operations and maintenance of the fiber and associated infrastructure.
- *Content Distribution.* Our primary Content Distribution products and services include the following.
- *Content Delivery Network.* Our content delivery network services combine our IP network, gateway facilities and patented technology that directs a requestor or end user to the best location or server cluster in our network to retrieve the requested content based on location and network conditions. Our CDN services provide customers with improved cost performance, scalability, reliability and reach for their web applications. Our Caching and Download Services provide efficient delivery of large files such as video, software, security patches, audio and graphics to mass audiences. Our Streaming Services can be used to deliver high performance streams, either live or on-demand, to end users using leading proprietary protocols. We also offer storage solutions enabling customers to upload and store content to our network as part of an optimized delivery platform. In addition to our delivery services, our Intelligent Traffic Management software continuously monitors systems and Internet conditions and enables customers to set rules to dynamically route traffic to meet failover or dual vendor objectives.

- *Media Delivery Services.* Since the acquisition of Servecast in July 2007, we offer media delivery services to customers seeking to manage, protect and monetize content delivered over the internet. Media Delivery Services provide customers with means to ingest and digitize live video content and to manage the organization and presentation of both live and on demand video to end users via a content management system. Content may be secured to prevent unauthorized access, redistribution or syndication. Additionally, support for content monetization via paid and advertising supported models is provided. Media Delivery Services leverage our Content Delivery Network for the delivery of managed content to end users.
- *Fiber Optic and Satellite Video Transport Services.* We offer various products to provide audio and video feeds over fiber or satellite for broadcast and production customers. These products vary in capacity provided, frequency of use (that is, may be provided on an occasional or dedicated basis) and price. In 2004, Super Bowl® XXXVIII was the first live broadcast event ever carried using our new high definition (HD) transport product.
- *Advertising Distribution Services.* These services include Audio Distribution and Video Distribution. Our Audio Distribution services distribute radio spots to stations via electronic and physical distribution. Spots are distributed to over 10,500 stations in North America via the Internet using no proprietary hardware. Our Video Distribution services offer customers the capability to deliver video content electronically and physically to television stations, broadcast networks and cable networks across the United States.

On December 19, 2007, we announced that our wholly owned subsidiaries, WiTel Communications, LLC, Level 3 Communications, LLC and Vyvx, LLC, as the sellers, had entered into an Asset Purchase Agreement with DG FastChannel, Inc. Pursuant to the terms of the Purchase Agreement, the sellers will sell to DG FastChannel for cash certain assets relating to the Advertising Distribution Services business. Under the terms of the Purchase Agreement, we will receive \$129 million in cash upon the closing of the transaction. The purchase price is subject to certain post closing working capital adjustments. Consummation of the transaction is subject to customary closing conditions, including receipt of applicable federal regulatory approvals.

- *Switched Services.* We pioneered and developed the Softswitch—a distributed computer system that emulates the functions performed by traditional circuit switches—which enables us to control and process voice and data calls over an Internet Protocol network. We also offer several traditional circuit switch-based voice services. Our Switched Services include the following.
- *Level 3 VoIP Enhanced Local.* Level 3 VoIP Enhanced Local is a VoIP solution that enables broadband cable operators, IXCs, voice over IP providers, and other companies operating their own switching infrastructure to launch IP-based local and long-distance voice to residential and business customers via any broadband connection. With the purchase of Level 3 VoIP Enhanced Local service, a customer obtains the essential building blocks required to offer residential or business voice over IP phone service such as local phone numbers, local number portability, local and long distance calling, E-911, operator assistance, directory listings, and directory assistance.
- *Level 3 Local Inbound.* Level 3 Local Inbound service terminates traditional telephone network originated calls to Internet Protocol termination points. Customers, such as call centers, conferencing providers, and voice over IP service providers, can obtain telephone numbers from us or port-in local telephone numbers that the customer already controls. These local calls are then converted to IP and transported over our backbone to a customer's IP voice application at a customer-selected IP voice end point.

- *Level 3 E-911 Direct.* Level 3 E-911 Direct is a portfolio of E-911, or Enhanced 911, solutions, including a fixed-location solution with network connections to public safety answering points or PSAPs that serve approximately 70 percent of all U.S. households, and a solution for nomadic voice over IP providers that takes advantage of the same network connections as the fixed-location solution. Enhanced 911 service allows an emergency services operator to automatically receive information related to a 911 caller's registered address and callback phone number. A nomadic voice over IP provider is a company that permits its end user customer to use VoIP services from more than one location. Level 3 E-911 Direct provides the network capabilities that route and complete 911 calls to appropriate selective routers and PSAPs on the traditional telephone 911 network. When used with the services provided by a third party VoIP Positioning Center, or VPC, to collect, update and report subscriber location information, our Level 3 E-911 Direct service enables VoIP service providers to supply 911 services to their subscribers.
- *Level 3 One Plus.* Level 3 One Plus service provides non-facilities-based resellers, or carriers with regional networks, the ability to originate PSTN calls from anywhere in the continental US. Level 3 then terminates the domestic, international and Operator Services calls over our nationwide network, or customers may choose to have calls handed back to them over a dedicated facility. This service suite features Automatic Number Identification (ANI)-based and Carrier Identification Code (CIC)-based services as well as a dedicated end-user service.
- *Level 3 Enterprise Local and Long Distance Voice Services.* Level 3 Enterprise Local Voice Services provide PSTN connectivity for customer telephone equipment; telephone numbers, which include associated directory listings; standard services, which include operator services, directory assistance, and 911 services; and long-distance access, which provides equal access to all long-distance carriers, including Level 3. Level 3 Enterprise Long Distance services offer intrastate and interstate voice service at simple, cost-effective rates as well as access to over 290 international locations.
- *Level 3 Enterprise Toll-Free Services.* Level 3 Enterprise Toll-Free Services offer customers the ability to receive and pay for inbound calls, rather than those calls being paid for by the call originator. Additionally, a number of routing and call information features are available.
- *Level 3 Voice Termination.* Level 3 Voice Termination consists of long distance transport and termination services, offered over circuit switch or Softswitch technologies. These services are offered primarily to inter-exchange carriers, or IXCs, wireless providers, local phone companies, cable companies and voice over IP providers. We also offer the termination of international voice traffic over circuit switch or Softswitch technologies. Customers for these services include local phone companies, wireless providers, cable companies and voice over IP providers.
- *Level 3 Toll Free.* Level 3 Toll Free consists of services that terminate toll free calls that are originated or placed on the traditional telephone network. These toll free calls are carried over either a circuit switch or Softswitch network and delivered to customers in Internet Protocol or traditional TDM format. Customers for these services include call centers, conferencing providers, and voice over IP providers.
- *Level 3 Managed Modem.* Level 3 Managed Modem is an outsourced, turn-key infrastructure solution for the management of dial up access to the public Internet. ISPs comprise a majority of the customer base for Level 3 Managed Modem and are provided a fully managed dial up network infrastructure. As part of this service, Level 3 arranges for the provision of local network coverage, dedicated local telephone numbers, racks and modems as well as dedicated connectivity from the customer's location to the Level 3 Gateway facility.

For a discussion of certain geographic information regarding our revenue from external customers and long-lived assets, please see the notes to our Consolidated Financial Statements appearing elsewhere in this Form 10-K. For a discussion of our communications revenue, please also see Management's Discussion and Analysis of Financial Condition and Results of Operations appearing later in this Form 10-K. Our management continues to review our existing lines of business and service offerings to determine how those lines of business and service offerings assist with our focus on the delivery of communications services and meeting our financial objectives. This exercise takes place both with respect to integration activities and in the ordinary course of our business. To the extent that certain lines of business or service offerings are not considered to be compatible with the delivery of communications or with obtaining our financial objectives, we may exit those lines of business or stop offering those services.

Our communications network

Our network is an advanced, international, facilities based communications network. Today, we primarily provide services over our own facilities. At December 31, 2007, our network encompasses:

- approximately 67,000 intercity route miles in North America, which we expect to reduce to approximately 38,000 intercity route miles after we complete the integration of acquired companies;
- approximately 125 markets having metropolitan fiber networks containing approximately 27,000 route miles in the United States and Europe, connecting approximately 7,300 traffic aggregation points and buildings in the aggregate;
- local networks in approximately 116 North American markets;
- an intercity network covering approximately 10,000 miles across Europe;
- local networks in approximately 9 European markets;
- approximately 6.9 million square feet of Gateway and transmission facilities in North America and Europe; and
- a 1.28 Tbps capable transatlantic cable system currently equipped at 640 Gbps.

Intercity Networks. Our approximately 67,000 mile fiber optic intercity network in North America, which we expect will be approximately 38,000 miles after we complete our integration of acquired companies, consists of the following:

- **Multiple conduits.** In approximately 30,000 miles of our intercity network, we have installed groups of multiple conduits. We believe that the availability of spare conduit will allow us to deploy future technological innovations in optical networking components as well as providing us with the flexibility to offer conduit to other entities.
- **Initial installation of optical fiber strands designed to accommodate dense wave division multiplexing transmission technology.** In addition, we believe that the installation of newer optical fibers will allow a combination of greater wavelengths of light per strand, higher transmission speeds and longer physical spacing between network electronics. We also believe that each new generation of optical fiber will allow increases in the performance of these network design aspects and will therefore enable lower unit costs.
- **High speed Intercity Dense Wave Division Multiplexing, or DWDM, equipment providing high quality, reliable and cost effective transmission across our fiber backbone.** We are continually evaluating advancements in technology that will enable us to scale, lower our cost and provide higher speed services over our intercity network. We believe that the market will continue to move toward Ethernet based services and higher speed interfaces. Through our technology

evaluations we believe that we have positioned ourselves to be able to deliver these capabilities for both our own IP network needs as well as those of our customers.

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

During the first quarter of 2001, we completed our construction activities relating to our North American intercity network. Also during 2001, we completed the migration of customer traffic from our original leased capacity network to our completed North America intercity network. Deployment of the North American intercity network was accomplished through simultaneous construction efforts in multiple locations, with different portions being completed at different times. In 2003, we added approximately 2,985 miles to our North America intercity network as part of the Genuity transaction, and in 2005, we added approximately 30,000 miles (including IRUs) to our intercity network as part of the WilTel Communications transaction. In 2006 and January 2007, we added approximately 26,000 miles (including IRUs) to our North America intercity network as part of the various acquisitions during that period.

In Europe, we have completed construction of our fiber optic intercity network with characteristics similar to those of the North American intercity network in a multiple ring architecture. During 2000, we completed the construction of Ring 1 and Ring 2 of our European network. Ring 1, which is approximately 1,900 miles, connects the major European cities of Paris, Frankfurt, Amsterdam, Brussels and London and was operational at December 31, 2000. Ring 2, which is approximately 1,650 miles, connects the major German cities of Berlin, Cologne, Dusseldorf, Frankfurt, Hamburg, and Munich. Ring 2 became operational during the first quarter of 2001. Subsequently, we created two additional rings generally through IRU acquisitions to connect to our expanded operations in Europe that are described below. The first ring is approximately 2,150 miles and connects Copenhagen, Stockholm and Oslo and the second ring is approximately 1,700 miles and connects Milan, Zurich and Geneva.

During 2002, we completed an expansion of our European operations to seven additional cities. Our expansion to these additional locations was facilitated through the acquisition of available capacity from other carriers in the region. During 2003, we completed an expansion of our European operations to four additional cities. In addition, during 2004, we completed an expansion of our European operations to two cities. During 2005, we completed an expansion of our European operations to one city. During 2006, we obtained dark fiber primarily in those cities currently served by leased wavelength capacity and additionally in 2006 we completed an expansion of our European operations to 9 additional cities. During 2007, we obtained dark fiber in three cities that had been served by leased wavelength capacity and additionally in 2007 we completed an expansion of our European operations to 9 additional cities. In 2008, we expect to continue our European expansion to one additional city using leased wavelength capacity. We expect to use the dark fiber with appropriate transmission equipment to sell a full suite of transport and IP services.

Our European network is linked to our North American intercity network by the Level 3 transatlantic 1.28 Tbps capable cable system, which was also completed and placed into service during 2000. The transatlantic cable system—which we refer to as the Yellow system—has a current capacity of 640 Gbps and was upgradeable to 1.28 Tbps when brought into service. The deployment of the Yellow system was completed pursuant to a co-build agreement announced in February 2000, whereby Global Crossing Ltd. participated in the construction of, and obtained a 50% ownership interest in, the Yellow system. Under the co-build agreement, Level 3 and Global Crossing Ltd. each now separately own and operate two of the four fiber pairs on the Yellow system. We also acquired additional capacity on Global Crossing Ltd.'s transatlantic cable, Atlantic Crossing 1, during 2000 to serve as redundant capacity for our fiber pairs on the Yellow system. We also own capacity in the TAT14 cable system. In connection with the WilTel acquisition, we have secured additional capacity on Global Crossing's transatlantic cable, Atlantic Crossing 1, and TAT-14. In 2006, we purchased 300 Gigabits of transatlantic

capacity with the right to purchase 300 Gigabits of additional capacity from Apollo Submarine Cable System Ltd. In January 2007 we purchased 150 Gigabits of the additional capacity available from Apollo Submarine Cable System Ltd, 300 Gigabits in May 2007 and an additional 100 Gigabits in November 2007. We are also an owner on the Japan-US, and China-US cable systems, an IRU holder on Southern Cross cable system as well as an owner on the Americas II cable and an IRU holder on the Arcos system.

Local Market Infrastructure. Our local facilities include fiber optic metropolitan networks connecting our intercity network and Gateways to buildings housing communications-intensive end users and traffic aggregation points—including ILEC and CLEC central offices, long distance carrier points-of-presence or POPs, cable head-ends, wireless providers' facilities and Internet peering and transit facilities. As of December 31, 2007, we had in the aggregate approximately 7,300 traffic aggregation points and buildings connected to our metropolitan networks. Our high fiber count metropolitan networks allow us to extend our services directly to our customers' locations at low costs, because the availability of this network infrastructure does not require extensive multiplexing equipment to reach a customer location, which is required in ordinary fiber constrained metropolitan networks.

We had secured approximately 6.9 million square feet of space for our Gateway and transmission facilities as of December 31, 2007, and had completed the buildout of approximately 4.6 million square feet of this space. Our initial Gateway facilities were designed to house local sales staff, operational staff, our transmission and Internet Protocol routing and Softswitch facilities and technical space to accommodate colocation services—that is, the colocation of equipment by high-volume Level 3 customers, in an environmentally controlled, secure site with direct access to Level 3's network generally through dual, fault tolerant connections. Some of our facilities are larger than our initial facilities and were designed to include a smaller percentage of total square feet for our transmission and Internet Protocol routing/Softswitch facilities and a larger percentage of total square feet to support the sale of colocation services. Availability of these services varies by location.

As of December 31, 2007, we had operational, facilities-based, local metropolitan networks in 116 U.S. markets and 9 European markets.

As of December 31, 2007, we had approximately 145 markets in service in North America and approximately 42 markets in service in Europe.

Our Patent Portfolio

Through acquisitions and through our own research and development, we have created an extensive patent portfolio, consisting of approximately 880 patents and patent applications filed in the United States and around the world. Our patent portfolio includes patents filed in each of the last three decades covering technologies ranging from data and voice services to content distribution to transmission and networking equipment. Most of our issued patents are not scheduled to expire for more than ten years.

In addition to the patents and patent applications we own, we have received licenses to patents held by others, including through a recently-announced cross-license with IBM, giving us access to that company's more than 40,000 patents covering many technologies relevant to our business. While patents give us the right to prevent others, particularly competitors, from using our proprietary technologies, patent licenses give us the freedom to operate our business without the risk of interruption from the holder of the patent that has been licensed to us.

We have used our patent portfolio in a number of ways. First, developing or acquiring technologies and receiving the legal right to preclude others from using them may give us a competitive advantage. By way of example, at the end of 2007, we initiated a lawsuit against competitor Limelight Networks, Inc., alleging that that company infringes three of our patents relating to the distribution of content. That lawsuit is expected to go to trial before the end of 2008 and, if successful, could result in a court order prohibiting Limelight from using our patented technology in relevant service offerings. Second, the breadth and depth of our patent portfolio may deter others, particularly telecommunications operators, from bringing patent infringement claims against us for fear of counter-claim by us. There have been relatively few patent infringements brought against us to date. Most of those have been initiated by patent-holding companies who do not operate telecommunications businesses and who are less likely to be subject to a counter-claim of infringement by us. Finally, the extensiveness of our patent portfolio allows us to cross-license with others having similarly broad portfolios on terms acceptable to us, mitigating the risk that others will be able to assert patent infringement claims against us.

We will continue to file new patent applications as we enhance and develop products and services, we will continue to seek opportunities to expand our patent portfolio through strategic acquisitions and licensing, and we will continue to enforce our patents against infringement by others.

Our Content Delivery Network

Content Delivery Network, or CDN, describes a system of computers networked together across the Internet to provide content to users in the most efficient manner to enable an optimal user experience. In a CDN, nodes or groups of computers are deployed in multiple locations closer to the end user, also known as the "edge of the network" and cooperate with each other to satisfy requests for content by end users, transparently moving content behind the scenes to optimize the delivery process. Requests for content are directed intelligently through sophisticated software applications to nodes that provide optimal performance for end users.

Our content delivery network is a unique configuration of our hosting and network assets located in approximately 17 countries, which is designed to improve the performance, reliability, and reach of web applications.

We believe that as a result of the combination of our CDN assets and our other network infrastructure, we are strongly positioned to grow our market share in the CDN business. This belief is based on several factors.

- *Network Scale.* Because we own our own network, our ability to increase capacity to meet the needs of content providers is greater than other CDN providers who do not have the flexibility to quickly increase their available network capacity.
- *Network Reach.* Our customers reach global Internet destinations using an average number of "hops" that are fewer than with most any other provider, enabling our customers to easily reach their audiences and provide better performance. The fewer number of hops required by our customers to reach their Internet destinations serves to reduce latency and jitter.
- *Low Cost Position.* Because we own the underlying network infrastructure, we believe that we are positioned to offer cost advantages to our customers. By moving content at scale, our customers can take advantage of lower unit costs for bandwidth, colocation, servers and disk space.

CDN Applications

There are an increasing number of applications for CDN, across many types of customers, particularly Internet-centric businesses and businesses that desire to accommodate increasingly larger

file sizes for transmission over the Internet. The media and entertainment industries use CDN services to provide on-demand streaming and live streaming. Social Networking businesses require CDN to provide their customers with fast reliable music and video downloads. Likewise, through the use of CDN, software companies are able to provide software downloads for their customers. Online retailers and advertisers use CDN services to provide images and flash files and to download advertisements. Online gaming companies provide for game downloads, applications updates and delivery of demos and trailers through CDN.

Content Distribution Services Architecture

The CDN platform uses our existing physical network and infrastructure, and is composed of the Edge server or computer, which provides caching and streaming functions and the Global server, which provides load balancing—that is, a computer that directs the traffic to the most efficient server to meet the end users request. The Edge server enables the storage of popular content in a location that is closer to the end user and thereby reduces bandwidth requirements and improves client response times for content stored in the cache. The Global server or computer load balancing components of the CDN directs end user requests to the content source that is best able to serve the request of the particular end user, such as routing to the service noted that is closest to the end user or to the one with enough capacity to service the request of the end user.

We also transmit audio and video programming for our customers over our fiber-optic network and via satellite. We use our network to carry many live traditional broadcast and cable television events from the site of the event to the network control centers of the broadcasters of the event. These events include live sporting events of the major professional sports leagues. For live events where the location is not known in advance, such as breaking news stories in remote locations, we provide an integrated satellite and fiber-optic network based service to transmit the content to our customers. Most of our customers for these services contract for the service on an event-by-event basis; however, we have some customers who have purchased a dedicated point-to-point service, which enables these customers to transmit programming at any time.

We also distribute advertising spots to radio and television stations throughout the United States, both electronically and in physical form. Customers for these services can utilize a network-based method for aggregating, managing, storing and distributing content for content owners and rights holders. On December 19, 2007, we announced that our wholly owned subsidiaries, WilTel Communications, LLC, Level 3 Communications, LLC and Vyvx, LLC, as the sellers, had entered into an Asset Purchase Agreement with DG FastChannel, Inc. Pursuant to the terms of the Purchase Agreement, the sellers will sell to DG FastChannel for cash certain assets relating to the Advertising Distribution Services business. Under the terms of the Purchase Agreement, we will receive \$129 million in cash upon the closing of the transaction. The purchase price is subject to certain post closing working capital adjustments. Consummation of the transaction is subject to customary closing conditions, including receipt of applicable federal regulatory approvals.

Distribution Strategy

Our communications services sales strategy with respect to our Wholesale Markets Group and Europe is to utilize a direct sales force focused on companies with high bandwidth and/or voice requirements. These businesses include incumbent local exchange carriers, established next generation carriers, international carriers also known as PTTs, major ISPs, broadband cable television operators, major interexchange carriers, wireless carriers, systems integrators, governments, emerging VoIP service providers, calling card providers, conferencing providers and call centers.

With respect to our Business Markets Group, medium to large enterprises will be serviced by a field based direct sales force. Smaller business opportunities are serviced by an inside sales force

generally selling pre-defined bundles of services. We also compliment our direct sales force with an indirect sales channel of agent partners.

Our communications services sales strategy with respect to the Content Markets Group is also to utilize a direct sales force. Targeted customers include video distribution companies; providers of online gaming and mega-portals; software service providers; social networking providers; and traditional media distribution companies including broadcasters, television networks and sports leagues.

We have in place policies and procedures to review the financial condition of potential and existing customers. We apply these procedures to determine whether collectability of services billed is probable prior to the time that we begin delivering services to a customer. If the financial condition of an existing customer deteriorates to a point where payment for services is in doubt, we will not recognize revenue attributable to that customer until we receive cash. Based on these policies and procedures, we believe our exposure to collection risk within the communications business and the possible effect on our financial statements is limited. We may also experience the effects of possible downturns in the economy and specifically the telecommunications industry; however, we believe the concentration of credit risk with respect to receivables is mitigated due to the dispersion of our customer base among geographic areas and remedies provided by terms of contracts and statutes.

For the year ended December 31, 2007, our top ten customers represented approximately 34% of our consolidated total revenue. Revenue from our largest customer, AT&T Inc. and its subsidiaries, including SBC Communications, BellSouth and Cingular, (assuming those subsidiaries were wholly owned by AT&T for all of 2007), represented approximately 15% of our consolidated total revenue for 2007. The next largest customer accounted for approximately 5% of our consolidated total revenue and the remaining top ten customers each account for 3% or less of our consolidated total revenue.

In connection with the acquisition of WilTel in December 2005, we acquired a large customer contract between WilTel and SBC Communications, a subsidiary of AT&T. We expect that the revenue generated under this contract will continue to decline over time as SBC Communications migrates its traffic from our network to the merged SBC and AT&T Communications network that SBC Communications acquired from the former AT&T.

Business Support Systems

In order to pursue our sales and distribution strategies, we have developed and are continuing to develop and implement a set of integrated software applications designed to automate our operational processes. These development activities also relate to the integration of the systems that were used by the companies that we have acquired. Through the development of a robust, scalable business support system, we believe that we have the opportunity to develop a competitive advantage relative to traditional telecommunications companies. In addition, we recognize that for the success of certain of our services that some of our business support systems will need to be easily accessible and usable directly by our customers.

We are currently deploying a unified set of simplified processes and systems that are streamlining and synchronizing our service, sales, and operational functions through our "Unity" platform. Unity has been designed to provide improved capability in service catalog management, sales opportunity management, customer management, quoting, order entry, order workflow, physical and logical network inventory management, service management, and financial management.

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

- integrated modular applications to allow us to upgrade specific applications as new services are available;

- a scalable architecture that allows our customers and distributors direct access to certain functions that would otherwise have to be performed by our employees;
- phased completion of software releases designed to allow us to test functionality on an incremental basis;
- "web-enabled" applications so that on-line access to order entry, network operations, billing, and customer care functions is available to all authorized users, including our customers;
- use of a tiered, client/server architecture that is designed to separate data and applications, and is expected to enable continued improvement of software functionality at minimum cost; and
- use of pre-developed or commercial "off-the-shelf" applications, where applicable, which will interface to our internally developed applications.

Our Employees

As of December 31, 2007, we had approximately 6,680 employees. We believe that our success depends in large part on our ability to attract and retain substantial numbers of qualified employees.

Competition

The communications industry is highly competitive. A number of factors in recent years have increased the number of competitors in the market. First, the Telecommunications Act of 1996 created opportunities for non-incumbent providers to enter the marketplace. Second, the capital markets responded by making funding more available to new and existing competitors. Third, enthusiasm over the opportunities created by the rapid developments of the Internet led investors and market participants in general to overestimate the rate at which demand for communications services would grow. Finally, the emergence of new IP-based services has created prospects for new entrants with non-traditional business models to compete with legacy providers.

We believe that a confluence of these factors created an unsustainable level of competition in the market. We believe that this was evidenced by both the number of competitors vying for similar business and by the amount of inventory or capacity each brought to the market for many services. The result of these actions was an oversupply of capacity and an intensely competitive environment.

While we believe the current industry structure has improved significantly, we believe that further restructuring is likely. With the growth of communications demand, excess capacity is increasingly being absorbed. Similarly, some form of industry consolidation will continue to occur based on underlying economics. Given the large ongoing fixed costs associated with operating a backbone network, we believe that the natural industry structure will continue to evolve to a more limited number of competitors with each having high traffic scale across their networks.

While we believe that the long-run industry structure will evolve toward that described above, uncertainty surrounds how the existing competitive landscape will evolve toward this new structure. For example, while a number of next-generation and incumbent providers have been consolidated, we believe there are still a number of competitors operating fundamentally poor business models, are resource constrained, and are unlikely to be long-term survivors in their current forms. In addition, the ultimate effect of the completed acquisition transactions by AT&T and Verizon is yet to be known.

We believe that each competitor's long-run success in the market will be driven by its available resources (for example, financial, personnel, marketing, customers) and the effectiveness of its business model (for example, service focus and mix, cost effectiveness, ability to adapt to new technologies, channel effectiveness). We recognize that many of our existing and potential competitors in the communications industry have resources significantly greater than ours.

Our primary competitors are long distance carriers, incumbent local exchange carriers, competitive local exchange carriers, PTTs, Content Delivery Network companies, and other companies that provide communications services. The following information identifies key competitors for each of our product offerings.

Our key competitors for our voice service offerings are other providers of wholesale communications services including AT&T, Verizon, Sprint and competitive local exchange carriers. Our key competitors for managed modem services are other providers of dial up Internet access including Verizon and Qwest Communications.

For our IP and Data services, we compete with companies that include Verizon, Sprint, AT&T, Qwest Communications, Global Crossing, Cogent and XO in North America, and Sprint, Verizon, France Telecom, Deutsche Telecom, Global Crossing and Cogent in Europe.

For transport services, our key competitors in the United States are other facilities based communications companies including AT&T, Verizon, Sprint, Qwest Communications and XO. In Europe, our key competitors are other carriers such as PTTs, Telia International, Colt Telecom Group plc, Verizon, and Global Crossing.

Our key competitors for our colocation services are other facilities based communications companies, and other colocation providers such as web hosting companies and third party colocation companies. In the United States, these companies include AT&T, Savvis, Equinix, Switch & Data and Qwest Communications. In Europe, competitors include Global Switch, InterXion, Redbus, Teleticity and Telehouse Europe.

For enterprise services, our key competitors include incumbent local exchange carriers (such as AT&T, Verizon and Qwest), long distance services providers (such as Sprint), and competitive local exchange carriers (such as Time Warner Telecom and XO).

For content distribution network or CDN services, our key competitors include Akamai Technologies and Limelight Networks.

The communications industry is subject to rapid and significant changes in technology. For instance, recent technological advances permit substantial increases in transmission capacity of both new and existing fiber, and the introduction of new products or emergence of new technologies may reduce the cost or increase the supply of certain services similar to those which we plan on providing. Accordingly, in the future our most significant competitors may be new entrants to the communications industry, which—unlike the traditional incumbent carriers we also compete with—are not burdened by an installed base of outmoded or legacy equipment.

Regulation

Federal Regulation

The Federal Communications Commission or the FCC has jurisdiction over interstate and international communications services, among other things. The FCC's regulation of common carriers without market power, such as us, is less stringent than its regulation of dominant incumbent local exchange carriers. We have obtained FCC approval to land our transatlantic cable in the United States. We have obtained FCC authorization to provide international services on a facilities and resale basis. Under the Telecommunications Act of 1996 (the "1996 Act"), any entity, including cable television companies, electric and gas utilities, may enter any telecommunications market, subject to reasonable state regulation of safety, quality and consumer protection.

The FCC has pending a Notice of Proposed Rulemaking ("NPRM") to initiate a comprehensive review of rules governing the pricing of special access service offered by ILECs subject to price cap regulation. Special access pricing by these carriers currently is subject to price cap rules, as well as

pricing flexibility rules which permit these carriers to offer volume and term discounts and contract tariffs (Phase I pricing flexibility) and/or remove from price caps regulation special access service in a defined geographic area (Phase II pricing flexibility) based on showings of competition. In the NPRM the FCC tentatively concludes to continue to permit pricing flexibility where competitive market forces are sufficient to constrain special access prices, but undertakes an examination of whether the current triggers for pricing flexibility accurately assess competition and have worked as intended. The NPRM also asks for comment on whether certain aspects of ILEC special access tariff offerings (e.g., basing discounts on previous volumes of service; tying nonrecurring charges and termination penalties to term commitments; and imposing use restrictions in connection with discounts), are unreasonable. At this time, we cannot predict the impact, if any, that a ruling on the NPRM will have on our network cost structure.

Both AT&T and Verizon, in connection with large acquisitions, have agreed to abide by certain conditions that are enforceable by the FCC in connection with special access prices, terms and conditions. In December 2007, we filed a complaint against AT&T alleging, among other things, that AT&T had violated those commitments. At this stage, the proceeding is continuing and we intend to vigorously pursue our claims. We cannot at this time predict the outcome of that proceeding.

As of August 1, 2001, our tariffs for interstate end user services were eliminated and our tariffs for international interexchange services were eliminated on January 28, 2002. Our rates must still be just and reasonable and nondiscriminatory. Our state tariffs remain in place. We have historically relied primarily on our sales force and marketing activities to provide information to our customers regarding these matters and expect to continue to do so. Further, in accordance with the FCC's orders we maintain a schedule of our rates, terms and conditions for our domestic and international private line services on our web site.

Intercarrier compensation. Telecommunications carriers compensate one another for traffic carried on each other's networks. Interexchange carriers pay access charges to local telephone companies for long distance calls that originate and terminate on local networks. Local telephone companies typically charge one another for local and Internet-bound traffic terminating on each other's networks. The entire methodology by which carriers compensate one another for exchanged traffic, whether it be for local, intrastate or interstate traffic, is under review at the FCC.

Apart from this comprehensive review of intercarrier compensation, individual compensation issues have been the subject of FCC and state commission rulings. Since 1997 the issue of compensation to be paid for calls dialed to Internet service providers or ISPs has been heavily litigated. Since 2004, the issue of compensation to be paid in connection with the exchange of Voice over Internet Protocol or VoIP calls has been also been the subject of much debate.

While the FCC has released a number of orders asserting its jurisdiction over intercarrier compensation for ISP traffic, states such as California and Massachusetts have increasingly assumed the role of determining the compensation obligations as between the carrier serving the customer dialing the ISP and the carrier serving the ISP. RBOCs and other incumbent local exchange carriers typically assert that either they owe no compensation to the carrier serving the ISP or alternatively that they are owed compensation by such carrier.

There is also uncertainty in respect to intercarrier compensation for VoIP traffic. As in the ISP intercarrier compensation situation, the FCC has issued a number of rulings asserting its jurisdiction over such traffic, but to date it has not issued any rulings on the scope and rate of intercarrier compensation to be paid by carriers exchanging VoIP traffic. While carriers that serve VoIP providers such as Level 3 have typically asserted that VoIP traffic is local in nature and thereby subject to local compensation rates, the RBOCS and other incumbents have taken the position that some or all of this traffic should be subject to higher intrastate or interstate rates. Currently the FCC has two forbearance petitions before it requesting that the FCC either forbear from subjecting VoIP to the higher interstate

or intrastate rates, or alternatively to forbear from imposing rules that might be construed to require the payment of access charges on VoIP traffic terminated to the PSTN.

Until such time as the FCC acts in such a way as to either clarify its rulings on ISP compensation, VoIP compensation or rules on intercarrier compensation in its entirety, and such rules are final and non-appealable, the scope of intercarrier compensation obligations between carriers exchanging ISP or VoIP traffic is uncertain.

Prior to 2004, we entered into agreements providing for payment of compensation for terminating ISP-bound traffic with Verizon, in its former Bell Atlantic operating territory, with SBC Corporation for the 13-state operating territory that includes its affiliates Pacific Bell, Southwestern Bell, Ameritech and Southern New England Telephone, and with BellSouth in its nine-state operating territory. We also entered into interconnection agreements with Qwest, Cincinnati Bell Telephone, and Sprint that reflect the intercarrier compensation rates adopted by the FCC in its ISP Remand Order.

In late 2003, we reached an agreement with SBC, now AT&T, continuing payment for the exchange of ISP-bound traffic. In February 2005, we and SBC agreed to successor interconnection agreements which cover the payment for the exchange of ISP traffic and treating VoIP traffic as subject to dispute. The SBC agreement expired on December 31, 2006. Level 3 and SBC continue to provide services and exchange payments under that agreement until a successor agreement is reached.

In May 2004, we reached a new interconnection agreement with Bell South, now AT&T, that incorporated terms contained in FCC orders relating to ISP-bound traffic. Level 3 and BellSouth agreed that compensation for VoIP traffic was disputed. BellSouth requested renegotiation of this agreement in early October 2006; the parties continue to provide services and exchange payments under the agreement until a successor agreement is reached.

As a result of representations regarding the extension of interconnection agreements made by AT&T to the FCC in connection with its merger with BellSouth, we have requested that AT&T extend the BellSouth and SBC (now AT&T) interconnection agreements for a three-year period with an effective termination date of January 10, 2011. We are awaiting a response from AT&T.

In September 2004, Level 3 and Verizon amended our existing interconnection agreements to establish intercarrier compensation terms. The compensation section of amendments to those agreements expired in August 2007. Level 3 and Verizon will continue to provide services under these agreements until successor agreements are executed.

We are negotiating new agreements with each of these carriers but at this time cannot predict what the final terms will be, including compensation for ISP-bound traffic or VoIP traffic. Given the general uncertainty surrounding the effect of the FCC and state decisions and appeals, we may have to change (1) how we treat the compensation we receive for terminating calls bound for ISPs if the agreements under which compensation is paid provided for the incorporation of changes in FCC rules and regulations; (2) the manner in which we account for the compensation and costs of intercarrier compensation for VOIP.

Universal Service. Level 3 is subject to federal and state regulations that implement universal service support for access to communications services in rural, high-cost and low-income markets at reasonable rates; and access to advanced communications services by schools, libraries and rural health care providers. Currently, the FCC assesses Level 3 a percentage of interstate revenue it receives from retail customers as its contribution to the federal Universal Service Fund. The FCC is currently considering changing the method by which our contributions are assessed to a flat-fee charge, such as a per-line or per-number charge. Any change in the assessment methodology may affect Level 3's revenues but at this time, it is not possible to predict the extent we would be affected if at all.

State Regulation

The 1996 Act is intended to increase competition in the telecommunications industry, especially in the local exchange market. With respect to local services, ILECs are required to allow interconnection to their networks and to provide unbundled access to network facilities, as well as a number of other pro-competitive measures. Because the implementation of the 1996 Act is subject to numerous state rulemaking proceedings on these issues, it is currently difficult to predict how quickly full competition for local services will be realized.

State regulatory agencies have jurisdiction when our facilities and services are used to provide intrastate telecommunications services. A portion of our traffic may be classified as intrastate telecommunications and therefore subject to state regulation. We expect that we will offer more intrastate telecommunications services (including intrastate switched services) as our business and product lines expand. To provide intrastate services, we generally must obtain a certificate of public convenience and necessity from the state regulatory agency and comply with state requirements for telecommunications utilities, including state tariffing requirements. We currently are authorized to provide telecommunications services in all fifty states and the District of Columbia. In addition, we will be required to obtain and maintain interconnection agreements with ILECs where we wish to provide service. We expect that we should be able to negotiate or otherwise obtain renewals or successor agreements through adoption of others' contracts or arbitration proceedings, although the rates, terms, and conditions applicable to interconnection and the exchange of traffic with certain ILECs could change significantly in certain cases. The degree to which the rates, terms, and conditions may change will depend not only upon the negotiation and arbitration process and availability of other interconnection agreements, but will also depend in significant part upon state commission proceedings that either uphold or modify the current regimes governing interconnection and the exchange of certain kinds of traffic between carriers. In May 2004, we reached agreement on new interconnection agreements with BellSouth in all nine of the BellSouth states. In September 2004, we reached new interconnection agreements with Verizon, and with SBC in February 2005.

States also often require prior approvals or notifications for certain transfers of assets, customers or ownership of certificated carriers and for issuances by certified carriers of equity or debt.

Local Regulation

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

Regulation of Voice over Internet Protocol (VoIP)

Federal and State

Due to the growing acceptance and deployment of VoIP services, the FCC and state public utility commissions are conducting regulatory proceedings that could affect the regulatory duties and rights of entities such as us or our affiliates that provide IP-based voice applications. There is regulatory uncertainty as to the imposition of access charges and other taxes, fees and surcharges on VoIP services that use the public switched telephone network. There is regulatory uncertainty as to the imposition of traditional retail, common carrier regulation on VoIP products and services.

The rules respecting the payments made by carriers for the exchange of VoIP traffic have been subject to much debate. The FCC has not clarified whether VoIP traffic is to be subjected to the access charges regime that is applicable to traditional telecom service, or whether VoIP traffic is to be treated as an "information service" or "enhanced" and not subject to access charges. There are a number of

petitions and proceedings pending before the FCC where this issue could be resolved. At this time, it is difficult to predict the outcome of any of these proceedings or the timing for their eventual resolution. As a result, we cannot predict the effect that any such rulings could have on our provision of VoIP services.

The FCC has classified VoIP services as "interstate" services subject to FCC regulations, and has stated that states have limited authority to regulate the offering of VoIP services. On September 22, 2003, Vonage Holdings Corporation ("Vonage") filed a petition with the FCC requesting a declaration that its offerings, which originate on a broadband network in IP format and terminate on the PSTN, are interstate information services not subject to state regulation under the 1996 Act and existing FCC rules. On November 10, 2004, the FCC adopted an order (which was subsequently upheld on appeal) ruling that Vonage's service was an interstate service not subject to state regulation.

On June 3, 2005, the FCC issued an order (which was subsequently upheld on appeal) requiring all interconnected VoIP providers to deliver enhanced 911 capabilities to their subscribers by no later than November 28, 2005. We have modified our service offerings to VoIP providers in order to assist them in complying with the FCC mandate.

In 2007, the FCC imposed some regulatory requirements on VoIP providers that had previously been applicable only to traditional telecommunications providers. Specifically, the FCC (a) imposed obligations on VoIP providers to contribute to the federal universal service fund, and (b) required VoIP carriers to comply with regulations relating to local number portability (including contributing to the costs of managing number portability requirements). In addition, a number of state public utility commissions are conducting regulatory proceedings that could impact our rights and obligations with respect to IP-based voice applications. Specifically, some states have taken the position that the "local" component of VoIP service is subject to traditional regulations applicable to local telecommunications services, such as the obligation to pay intrastate universal service fees.

We cannot predict the outcome of any of these petitions and regulatory proceedings or any similar petitions and regulatory proceedings pending before the FCC or state public utility commissions. Moreover, we cannot predict how their outcomes may affect our operations or whether the FCC or state public utility commissions will impose additional requirements, regulations or charges upon our provision of services related to IP communications.

European Regulation

Unlike the United States which has a fractured regulatory scheme with respect to VoIP services, the European Union has adopted a more systematic approach to the convergence of networks and VoIP regulation specifically. The European Commission will oversee the implementation by its member-states of six new directives developed to regulate electronic communications in a technology and platform neutral manner. Implementation of the directives has not been uniform across the Member States of the European Union and it is difficult to predict when they will be implemented at the national level. Even with harmonization, the national regulatory agencies will continue to be responsible for issuing general authorizations and specific licenses.

The European Union's approach to the regulation of VoIP turns on whether VoIP is voice telephony. The European Commission has defined voice telephony to have four elements: (1) commercial offering as voice telephony; (2) provision to the public; (3) provision to and from the public switched telephone network termination points; and (4) direct speech transport and switching of speech in real time, particularly at the same level of reliability and speech quality as provided by the PSTN. In its "Communication from the Commission, Consultation on Voice on the Internet" in June 2000, the European Commission directed that "Member States should continue to allow Internet access providers to offer voice over Internet protocol under data transmission general authorizations, and that specific licensing conditions are not justified."

The European Commission has subsequently redefined its definitions to suggest that some VoIP offerings are voice telephony. In its December 2000 communication, the European Commission noted that increasing quality and reliability as well as marketing of voice capabilities with bundled services, made certain kinds of "voice over Internet" much more like voice services. While the current European Commission directives do not mandate the treatment of VoIP as voice telephony, the commission will continue to reevaluate the regulation of VoIP as service quality becomes the equivalent of traditional voice telephony.

In February 2003, the European Union adopted a new regulatory framework for electronic communications that is designed to address in a technologically neutral manner the convergence of communications across telecommunications, computer and broadcasting networks. The directives address: (1) framework (2) interconnection and access, (3) authorization and licensing, (4) universal service and (5) privacy. These directives and an additional decision on radio spectrum replace the existing 20 directives on electronic communications. Under the framework, voice telephony providers will face additional obligations, including specific licensing and universal service obligations. Others will likely face new regulation. One example could be VoIP. If it is classified as an electronic communications service, rather than voice telephony, it would still be subject to additional regulations to achieve regulatory parity with other electronic communications.

The United Kingdom was one of the first countries to fully implement the European Union's new framework for electronic communications, which it did by July 25, 2003. At that time, certain provisions of the United Kingdom's Telecommunications Act of 1984 were repealed. Pursuant to that framework, the licensing regime was replaced with a general authorization. Our existing licenses were canceled and replaced with a general authorization.

Under the regime, the United Kingdom regulates VoIP as an electronic communication service. The degree of regulation imposed on the service depends upon whether the service is considered to be a Publicly Available Telephone Service (PATS). A service is considered to be a PATS if the following conditions are met: it is marketed as a substitute for the traditional telephone service; the service appears to the customer to be a substitute for the traditional public telephone service over which they expect access to emergency services; or the service provides the customers sole means of access to the traditional circuit switched public telephone network.

While the Ofcom, the United Kingdom regulator, has established technical standards and interconnection rights for VoIP service providers, it has recently opened a consultation to assess the appropriate allocation of phone numbers to VoIP providers. We cannot predict the result of this proceeding and how it will affect our ability to provide services.

As we expand the deployment of our VoIP applications in Europe, we will have to consider the appropriate regulatory requirements for each nation before deploying services.

Canadian Regulation

The Canadian Radio-television and Telecommunications Commission, or the CRTC, has jurisdiction to regulate long distance telecommunications services in Canada. Regulatory developments over the past several years have terminated the historic monopolies of the regional telephone companies, bringing significant competition to this industry for both domestic and international long distance services, but also lessening regulation of domestic long distance companies. Resellers, which, as well as facilities based carriers, now have interconnection rights, but which are not obligated to file tariffs, may not only provide transborder services to the U.S. by reselling the services provided by the regional companies and other entities but also may resell the services of the former monopoly international carrier, Teleglobe Canada or Teleglobe, including offering international switched services provisioned over leased lines. Although the CRTC formerly restricted the practice of "switched hubbing" over leased lines through intermediate countries to or from a third country, the CRTC lifted this restriction. The Teleglobe monopoly on international services and undersea cable landing rights

terminated as of October 1, 1998, although the provision of Canadian international transmission facilities based services remains restricted to "Canadian carriers" with majority ownership by Canadians. Ownership of non-international transmission facilities are limited to Canadian carriers but we can own international undersea cables landing in Canada. We cannot, under current law, enter the Canadian market as a provider of transmission facilities based domestic services. In 2003, two committees of the Canadian House of Commons issued conflicting recommendations on whether to lift the foreign ownership restrictions that prohibit carriers like us from owning intra-Canadian transmission facilities. If the ownership restrictions are repealed, we anticipate that we will be able to expand our operations and service offerings in Canada. Recent CRTC rulings address issues such as the framework for international contribution charges payable to the local exchange carriers to offset some of the capital and operating costs of the provision of switched local access services of the incumbent regional telephone companies, in their capacity as ILECs, and the new entrant CLECs.

While competition is permitted in virtually all other Canadian telecommunications market segments, we believe that the regional companies continue to retain a substantial majority of the local and calling card markets. Beginning in May 1997, the CRTC released a number of decisions opening to competition the Canadian local telecommunications services market, which decisions were made applicable in the territories of all of the regional telephone companies. As a result, networks operated by CLECs may now be interconnected with the networks of the ILECs. Transmission facilities based CLECs are subject to the same majority Canadian ownership "Canadian carrier" requirements as transmission facilities based long distance carriers. CLECs have the same status as ILECs, but they do not have universal service or customer tariff-filing obligations. CLECs are subject to certain consumer protection safeguards and other CRTC regulatory oversight requirements. CLECs must file interconnection tariffs for services to interexchange service providers and wireless service providers. Certain ILEC services must be provided to CLECs on an unbundled basis and subject to mandatory pricing, including central office codes, subscriber listings, and local loops in small urban and rural areas. For a five-year period, certain other important CLEC services must be provided on an unbundled basis at mandated prices, notably unbundled local loops in large, urban areas. ILECs, which, unlike CLECs, remained fully regulated, are subject to price cap regulation in respect of their utility services and these services must not be priced below cost. Interexchange contribution payments are now pooled and distributed among ILECs and CLECs according to a formula based on their respective proportions of residential lines, with no explicit contribution payable from local business exchange or directory revenue. CLECs must pay an annual telecommunications fee based on their proportion of total CLEC operating revenue. All bundled and unbundled local services (including residential lines and other bulk services) may now be resold, but ILECs need not provide these services to resellers at wholesale prices. Transmission facilities based local and long distance carriers (but not resellers) are entitled to colocate equipment in ILEC central offices pursuant to terms and conditions of tariffs and intercarrier agreements. Certain local competition issues are still to be resolved. The CRTC has ruled that resellers cannot be classified as CLECs, and thus are not entitled to CLEC interconnection terms and conditions. The CRTC conducted a proceeding in 2004 to review issues relating to the introduction of VoIP technology. The CRTC has expressed a number of preliminary views about how it proposes to regulate VoIP services including the view that VoIP services (and service providers) should be regulated according to the CRTC's existing rules. If the preliminary views are confirmed, then the rules for VoIP-based services will depend on the category of service provider (ie., ILEC, CLEC or reseller), the nature of the service and the geographic area in which the service is provided.

Our Other Business

Our company was incorporated as Peter Kiewit Sons', Inc. in Delaware in 1941 to continue a construction business founded in Omaha, Nebraska in 1884. In subsequent years, we invested a portion of the cash flow generated by our construction activities in a variety of other businesses. We entered the coal mining business in 1943, the telecommunications business in 1988, the information services

business in 1990 and the alternative energy business in 1991. We have also made investments in several development-stage ventures.

In December 1997, our stockholders ratified the decision of the Board to effect the split-off separating our historical construction business from the remainder of our operations. As a result of the split-off, which was completed on March 31, 1998, we no longer own any interest in the prior construction business. In conjunction with the split-off, we changed our name to "Level 3 Communications, Inc.," and the entity that held the prior construction business changed its name to "Peter Kiewit Sons', Inc."

On November 30, 2005, we completed the sale of our (i)Structure, LLC subsidiary to Infocrossing, Inc. Prior to the sale, (i)Structure provided computer operations outsourcing to customers located primarily in the United States.

On September 7, 2006, we completed the sale of 100% of the capital stock of our indirect, wholly owned subsidiary, Software Spectrum, Inc., to Insight Enterprises, Inc. In connection with the transaction, we received total proceeds of approximately \$351 million in cash. Prior to the sale, Software Spectrum was a leading direct marketer of software and provider of software licensing services to corporations. With the completion of the sale of Software Spectrum, we exited the information services business.

Coal Mining

We are engaged in coal mining through our subsidiary, KCP, Inc. or KCP. KCP has a 50% interest in two mines, which are operated by a subsidiary of Peter Kiewit Sons', Inc. or PKS. Decker Coal Company or Decker is a joint venture with Western Minerals, Inc., which is a subsidiary of Rio Tinto Energy America Inc. Black Butte Coal Company or Black Butte is a joint venture with Bitter Creek Coal Company, a subsidiary of Anadarko Petroleum Corporation. The Decker mine is located in southeastern Montana and the Black Butte mine is in southwestern Wyoming. The coal mines use the surface mining method.

The coal produced from the KCP mines is sold primarily to electric utilities, which burn coal to produce steam to generate electricity. Essentially all of the sales were made under long-term contracts. Approximately 36%, 37% and 44% of KCP's revenue in 2007, 2006 and 2005, respectively, were derived from long-term contracts with Commonwealth Edison Company (with Decker) and The Detroit Edison Company (with Decker). KCP has commitments to deliver approximately 9.0 million tons of coal through 2012 under contracts with Commonwealth Edison and Detroit Edison. KCP also has other sales commitments, including those with Sierra Pacific, Idaho Power, PacifiCorp, and Minnesota Power that provide for the delivery of approximately 6.8 million tons through 2011. Under a mine management agreement, KCP pays a subsidiary of PKS an annual fee equal to 30% of KCP's adjusted operating income. The fee for 2007 was approximately \$1 million.

The coal industry is highly competitive. KCP competes not only with other domestic and foreign coal suppliers, some of whom are larger and have greater capital resources than KCP, but also with alternative methods of generating electricity and alternative energy sources. In 2006, the most recent year for which information is available, KCP's production represented less than 1% of total U.S. coal production. Demand for KCP's coal is affected by economic, political and regulatory factors. For example, recent "clean air" laws may stimulate demand for low sulfur coal. KCP's western coal reserves generally have a low sulfur content (less than one percent) and are currently useful principally as fuel for coal-fired, steam-electric generating units.

KCP's sales of its coal, like sales by other western coal producers, typically provide for delivery to customers at the mine. A significant portion of the customer's delivered cost of coal is attributable to transportation costs. Most of the coal sold from KCP's western mines is currently shipped by rail to utilities outside Montana and Wyoming. The Decker and Black Butte mines are each served by a single

railroad. Many of their western coal competitors are served by two railroads and such competitors' customers often benefit from lower transportation costs because of competition between railroads for coal hauling business. Other western coal producers, particularly those in the Powder River Basin of Wyoming, have lower stripping ratios (that is, the amount of overburden that must be removed in proportion to the amount of minable coal) than the Black Butte and Decker mines, often resulting in lower comparative costs of production. As a result, KCP's production costs per ton of coal at the Black Butte and Decker mines can be as much as four and five times greater than production costs of certain competitors. Because of these cost disadvantages, there is no assurance that KCP will be able to enter into additional long-term coal purchase contracts for Black Butte and Decker production. In addition, these cost disadvantages may adversely affect KCP's ability to compete for sales in the future.

We are required to comply with various federal, state and local laws and regulations concerning protection of the environment. KCP's share of land reclamation expenses for the year ended December 31, 2007 was approximately \$7 million. KCP's share of accrued estimated reclamation costs was \$98 million at December 31, 2007. We did not make significant capital expenditures for environmental compliance with respect to the coal business in 2007. We believe our compliance with environmental protection and land restoration laws will not affect our competitive position since our competitors in the mining industry are similarly affected by such laws. However, failure to comply with environmental protection and land restoration laws, or actual reclamation costs in excess of our accruals, could have an adverse effect on our business, results of operations, and financial condition.

Glossary of Terms

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| access | Telecommunications services that permit long distance carriers to use local exchange facilities to originate and/or terminate long distance service. |
| access charges | The fees paid by long distance carriers to LECs for originating and terminating long distance calls on the LECs' local networks. |
| backbone | A high-speed network that interconnects smaller, independent networks. It is the through- portion of a transmission network, as opposed to spurs which branch off the through- portions. |
| ATM (asynchronous transfer mode) | An information transfer standard that is one of a general class of packet technologies that relay traffic by way of an address contained within the first five bytes of a standard fifty-three byte long packet or cell. The ATM format can be used by many different information systems, including LANs, to deliver traffic at varying rates, permitting a mix of data, voice and video. |
| CAP | Competitive Access Provider. A company that provides its customers with an alternative to the local exchange company for local transport of private line and special access telecommunications services. |
| caching | A process by which a Web storage device or cache is located between Web servers (or origin servers) and a user, and watches requests for HTML pages and objects such as images, audio, and video, then saves a copy for itself. If there is another request for the same object, the cache will use its copy, instead of asking the origin server for it again. |

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| capacity | The information carrying ability of a telecommunications facility. |
| carrier | A provider of communications transmission services by fiber, wire or radio. |
| CDN | Content Distribution Network or CDN describes a system of computers networked together across the Internet that cooperate transparently to deliver various types of content to end users. The delivery process is optimized generally for either performance or cost. When optimizing for performance, locations that can serve content quickly to the user are chosen. When optimizing for cost, locations that are less expensive to serve from may be chosen instead. |
| central office | Telephone company facility where subscribers' lines are joined to switching equipment for connecting other subscribers to each other, locally and long distance. |
| CLEC | Competitive Local Exchange Carrier. A company that competes with LECs in the local services market. |
| co-carrier | A relationship between a CLEC and an ILEC that affords each |

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| | company the same access to and right on the other's network and provides access and services on an equal basis. |
| common carrier | A government-defined group of private companies offering telecommunications services or facilities to the general public on a non-discriminatory basis. |
| conduit | A pipe, usually made of metal, ceramic or plastic, that protects buried cables. |
| DS-3 | A data communications circuit capable of transmitting data at 45 Mbps. |
| dark fiber | Fiber optic strands that are not connected to transmission equipment. |
| dedicated lines | Telecommunications lines reserved for use by particular customers. |
| dialing parity | The ability of a competing local or toll service provider to provide telecommunications services in such a manner that customers have the ability to route automatically, without the use of any access code, their telecommunications to the service provider of the customers' designation. |
| equal access | The basis upon which customers of interexchange carriers are able to obtain access to their Primary Interexchange Carriers' (PIC) long distance telephone network by dialing "1", thus eliminating the need to dial additional digits and an authorization code to obtain such access. |
| facilities based carriers | Carriers that own and operate their own network and equipment. |

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| fiber optics | A technology in which light is used to transport information from one point to another. Fiber optic cables are thin filaments of glass through which light beams are transmitted over long distances carrying enormous amounts of data. Modulating light on thin strands of glass produces major benefits including high bandwidth, relatively low cost, low power consumption, small space needs and total insensitivity to electromagnetic interference. |
| Gbps | Gigabits per second. A transmission rate. One gigabit equals 1,024 billion bits of information. |
| ILEC | Incumbent Local Exchange Carrier. A company historically providing local telephone service. Often refers to one of the Regional Bell Operating Companies (RBOCs). Often referred to as "LEC" (Local Exchange Carrier). |
| Interconnection | Interconnection of facilities between or among the networks of carriers, including potential physical colocation of one carrier's equipment in the other carrier's premises to facilitate such interconnection. |
| InterLATA | Telecommunications services originating in a LATA and terminating outside of that LATA. |
| Internet | A global collection of interconnected computer networks which use a specific communications protocol. |
| IntraLATA | Telecommunications services originating and terminating in the same LATA. |
| ISDN | Integrated Services Digital Network. An information transfer standard for transmitting digital voice and data over telephone lines at speeds up to 128 Kbps. |
| ISPs | Internet Service Providers. Companies formed to provide access to the Internet to consumers and business customers via local networks. |
| IXC | Interexchange Carrier. A telecommunications company that provides telecommunications services between local exchanges on an interstate or intrastate basis. |
| Kbps | Kilobits per second. A transmission rate. One kilobit equals 1,024 bits of information. |
| LATA | Local Access and Transport Area. A geographic area composed of contiguous local exchanges, usually but not always within a single state. There are approximately 200 LATAs in the United |

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| leased line | States. An amount of telecommunications capacity dedicated to a particular customer along predetermined routes. |
| LEC | Local Exchange Carrier. A telecommunications company that provides telecommunications services in a geographic area. LECs include both ILECs and CLECs. |

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| local exchange | A geographic area determined by the appropriate state regulatory authority in which calls generally are transmitted without toll charges to the calling or called party. |
| local loop | A circuit that connects an end user to the LEC central office within a LATA. |
| long distance carriers | Long distance carriers provide services between local exchanges on an interstate or intrastate basis. A long distance carrier may offer services over its own or another carrier's facilities. |
| Mbps | Megabits per second. A transmission rate. One megabit equals 1.024 million bits of information. |
| MPLS | MultiProtocol Label Switching. A standards-approved technology for speeding up network traffic flow and making it easier to manage. MPLS involves setting up a specific path for a given sequence of packets, identified by a label put in each packet, thus saving the time needed for a router or switch to look up the address to the next node to forward the packet to. |
| multiplexing | An electronic or optical process that combines a large number of lower speed transmission lines into one high speed line by splitting the total available bandwidth into narrower bands (frequency division), or by allotting a common channel to several different transmitting devices, one at a time in sequence (time division). |
| NAP | Network Access Point. A location at which ISPs exchange traffic with each other. |
| OC-3 | A data communications circuit capable of transmitting data at 155 bps. |
| OC-12 | A data communications circuit capable of transmitting data at 622 Mbps. |
| OC-48 | A data communications circuit capable of transmitting data at approximately 2.45 Gbps. |
| PBX | Private Branch eXchange. A PBX, sometimes known as a phone switch or phone switching device, is a device that connects office telephones in a business with the PSTN. The functions of a PBX include routing incoming calls to the appropriate extension in an office, sharing phone lines between extensions, automated greetings for callers using recorded messages, dialing menus, connections to voicemail, automatic call distribution and teleconferencing. |

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| peering | The commercial practice under which ISPs exchange traffic with each other. Although ISPs are free to make a private commercial arrangement, there are generally two types of peering. With a settlement free peering arrangement the ISPs do not need to pay each other for the exchange of traffic. With paid peering, the larger ISP receives payment from the smaller ISP to carry the traffic of that smaller ISP. Peering occurs at both public and private exchange points. |
| POP | Point of Presence. Telecommunications facility where a communications provider locates network equipment used to connect customers to its network backbone. |
| private line | A dedicated telecommunications connection between end user locations. |
| PSTN | Public Switched Telephone Network. That portion of a local exchange company's network available to all users generally on a shared basis (i.e., not dedicated to a particular user). Traffic along the public switched network is generally switched at the local exchange company's central offices. |
| Public Safety Answering Point | An answering location for 911 calls originating in a given area. PSAPs are typically a common bureau used to answer emergency calls and dispatch safety agencies such as police, fire, emergency medical, etc. |
| RBOCs | Regional Bell Operating Companies. Originally, the seven local telephone companies established as a result of the AT&T |

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| reciprocal compensation | Divestiture. The compensation of a CLEC for termination of a local call by the ILEC on the CLEC's network, which is the same as the compensation that the CLEC pays the ILEC for termination of local calls on the ILEC's network. |
| resale | Resale by a provider of telecommunications services (such as a LEC) of such services to other providers or carriers on a wholesale or a retail basis. |
| router | Equipment placed between networks that relays data to those networks based upon a destination address contained in the data packets being routed. |
| selective router | Telephone switch or functional equivalent, controlled by the relevant local exchange carrier (LEC), which determines the PSAP to which a 911 call should be delivered based on the location of the 911 caller. |
| SONET | Synchronous Optical Network. An electronics and network architecture for variable bandwidth products which enables transmission of voice, data and video (multimedia) at very high speeds. SONET ring architecture provides for virtually instantaneous restoration of service in the event of a fiber cut or equipment failure by automatically rerouting traffic in the opposite direction around the ring. |

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| special access services | The lease of private, dedicated telecommunications lines or "circuits" along the network of a local exchange company or a CAP, which lines or circuits run to or from the long distance carrier POPs. Examples of special access services are telecommunications lines running between POPs of a single long distance carrier, from one long distance carrier POP to the POP of another long distance carrier or from an end user to a long distance carrier POP. |
| streaming | Streaming is the delivery of media, such as movies and live presentations, over a network in real time. A computer (a streaming server) sends the media to another computer (a client computer), which plays the media as it is delivered. |
| switch | A device that selects the paths or circuits to be used for transmission of information and establishes a connection. Switching is the process of interconnecting circuits to form a transmission path between users and it also captures information for billing purposes. |
| Tbps | Terabits per second. A transmission rate. One terabit equals 1.024 trillion bits of information. |
| T-1 | A data communications circuit capable of transmitting data at 1.544 Mbps. |
| unbundled | Services, programs, software and training sold separately from the hardware. |
| unbundled access | Access to unbundled elements of a telecommunications services provider's network including network facilities, equipment, features, functions and capabilities, at any technically feasible point within such network. |
| VoIP | Voice over Internet Protocol |
| VPC | VoIP Positioning Center. An entity that maintains an end user location database and manages the technology including query keys and routing number pools used to deliver 911 calls to the correct PSAP for emergency handling. |
| web site | A server connected to the Internet from which Internet users can obtain information. |
| wireless | A communications system that operates without wires. Cellular service is an example. |
| world wide web or web | A collection of computer systems supporting a communications protocol that permits multimedia presentation of information over the Internet. |
| xDSL | A term referring to a variety of new Digital Subscriber Line |

technologies. Some of these new varieties are asymmetric with different data rates in the downstream and upstream directions. Others are symmetric. Downstream speeds range from 384 Kbps (or "SDSL") to 1.5 to 8 Mbps ("ADSL").

Directors and Executive Officers

Set forth below is information as of February 28, 2008, about our directors and our executive officers. Our executive officers have been determined in accordance with the rules of the SEC.

| Name | Age | Position |
|--------------------------------|-----|---|
| Walter Scott, Jr. | 76 | Chairman of the Board |
| James Q. Crowe | 58 | Chief Executive Officer and Director |
| Kevin J. O'Hara | 47 | President and Chief Operating Officer |
| Charles C. Miller, III | 55 | Vice Chairman and Executive Vice President |
| Thomas C. Stortz | 56 | Executive Vice President, Chief Legal Officer and Secretary |
| Sunit S. Patel | 46 | Group Vice President and Chief Financial Officer |
| John Neil Hobbs | 48 | Executive Vice President Sales and Operations of Level 3 Communications, LLC |
| Brady Rafuse | 44 | President Content Markets Group of Level 3 Communications, LLC and President and CEO of Europe Operations |
| Eric J. Mortensen | 49 | Senior Vice President and Controller |
| Douglas C. Eby | 48 | Director |
| Admiral James O. Ellis, Jr.(3) | 60 | Director |
| Richard R. Jaros(2) | 56 | Director |
| Robert E. Julian(1)(2) | 68 | Director |
| Michael J. Mahoney | 57 | Director |
| Arun Netravali(2) | 61 | Director |
| John T. Reed(1)(3) | 64 | Director |
| Michael B. Yanney(3) | 74 | Director |
| Dr. Albert C. Yates(1) | 66 | Director |

- (1) Member of Audit Committee
- (2) Member of Compensation Committee
- (3) Member of Nominating and Governance Committee

Other Management

Set forth below is information as of February 28, 2008, about the following members of senior management of Level 3 Communications, LLC, except as otherwise noted.

| Name | Age | Position |
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| Raouf F. Abdel | 40 | President Business Markets Group |
| Sureel A. Choksi | 35 | Chief Marketing Officer |
| Andrew Crouch | 37 | President Wholesale Markets Group |
| John F. Waters, Jr. | 43 | President Operations, Chief Technology Officer |
| Kevin T. Hart | 41 | Chief Information Officer |
| Margaret E. Porfido | 50 | Chief Human Resources Officer |
| Donald H. Gips | 48 | Group Vice President |

Walter Scott, Jr. has been the Chairman of the Board of the Company since September 1979, and a director of the Company since April 1964. Mr. Scott has been Chairman Emeritus of Peter Kiewit Sons', Inc. ("PKS") since the split-off in 1998. Mr. Scott is also a director of PKS, Berkshire Hathaway Inc., MidAmerican Energy Holdings Company, and Valmont Industries, Inc. Mr. Scott is the Chairman of the Board of Directors.

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

Kevin J. O'Hara has been President of the Company since July 2000 and Chief Operating Officer of the Company since March 1998. Mr. O'Hara was also Executive Vice President of the Company from August 1997 until July 2000. Prior to that, Mr. O'Hara served as President and Chief Executive Officer of MFS Global Network Services, Inc. from 1995 to 1997, and as Senior Vice President of MFS and President of MFS Development, Inc. from October 1992 to August 1995. From 1990 to 1992, he was a Vice President of MFS Telecom, Inc. ("MFS Telecom").

Charles C. Miller, III has been Vice Chairman and Executive Vice President of the Company since February 15, 2001. Mr. Miller was also a director from February 15, 2001 until May 18, 2004. Prior to that, Mr. Miller was President of Bellsouth International, a subsidiary of Bellsouth Corporation from 1995 until December 2000. Prior to that, Mr. Miller held various senior level officer and management position at BellSouth from 1987 until 1995.

Thomas C. Stortz has been Executive Vice President, Chief Legal Officer and Secretary since February 2004. Prior to that, Mr. Stortz was Group Vice President, General Counsel and Secretary of the Company from February 2000 to February 2004. Prior to that, Mr. Stortz served as Senior Vice President, General Counsel and Secretary of the Company from September 1998 to February 1, 2000. Prior to that, he served as Vice President and General Counsel of Peter Kiewit Sons', Inc. and Kiewit Construction Group, Inc. from April 1991 to September 1998. He has served as a director of Peter Kiewit Sons', Inc.

Sunit S. Patel has been Chief Financial Officer since May 2003 and a Group Vice President of the Company since March 13, 2003. Prior to that, Mr. Patel was Chief Financial Officer of Looking Glass Networks, Inc., a provider of metropolitan fiber optic networks, from April 2000 until March 2003. Mr. Patel was Treasurer of WorldCom Inc. and MCIWorldcom Inc., each long distance telephone services providers from 1997 to March 2000. From 1994 to 1997, Mr. Patel was Treasurer of MFS Communications Company Inc., a competitive local exchange carrier. On October 15, 2007, the Company announced that it has begun a search for a new Chief Financial Officer, and that Mr. Patel is expected to remain with the Company during the transition.

John Neil Hobbs has been Executive Vice President Sales and Operations since January 2008. Mr. Hobbs has responsibility for our Wholesale Markets Group, Business Markets Group and Global Network Services. Prior to that, Mr. Hobbs was President Global Network Services from August 2006 to January 2008. Prior to that, Mr. Hobbs was Executive Vice President Sales and Marketing from January 2006 to August 2006. Prior to that, Mr. Hobbs was Group Vice President Global Sales from September 2000 to January 2006. Prior to that, Mr. Hobbs was President, Global Accounts for Concert, a joint venture between AT&T and British Telecom from July 1999 until September 2000. Prior to that, Mr. Hobbs was Director Transition and Implementation for the formation of Concert representing British Telecom from June 1998 until July 1999. From April 1997 until June 1998, Mr. Hobbs was British Telecom's General Manager for Global Sales & Service and from April 1994 until April 1997, Mr. Hobbs was British Telecom's General Manager for Corporate Clients.

Brady Rafuse has been President Content Markets Group since August 2006 and President and CEO of our European operations since January 2006. Prior to this role, Mr. Rafuse was Group Vice President and President of our European operations from August 2001 to January 2006 and Senior Vice President of European Sales and Marketing from December 2000 to August 2001. Prior to that, Mr. Rafuse served as Head of Commercial Operations for Concert, a joint venture between AT&T and British Telecom, from September 1999 to December 2000, and in a variety of positions with British Telecom from 1987 until December 2000. His last position was as General Manager, Global Energy Sector which he held from August 1998 to September 1999 and prior to that he was Deputy General Manager, Banking Sector from April 1997 to August 1998.

Eric J. Mortensen has been Senior Vice President and Controller of the Company since 2003. Prior to that, Mr. Mortensen was Vice President and Controller of the Company from 1999 to 2003 and was the Controller of the Company from 1997 to 1999. Prior to that, Mr. Mortensen was Controller and Assistant Controller of Kiewit Diversified Group for more than five years.

Douglas C. Eby has been a director of the Company since August 2007. Mr. Eby is chairman and CEO of TimePartners LLC, an investment advisory firm since 2004. Prior to that from April 1997 until September 2007, Mr. Eby was President of Torray LLC, an registered investment advisory firm, having joined Torray LLC in 1992. Mr. Eby is also a member of the Board of Directors of Markel Corporation, CBRE Realty Finance, Inc. and Suburban Healthcare System. Since July 2007, Mr. Eby is also the Chairman of the Board of the Boys and Girls Clubs of Greater Washington, D.C.

Admiral James O. Ellis, Jr. U.S. Navy (ret.) has been a director of the Company since March 2005. Effective May 18, 2005, Admiral Ellis became the president and chief executive officer of the Institute of Nuclear Power Operations or INPO, a nonprofit corporation established by the nuclear utility industry in 1979 to promote the highest levels of safety and reliability in the operation of nuclear electric generating plants. Admiral Ellis most recently served as Commander, U.S. Strategic Command in Omaha, Nebraska, before retiring in July 2004 after 35 years of service in the U.S. Navy, as Commander of the Strategic Command. In his Naval career, he held numerous commands. A graduate of the U.S. Naval Academy, he also holds M.S. degrees in Aerospace Engineering from the Georgia Institute of Technology and in Aeronautical Systems from the University of West Florida. He served as a Naval aviator and was a graduate of the U.S. Naval Test Pilot School. Admiral Ellis is also a member of the Board of Directors of Lockheed Martin Corporation and Inmarsat PLC. Admiral Ellis is the Chairman of the Nominating and Governance committee.

Richard R. Jaros has been a director of the Company since June 1993 and served as President of the Company from 1996 to 1997. Mr. Jaros has been a private investor for more than the past five years. Mr. Jaros served as Executive Vice President of the Company from 1993 to 1996 and Chief Financial Officer of the Company from 1995 to 1996. He also served as President and Chief Operating Officer of CalEnergy from 1992 to 1993. Mr. Jaros is the Chairman of the Compensation Committee.

Robert E. Julian has been a director of the Company since March 1998. Mr. Julian has been a private investor for more than the past five years. From 1992 to 1995 Mr. Julian served as Executive Vice President and Chief Financial Officer of the Company. Mr. Julian is a member of the Audit Committee and the Compensation Committee.

Michael J. Mahoney has been a director of the Company since August 2007. Mr. Mahoney is a private investor since March 2007. From 2000 until March 2007, Mr. Mahoney was the president and chief executive officer of Commonwealth Telephone Enterprises. Prior to that, from 1997 until 2000, Mr. Mahoney was president and chief operating officer of RCN Corporation. Mr. Mahoney also served as president and chief operating officer of C-TEC Corporation from 1993 until 1997. Mr. Mahoney is a member of the Board of Trustees of Wilkes University.

Arun Netravali has been a director of the Company since April 2003. Mr. Netravali is currently the managing partner of OmniCapital Group LLC, a venture capital firm since November 2004. Mr. Netravali was a private investor from April 2003 until November 2004. Prior to that, Mr. Netravali was Chief Scientist for Lucent Technologies, working with academic and investment communities to identify and implement important new networking technologies from January 2002 to April 2003. Prior to that position, Mr. Netravali was President of Bell Labs as well as Lucent's Chief Technology Officer and Chief Network Architect from June 1999 to January 2002. Bell Labs serves as the research and development organization for Lucent Technologies. Mr. Netravali is a director of LSI Corporation. Mr. Netravali is a member of the Compensation Committee.

John T. Reed has been a director of the Company since March 2003. Mr. Reed has been a private investor since February 2005. Mr. Reed is also a Director of and Chairman of the Audit Committee of First National Bank of Omaha. Mr. Reed is also Chairman of the Board of Alegent Health, a health care system headquartered in Omaha, Nebraska and a member of the Board and Chairman of the Audit Committee of Father Flanagan's Boys' Home located in Boys Town, Nebraska. Mr. Reed was Chairman of HMG Properties, the real estate investment banking joint venture of McCarthy Group, Inc. from 2000 until February 2005. Prior to that, he was Chairman of McCarthy & Co., the investment banking affiliate of McCarthy Group. Prior to joining McCarthy Group in 1997, Mr. Reed spent 32 years with Arthur Andersen LLP. Mr. Reed is the Chairman of the Audit Committee and a member of the Nominating and Governance Committee.

Michael B. Yanney has been a director of the Company since March 1998. He has served as Chairman of the Board of The Burlington Capital Group, LLC (formerly known as America First Companies L.L.C.) for more than the last five years. Mr. Yanney also served as President and Chief Executive Officer of The Burlington Capital Group, LLC. Mr. Yanney is a member of the Nominating and Governance Committee.

Dr. Albert C. Yates has been a director of the Company since March 2005. Dr. Yates retired after 13 years as president of Colorado State University in Fort Collins, Colorado in June 2003. He was also chancellor of the Colorado State University System until October 2003, and is a former member of the board of the Federal Reserve Board of Kansas City-Denver Branch and the board of directors of First Interstate Bank and Molson Coors Brewing Company. He currently serves as a director of Centennial Bank Holdings, Inc. and StarTek, Inc. Dr. Yates is a member of the Audit Committee.

Raouf F. Abdel has been President Business Markets Group since February 2007. Prior to that, Mr. Abdel was Group Vice President of Integration and Development Services from March 2006 to February 2007. Prior to those roles, Mr. Abdel was Senior Vice President of Integration and Development Services from November 2005 to March 2006, responsible for managing Level 3's integration and systems and process development. Prior to that, Mr. Abdel was Senior Vice President of Product Development from September 2003 to November 2005, responsible for developing and managing Level 3 product development activities. Prior to that, Mr. Abdel was Senior Vice President of M&A Integration from March 2002 to September 2003, responsible for managing the execution of Level 3's integration activities. From July 2000 until March 2002, Mr. Abdel was Senior Vice President of Network Deployment, and from September 1999 until July 2000, Mr. Abdel was Vice President of Colocation Services. Mr. Abdel joined Level 3 in February 1998 as Senior Director of Construction.

Sureel A. Choksi has been Chief Marketing Officer since January 2008, responsible for product management and marketing. Prior to that, Mr. Choksi was President Wholesale Markets Group from August 2006 to January 2008. Prior to that, Mr. Choksi was Executive Vice President of Switched Services from January 2006 to August 2006. Prior to this role, Mr. Choksi was Executive Vice President of Services from November 2004 to January 2006, responsible for developing and managing Level 3's communications services. Prior to that, Mr. Choksi was Executive Vice President Softswitch Services from January 2004 and Group Vice President Transport and Infrastructure from May 2003 until

January 2004. Mr. Choksi was a Group Vice President and Chief Financial Officer of the Company from July 2000 to May 2003. Prior to that, Mr. Choksi was Group Vice President Corporate Development and Treasurer of the Company from February 2000 until August 2000. Prior to that, Mr. Choksi served as Vice President and Treasurer of the Company from January 1999 to February 1, 2000. Prior to that, Mr. Choksi was a Director of Finance at the Company from 1997 to 1998, an Associate at TeleSoft Management, LLC in 1997 and an Analyst at Gleacher & Company from 1995 to 1997.

Andrew Crouch has been the President of the Wholesale Markets Group since January 2008, after serving as Group Vice President of Sales for the Wholesale Markets Group beginning in April 2006. Prior to that, Mr. Crouch served as the Senior Vice President of the Carrier Channel from January 2005 to April 2006, and Senior Vice President of the Enterprise Voice Services from January 2004 to January 2005. Mr. Crouch began his career at Level 3 in November 2001 as the Senior Vice President of Sales for the Cable and ISP Channel and held this position until December 2003. Before joining Level 3, Mr. Crouch served as the Deputy General Manager within the Corporate Clients Division at British Telecom. He also served as the Vice President of Commercial Operations for Concert Communications, a joint venture between British Telecom and AT&T from January 2000 to October 2001.

John F. Waters, Jr. has been President Operations, Chief Technology Officer since January 2008. Prior to that, Mr. Waters was Executive Vice President, Chief Technology Officer from January 2004 to January 2008. Prior to that, Mr. Waters was Group Vice President and Chief Technology Officer of the Company from February 2000 to January 2004. Prior to that, Mr. Waters was Vice President, Engineering of the Company from November 1997 until February 1, 2000. Prior to that, Mr. Waters was an executive staff member of MCI Communications from 1994 to November 1997.

Kevin T. Hart has been Chief Information officer since January 2008. Prior to that, Mr. Hart was Group Vice President Global Systems Development and Chief Information Officer from January 2005 to 2008. Prior to that, Mr. Hart was Vice President of Telecommunications, Media & Entertainment at Capgemini (formerly Ernst & Young), a management consulting firms in Dallas, Texas, for over nine years. In that role, he was responsible for the overall growth and direction of the organization's Communications Operations Support Systems, Billing/Business Support Systems and the Network Management Systems service offerings and delivery. Prior to joining Capgemini's management consulting practice, he held the positions of Director of Strategic Planning at International Paper and Manager of Operations at SBC Communications.

Margaret E. Porfido has been Chief Human Resources Officer since May 2007. Prior to that, Ms. Porfido was Senior Vice President Executive Operations from February 2000, acting as the chief of staff to Kevin J. O'Hara, Level 3's president and chief operating officer. Ms. Porfido joined Level 3 in September 1998 as Vice President Business Development. Prior to joining Level 3, Ms. Porfido served as Chief of Staff and chief legal adviser to Colorado Governor Roy Romer. Prior to her government service, Ms. Porfido was an attorney in private practice.

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

At our 2008 Annual Meeting of Stockholders, the term of office of all of our directors will expire. At each annual meeting of stockholders, successors to the directors will be elected for a one-year term.

Our officers are elected annually to serve until each successor is elected and qualified or until his or her death, resignation or removal.

We believe that the members of the Audit Committee are independent within the meaning of the listing standards of The NASDAQ Stock Market, LLC. The Board has determined that Mr. John T. Reed, Chairman of the Audit Committee, qualifies as a "financial expert" as defined by the Securities and Exchange Commission. The Board considered Mr. Reed's credentials and financial background and found that he was qualified to serve as the "financial expert."

Our website

Our website is www.level3.com . We caution you that any information that is included in our website is not part of this Form 10-K.

Code of Ethics

We have adopted a code of ethics that complies with the standards mandated by the Sarbanes-Oxley Act of 2002. The complete code of ethics is available on our website at www.level3.com . At any time that the code of ethics is not available on our website, we will provide a copy upon written request made to Investor Relations, Level 3 Communications, Inc., 1025 Eldorado Blvd., Broomfield, Colorado 80021. We caution you that any information that is included in our website is not part of this Form 10-K. If we amend the code of ethics, or grant any waiver from a provision of the code of ethics that applies to our executive officers or directors, we will publicly disclose such amendment or waiver as required by applicable law, including by posting such amendment or waiver on our website at www.level3.com or by filing a Form 8-K with the Securities and Exchange Commission or SEC.

SEC Filings

Our Form 10-K, along with all other reports and amendments filed with or furnished to the SEC are publicly available free of charge on the investor relations section of our website as soon as reasonably practicable after we file such materials with, or furnish them to, the SEC. We caution you that the information on our website is not part of this or any other report we file with, or furnish to, the SEC.

Section 16(a)—Beneficial Ownership Reporting Compliance

Except as described below, to our knowledge, no person that was a director, executive officer or beneficial owner of more than 10% of the outstanding shares of our common stock failed to timely file all reports required under Section 16(a) of the Securities Exchange Act of 1934. On one occasion, Dr. Albert C. Yates filed a late Form 4 to report an open market purchase of our common stock.

Employees

As of December 31, 2007, we had approximately 6,680 total employees. We believe that our success depends in large part on our ability to attract and retain substantial numbers of qualified employees.

Item 1A. RISK FACTORS

Forward Looking Statements

We, or our representatives, from time to time may make or may have made certain forward-looking statements, either orally or in writing, including without limitation statements made or to be made in this Form 10-K, our Quarterly Reports on Form 10-Q, information contained in other filings with the SEC, press releases and other public documents or statements. In addition, our

representatives, from time to time, participate in speeches and calls with market analysts, conferences with investors or potential investors in our securities and other meetings and conferences. Some of the information presented at these speeches, calls, meetings and conferences may include forward-looking statements. We use words like "expects," "anticipates" or "believes" to identify forward-looking statements.

We wish to ensure that all forward-looking statements are accompanied by meaningful cautionary statements, so as to ensure to the fullest extent possible the protections of the safe harbor established in the Private Securities Litigation Reform Act of 1995. Accordingly, all forward-looking statements are qualified in their entirety by reference to, and are accompanied by, the following discussion of certain important factors that could cause actual results to differ materially from those projected in these forward-looking statements. We caution the reader that this list of important factors may not be exhaustive. We operate in a rapidly changing business, and new risk factors emerge from time to time. We cannot predict every risk factor, nor can we assess the effect, if any, of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those projected in any forward-looking statements. Accordingly, forward-looking statements should not be relied upon as a prediction of actual results. Further, we undertake no obligation to update forward-looking statements after the date they are made to conform the statements to actual results or changes in our expectations.

Risks Related to Our Businesses

Communications Group

Our financial condition and growth depends upon the successful integration of our acquired businesses. We may not be able to efficiently and effectively integrate acquired operations, and thus may not fully realize the anticipated benefits from such acquisitions.

Achieving the anticipated benefits of the acquisitions that we have completed starting in December 2005 will depend in part upon whether we can integrate our businesses in an efficient and effective manner.

Since December 2005, we have acquired, in chronological order, WilTel Communications Group, LLC, Progress Telecom, LLC, ICG Communications, Inc., TelCove, Inc., Looking Glass Networks Holding Co., Inc., Broadwing Corporation, the CDN services business of SAVVIS, and Servecast Limited. In the future we may acquire additional businesses in accordance with our business strategy. The integration of our acquired businesses and any future businesses that we may acquire involves a number of risks, including, but not limited to:

- demands on management related to the significant increase in size after the acquisition;
- the disruption of ongoing business and the diversion of management's attention from the management of daily operations to the integration of operations;
- failure to fully achieve expected synergies and costs savings;
- unanticipated impediments in the integration of departments, systems, including accounting systems, technologies, books and records and procedures, as well as in maintaining uniform standards, controls, including internal control over financial reporting required by the Sarbanes-Oxley Act of 2002, procedures and policies;
- loss of customers or the failure of customers to order incremental services that we expect them to order;
- failure to provision services that are ordered by customers during the integration period;
- higher integration costs than anticipated; and

- difficulties in the assimilation and retention of highly qualified, experienced employees, many of whom are geographically dispersed.

Successful integration of these acquired businesses or operations will depend on our ability to manage these operations, realize opportunities for revenue growth presented by strengthened service offerings and expanded geographic market coverage, obtain better terms from our vendors due to increased buying power, and eliminate redundant and excess costs to fully realize the expected synergies. Because of difficulties in combining geographically distant operations and systems which may not be fully compatible, we may not be able to achieve the financial strength and growth we anticipate from the acquisitions.

We cannot be certain that we will realize our anticipated benefits from our acquisitions, or that we will be able to efficiently and effectively integrate the acquired operations as planned. If we fail to integrate the acquired businesses and operations efficiently and effectively or fail to realize the benefits we anticipate, we would be likely to experience material adverse effects on our business, financial condition, results of operations and future prospects.

We need to continue to increase the volume of traffic on our network to become profitable.

We must continue to increase the volume of data, voice and content transmissions on our communications network at acceptable prices in order to realize our targets for anticipated revenue growth, cash flow, operating efficiencies and the cost benefits of our network. If we do not maintain or improve our current relationships with existing customers and develop new large volume and enterprise customers, we may not be able to substantially increase traffic on our network, which would adversely affect our ability to become profitable.

Intellectual property and proprietary rights of others could prevent us from using necessary technology to provide our services or subject us to expensive intellectual property litigation.

If technology that is necessary for us to provide our services was determined by a court to infringe a patent held by another entity that is unwilling to grant us a license on terms acceptable to us, we could be precluded by a court order from using that technology and would likely be required to pay a significant monetary damages award to the patent-holder. The successful enforcement of these patents, or our inability to negotiate a license for these patents on acceptable terms, could force us to cease using the relevant technology and offering services incorporating the technology. In the event that a claim of infringement was brought against us based on the use of our technology or against our customers based on their use of our services for which we are obligated to indemnify, we could be subject to litigation to determine whether such use or sale is, in fact, infringing. This litigation could be expensive and distracting, regardless of the outcome of the suit.

While our own extensive patent portfolio may deter other operating companies from bringing such actions, patent infringement claims are increasingly being asserted by patent holding companies, which do not use technology and whose sole business is to enforce patents against operators, such as us, for monetary gain. Because such patent holding companies, commonly referred to as patent "trolls," do not provide services or use technology, the assertion of our own patents by way of counter-claim would be largely ineffective. We have already been the subject of time-consuming and expensive patent litigation brought by certain patent holding companies and we can reasonably expect that we will face further claims in the future, particularly if legislation now pending in Congress is not enacted in a way that will decrease the number and frequency of claims by patent trolls.

Our business requires the continued development of effective business support systems to implement customer orders and to provide and bill for services.

Our business depends on our ability to continue to develop effective business support systems. In certain cases, the development of these business support systems is required to realize our anticipated benefits from our acquisitions. This is a complicated undertaking requiring significant resources and expertise and support from third-party vendors. Business support systems are needed for:

- accepting and inputting customer orders for services;
- provisioning, installing and delivering these services; and
- billing for these services.

Because our business provides for continued rapid growth in the number of customers that we serve and the volume of services offered and requires the integration of acquired companies' business support systems, there is a need to continue to develop our business support systems on a schedule sufficient to meet proposed milestone dates. The failure to continue to develop effective unified business support systems could materially adversely affect our ability to implement our business plans, realize anticipated benefits from our acquisitions and meet our financial goals and objectives.

Our revenue is concentrated in a limited number of customers.

A significant portion of our communications revenue is concentrated among a limited number of customers. For the year ended December 31, 2007, our top ten customers represented approximately 34% of our consolidated total revenue. Revenue from our largest customer, AT&T Inc. and its subsidiaries, including SBC Communications, BellSouth and AT&T Mobility (assuming those subsidiaries were wholly owned by AT&T for all of 2007), represented approximately 15% of our consolidated total revenue for 2007. The next largest customer accounted for approximately 5% of our consolidated total revenue and most of the remaining top ten customers each account for 3% or less of our consolidated total revenue. If we lost one or more of our top five customers, or if one or more of these major customers significantly decreased orders for our services, our business would be materially and adversely affected.

In connection with the acquisition of WilTel in December 2005, we acquired a large customer contract between WilTel and SBC Communications, now known as AT&T. We expect that the revenue generated under this contract will continue to decline over time as SBC Communications migrates its traffic from our network to the merged SBC and AT&T Communications network that SBC Communications acquired when it purchased the former AT&T.

We may lose customers if we experience system failures that significantly disrupt the availability and quality of the services that we provide.

Our operations depend on our ability to avoid and mitigate any interruptions in service or reduced capacity for customers. Interruptions in service or performance problems, for whatever reason, could undermine confidence in our services and cause us to lose customers or make it more difficult to attract new ones. In addition, because many of our services are critical to the businesses of many of our customers, any significant interruption in service could result in lost profits or other losses to customers. Although we limit our liability for service failures in our service agreements to limited service credits, generally in the form of free service for a short period of time, a court might not enforce these limitations on liability, which could expose us to financial loss. In addition, we often provide our customers with committed service levels. If we are unable to meet these service level commitments as a result of service interruptions, we may be obligated to provide service credits to our customers, which could negatively affect our operating results.

The failure of any equipment or facility on our network, including our network operations control centers and network data storage locations, could result in the interruption of customer service until necessary repairs are effected or replacement equipment is installed. Network failures, delays and errors could also result from natural disasters, terrorist acts, power losses, security breaches, computer viruses, or other causes. These failures, faults or errors could cause delays, service interruptions, expose us to customer liability, or require expensive modifications that could significantly hurt our business.

There is no guarantee that we will be successful in increasing sales of our content distribution service offering.

As we believe that one of the largest sources of future incremental demand for our communications services will be derived from customers that are seeking to distribute their feature rich content, applications or video over the Internet, we purchased the content distribution network or CDN assets of SAVVIS, Inc. in January 2007 and we purchased Servecast Limited in July 2007. Although we have sold high speed Internet access, transport and colocation services since the late 1990's, we have only been selling our CDN services since January 2007. As a result, there are many difficulties that we may encounter, including customer acceptance, intellectual property matters, technological issues, developmental constraints and other problems that we may not anticipate. There is no guarantee that we will be successful in generating significant revenues from our CDN service offering.

Failure to develop and introduce new services could affect our ability to compete in the industry.

We continuously develop, test and introduce new communications services that are delivered over our communications network. These new services are intended to allow us to address new segments of the communications marketplace and to compete for additional customers. In certain instances, the introduction of new services requires the successful development of new technology. To the extent that upgrades of existing technology are required for the introduction of new services, the success of these upgrades may be dependent on reaching mutually-acceptable terms with vendors and on vendors meeting their obligations in a timely manner. In addition, new service offerings may not be widely accepted by our customers. If our new service offerings are not widely accepted by our customers, we may terminate those service offerings and we may be required to impair any assets or technology used to develop or offer those services. If we are not able to successfully complete the development and introduction of new services in a timely manner, our business could be materially adversely affected.

Rapid technological changes can lead to further competition.

The communications industry is subject to rapid and significant changes in technology. In addition, the introduction of new services or technologies, as well as the further development of existing services and technologies may reduce the cost or increase the supply of certain services similar to those that we provide. As a result, our most significant competitors in the future may be new entrants to the communications industry. These new entrants may not be burdened by an installed base of outdated equipment or obsolete technology. Our future success depends, in part, on our ability to anticipate and adapt in a timely manner to technological changes. Failure to do so could have a material adverse effect on our business.

During our communications business operating history we have generated substantial losses, and we expect to continue to generate losses.

The development of our communications business required, and may continue to require, significant expenditures. These expenditures could result in substantial negative cash flow from operating activities and substantial net losses for the near future. For the fiscal years ended December 31, 2007 and December 31, 2006, we incurred losses from continuing operations of approximately \$1.114 billion and \$790 million, respectively. We expect to continue to experience losses,

and we may not be able to achieve or sustain operating profitability in the future. Continued operating losses could limit our ability to obtain the cash needed to expand our network, make interest and principal payments on our debt, or fund other business needs.

We will need to continue to expand and adapt our network in order to remain competitive, which may require significant additional funding. Additional expansion and adaptations of our communications network's electronic and software components will be necessary in order to respond to:

- growing number of customers;
- the development and launching of new services;
- increased demands by customers to transmit larger amounts of data;
- changes in customers' service requirements;
- technological advances by competitors; and
- governmental regulations.

Future expansion or adaptation of our network will require substantial additional financial, operational and managerial resources, which may not be available at the time. If we are unable to expand or adapt our network to respond to these developments on a timely basis and at a commercially reasonable cost, our business will be materially adversely affected.

The market prices for certain of our communications services have decreased in the past and may decrease in the future, resulting in lower revenue than we anticipate.

Over the past few years, the market prices for certain of our communications services have decreased. These decreases resulted from downward market pressure and other factors including:

- technological changes and network expansions which have resulted in increased transmission capacity available for sale by us and by our competitors;
- some of our customer agreements contain volume-based pricing or other contractually agreed-upon decreases in prices during the term of the respective agreements; and
- some of our competitors have been willing to accept smaller operating margins in the short term in an attempt to increase long-term revenues.

In order to retain customers and revenue, we often must reduce prices in response to market conditions and trends. As our prices for some of our communications services decrease, our operating results may suffer unless we are unable to either reduce our operating expenses or increase traffic volume from which we can derive additional revenue.

We expect revenue from our managed modem services to continue to decline, primarily due to:

- an increase in the number of subscribers migrating to broadband services;
- continued pricing pressures; and
- declining customer obligations under existing contractual arrangements.

We may be liable for the information that content owners or distributors distribute over our network.

The law relating to the liability of private network operators for information carried on or disseminated through their networks is still unsettled. We may become subject to legal claims relating to the content disseminated on our network, even though such content is owned or distributed by our customers or a customer of our customers. For example, lawsuits may be brought against us claiming that material distributed using our network was inaccurate, offensive, or violated the law or the rights

of others. Claims could also involve matters such as defamation, invasion of privacy and copyright infringement. In addition, the law remains unclear over whether content may be distributed from one jurisdiction, where the content is legal, into another jurisdiction, where it is not. Companies operating private networks have been sued in the past, sometimes successfully, based on the nature of material distributed, even if the content is not owned by the network operator and the network operator has no knowledge of the content or its legality. It is not practical for us to monitor all of the content which is distributed using our network. If we need to take costly measures to reduce our exposure to these risks, or are required to defend ourselves against such claims, our financial results could be negatively affected.

The need to obtain additional capacity for our network from other providers increases our costs.

We use network resources owned by other companies for portions of our network both in North America and in Europe. We obtain the right to use such network portions, including both telecommunications capacity and rights to use dark fiber, through operating leases and IRU agreements. In several of those agreements, the counter party is responsible for network maintenance and repair. If a counter party to a lease or IRU suffers financial distress or bankruptcy, we may not be able to enforce our rights to use these network assets or, even if we could continue to use these network assets, we could incur material expenses related to maintenance and repair. We could also incur material expenses if we were required to locate alternative network assets. We may not be successful in obtaining reasonable alternative network assets if needed. Failure to obtain usage of alternative network assets, if necessary, could have a material adverse effect on our ability to carry on business operations. In addition, some of our agreements with other providers require the payment of amounts for services whether or not those services are used.

In the normal course of business, we need to enter into interconnection agreements with many domestic and foreign local telephone companies, but we are not always able to do so on favorable terms. Costs of obtaining local service from other carriers comprise a significant proportion of the operating expenses of long distance carriers. Similarly, a large proportion of the costs of providing international service consists of payments to other carriers. Changes in regulation, particularly the regulation of local and international telecommunication carriers, could indirectly, but significantly, affect our competitive position. These changes could increase or decrease the costs of providing our services.

We may be unable to hire and retain sufficient qualified personnel; the loss of any of our key executive officers could adversely affect on our business.

We believe that our future success will depend in large part on our ability to attract and retain highly skilled, knowledgeable, sophisticated and qualified managerial, professional and technical personnel. We have experienced significant competition in attracting and retaining personnel who possess the skills that we are seeking. As a result of this significant competition, we may experience a shortage of qualified personnel.

Our businesses are managed by a small number of key executive officers, including James Q. Crowe, Chief Executive Officer, Kevin J. O'Hara, President and Chief Operating Officer and Charles C. Miller, III, Vice Chairman and Executive Vice President. The loss of any of these key executive officers could have a material adverse effect on our business.

We must obtain and maintain permits and rights-of-way to operate our network.

If we are unable, on acceptable terms and on a timely basis, to obtain and maintain the franchises, permits and rights-of-way needed to expand and operate our network, our business could be materially adversely affected. In addition, the cancellation or non-renewal of the franchises, permits or

rights-of-way that are obtained could materially adversely affect our business. Our communications operating subsidiaries are defendants in several lawsuits that, among other things, challenge the subsidiaries' use of rights-of-way. The plaintiffs have sought to have these lawsuits certified as class actions. It is possible that additional suits challenging use of our rights-of-way will be filed and that those plaintiffs also may seek class certification. The outcome of such litigation may increase our costs and adversely affect our operating results.

Termination of relationships with key suppliers could cause delay and additional costs.

Our business is dependent on third-party suppliers for fiber, computers, software, optronics, transmission electronics and related components that are integrated into our network, some of which are critical to the operation of our business. If any of these critical relationships is terminated or a supplier fails to provide critical services or equipment and we are unable to reach suitable alternative arrangements quickly, we may experience significant additional costs or we may not be able to provide certain services to customers. If that happens, our business could be materially adversely affected.

AT&T and Verizon may not provide us local access services at prices which allow us to effectively compete.

We acquire a significant portion of our local access services, the connection between our owned network and the customer premises, from incumbent local exchange carriers or ILECs. With the recent acquisitions by AT&T and Verizon, the ILECs now compete directly with our business and may have a tendency to favor themselves and their affiliates to our detriment. Network access represents a very large portion of our total costs and if we face less favorable pricing and provisioning, we may be at a competitive disadvantage to the ILECs.

The success of our subscriber based VoIP services is dependent on the growth and public acceptance of VoIP telephony in general.

The success of our subscriber based VoIP services is dependent upon future demand for VoIP telephony services in general in the marketplace. In order for the IP telephony market to continue to grow, several things may need to occur, including the following:

- Telephone and cable service providers must continue to invest in the deployment of high speed broadband networks to residential and commercial customers.
- VoIP networks must continue to improve quality of service for real-time communications, managing effects such as packet jitter, packet loss and unreliable bandwidth, so that toll-quality service can be provided.
- VoIP telephony equipment and services must achieve a similar level of reliability that users of the public switched telephone network have come to expect from their telephone service, including emergency calling features and capabilities.
- VoIP telephony service providers must offer cost and feature benefits to their customers that are sufficient to cause the customers to switch away from traditional telephony service providers.

If any or all of these factors fail to occur, our VoIP services business may not continue or grow as expected.

We are subject to significant regulation that could change in an adverse manner.

Communications services are subject to significant regulation at the federal, state, local and international levels. These regulations affect our business and our existing and potential competitors. Delays in receiving required regulatory approvals (including approvals relating to acquisitions or

financing activities), completing interconnection agreements with incumbent local exchange carriers, or the enactment of new and adverse regulations or regulatory requirements may have a material adverse effect on our business. In addition, future legislative, judicial and regulatory agency actions could have a material adverse effect on our business.

Federal legislation provides for a significant deregulation of the U.S. telecommunications industry, including the local exchange, long distance and cable television industries. This legislation remains subject to judicial review and additional Federal Communications Commission, or FCC, rulemaking. As a result, we cannot predict the legislation's effect on our future operations. Many regulatory actions are under way or are being contemplated by federal and state authorities regarding important issues. These actions could have a material adverse effect on our business.

The law in certain countries currently does not permit us to offer services directly in those countries.

Ownership of telecommunications facilities that originate or terminate traffic in certain countries, such as Canada and China, is currently limited to nationals of those countries. This restriction hinders our entry into those markets.

Potential regulation of Internet service providers in the United States could adversely affect our operations.

The FCC has, to date, treated Internet service providers as enhanced service providers. In addition, Congress has, to date, not sought to heavily regulate the provision of IP-based services. Both Congress and the FCC are considering proposals that involve greater regulation of IP-based service providers. Depending on the content and scope of any regulations, the imposition of such regulations could have a material adverse effect on our business and the profitability of our services.

The communications industry is highly competitive with participants that have greater resources and a greater number of existing customers.

The communications industry is highly competitive. Many of our existing and potential competitors have financial, personnel, marketing and other resources significantly greater than ours. Many of these competitors have the added competitive advantage of a larger existing customer base. In addition, significant new competition could arise as a result of:

- the consolidation in the industry, led by AT&T and Verizon;
- allowing foreign carriers to more extensively compete in the U.S. market;
- further technological advances; and
- further deregulation and other regulatory initiatives.

If we are unable to compete successfully, our business could be significantly affected.

We may be unable to successfully identify, manage and assimilate future acquisitions, investments and strategic alliances, which could adversely affect our results of operations.

We continually evaluate potential investments and strategic opportunities to expand our network, enhance connectivity and add traffic to our network. In the future, we may seek additional investments, strategic alliances or similar arrangements, which may expose us to risks such as:

- the difficulty of identifying appropriate investments, strategic allies or opportunities on terms acceptable to us;
- the possibility that senior management may be required to spend considerable time negotiating agreements and monitoring these arrangements;

- potential regulatory issues applicable to the telecommunications business;
- the loss or reduction in value of the capital investment;
- our inability to capitalize on the opportunities presented by these arrangements; and
- the possibility of insolvency of a strategic ally.

There can be no assurance that we would successfully overcome these risks or any other problems encountered with these investments, strategic alliances or similar arrangements.

Other Operations

Environmental liabilities from our historical operations could be material.

There could be environmental liabilities arising from historical operations of our predecessors, for which we may be liable. Our operations and properties are subject to a wide variety of laws and regulations relating to environmental protection, human health and safety. These laws and regulations include those concerning the use and management of hazardous and non-hazardous substances and wastes. We have made and will continue to make significant expenditures relating to our environmental compliance obligations. Despite our best efforts, we may not at all times be in compliance with all of these requirements.

In connection with certain historical operations, we have responded to or been notified of potential environmental liability at approximately 148 properties as of February 15, 2008. We are engaged in addressing or have liquidated environmental liabilities at 70 of those properties. Of these: (a) we have formal commitments or other potential future costs at 14 sites; (b) there are 10 sites with minimal future costs; (c) there are 11 sites with unknown future costs and (d) there are 35 sites with no likely future costs. The remaining 78 properties have been dormant for several years. We could be held liable, jointly or severally, and without regard to fault, for such investigation and remediation. The discovery of additional environmental liabilities related to historical operations or changes in existing environmental requirements could have a material adverse effect on our business.

Potential liabilities and claims arising from coal operations could be significant.

Our coal operations are subject to extensive laws and regulations that impose stringent operational, maintenance, financial assurance, environmental compliance, reclamation, restoration and closure requirements. These requirements include those governing air and water emissions, waste disposal, worker health and safety, benefits for current and retired coal miners, and other general permitting and licensing requirements. Despite our best efforts, we may not at all times be in compliance with all of these requirements. Liabilities or claims associated with this non-compliance could require us to incur material costs or suspend production. Mine reclamation costs that exceed reserves for these matters also could require us to incur material costs.

General

If we are unable to comply with the restrictions and covenants in our debt agreements, there would be a default under the terms of these agreements, and this could result in an acceleration of payment of funds that have been borrowed.

If we were unable to comply with the restrictions and covenants in any of our debt agreements, there would be a default under the terms of those agreements. As a result, borrowings under other debt instruments that contain cross-acceleration or cross-default provisions may also be accelerated and become due and payable. If any of these events occur, there can be no assurance that we would be able to make necessary payments to the lenders and noteholders or that we would be able to find

alternative financing. Even if we were able to obtain alternative financing, there can be no assurance that it would be on terms that are acceptable.

We have substantial debt, which may hinder our growth and put us at a competitive disadvantage.

Our substantial debt may have important consequences, including the following:

- the ability to obtain additional financing for acquisitions, working capital, investments and capital or other expenditures could be impaired or financing may not be available on acceptable terms;
- a substantial portion of our cash flow will be used to make principal and interest payments on outstanding debt, reducing the funds that would otherwise be available for operations and future business opportunities;
- a substantial decrease in cash flows from operating activities or an increase in expenses could make it difficult to meet debt service requirements and force modifications to operations;
- We have more debt than certain of our competitors, which may place us at a competitive disadvantage; and
- substantial debt may make us more vulnerable to a downturn in business or the economy generally.

We had substantial deficiencies of earnings to cover fixed charges of approximately \$1.068 billion for the fiscal year ended December 31, 2007. We had deficiencies of earnings to cover fixed charges of \$720 million for the fiscal year ended December 31, 2006, \$634 million for the fiscal year ended December 31, 2005, \$409 million for the fiscal year ended December 31, 2004 and \$681 million for the fiscal year 2003.

We may not be able to repay our existing debt; failure to do so or refinance the debt could prevent us from implementing our strategy and realizing anticipated profits.

If we were unable to refinance our debt or to raise additional capital on acceptable terms, our ability to operate our business would be impaired. As of December 31, 2007, we had an aggregate of approximately \$6.864 billion of long-term debt on a consolidated basis and including current maturities, and approximately \$1.07 billion of stockholders' equity.

Our ability to make interest and principal payments on our debt and borrow additional funds on favorable terms depends on the future performance of the business. If we do not have enough cash flow in the future to make interest or principal payments on our debt, we may be required to refinance all or a part of our debt or to raise additional capital. We cannot be sure that we will be able to refinance our debt or raise additional capital on acceptable terms.

Restrictions and covenants in our debt agreements limit our ability to conduct our business and could prevent us from obtaining needed funds in the future.

Our debt and financing arrangements contain a number of significant limitations that restrict our ability to, among other things:

- borrow additional money or issue guarantees;
- pay dividends or other distributions to stockholders;
- make investments;
- create liens on assets;
- sell assets;

- enter into sale-leaseback transactions;
- enter into transactions with affiliates; and
- engage in mergers or consolidations.

If certain transactions occur with respect to our capital stock, we may be unable to fully utilize our net operating loss carryforwards to reduce our income taxes.

As of December 31, 2007, we had net operating loss carry forwards of approximately \$9.5 billion for federal income tax purposes, including \$953 million of net operating loss carry forwards from acquired companies after limitations that existed at the date of acquisition or that resulted from the acquisitions or both. If certain transactions occur with respect to our capital stock that result in a cumulative ownership change of more than 50 percentage points by 5-percent stockholders over a three-year period as determined under rules prescribed by the U.S. Internal Revenue Code and applicable regulations, annual limitations would be imposed with respect to our ability to utilize our net operating loss carry forwards and certain current deductions against any taxable income it achieves in future periods.

We have entered into transactions over the last three years resulting in significant cumulative changes in the ownership of our capital stock. Additional transactions that we enter into, as well as transactions by existing 5% stockholders and transactions by holders that become new 5% stockholders that we do not participate in, could cause us to incur a 50 percentage point ownership change by 5% stockholders and, if we trigger the above-noted Internal Revenue Code imposed limitations, such transactions would prevent us from fully utilizing net operating loss carry forwards and certain current deductions to reduce income taxes.

The unpredictability of our quarterly results may adversely affect the trading price of our common stock.

Our revenue and operating results will vary significantly from quarter to quarter due to a number of factors, many of which are outside of our control and any of which may cause the price of our common stock to fluctuate. The primary factors, among other things, that may affect our quarterly results include the following:

- The timing of costs associated with our integration activities with respect to our recently completed acquisitions;
- demand for communications services;
- loss of customers or the ability to attract new customers;
- changes in pricing policies or the pricing policies of our competitors;
- costs related to acquisitions of technology or businesses;
- changes in regulatory rulings; and
- general economic conditions as well as those specific to the communications and related industries.

A delay in generating revenue or the timing of recognizing revenue and expenses could cause significant variations in our operating results from quarter to quarter. It is possible that in some future quarters our results may be below analysts and investors expectations. In these circumstances, the price of our common stock will likely decrease.

Increased scrutiny of financial disclosure, particularly in the telecommunications industry in which we operate, could adversely affect investor confidence, and any restatement of earnings could increase litigation risks and limit our ability to access the capital markets.

Congress, the SEC, other regulatory authorities and the media are intensely scrutinizing a number of financial reporting issues and practices. Although all businesses face uncertainty with respect to how the U.S. financial disclosure regime may be affected by this process, particular attention has been focused recently on the telecommunications industry and companies' interpretations of generally accepted accounting principles.

If we were required to restate our financial statements as a result of a determination that we had incorrectly applied generally accepted accounting principles, that restatement could adversely affect our ability to access the capital markets or the trading price of our securities. The recent scrutiny regarding financial reporting has also resulted in an increase in litigation in the telecommunications industry. There can be no assurance that any such litigation against us would not materially adversely affect our business or the trading price of our securities.

Terrorist attacks and other acts of violence or war may adversely affect the financial markets and our business.

Since the September 11, 2001 terrorist attacks and subsequent events, there has been considerable uncertainty in world financial markets. The full effect on the financial markets of these events, as well as concerns about future terrorist attacks, is not yet known. They could, however, adversely affect our ability to obtain financing on terms acceptable to us, or at all.

There can be no assurance that there will not be further terrorist attacks against the United States or U.S. businesses. These attacks or armed conflicts may directly affect our physical facilities or those of our customers. These events could cause consumer confidence and spending to decrease or result in increased volatility in the U.S. and world financial markets and economy. Any of these occurrences could materially adversely affect our business.

Our international operations and investments expose us to risks that could materially adversely affect the business.

We have operations and investments outside of the United States, as well as rights to undersea cable capacity extending to other countries, that expose us to risks inherent in international operations. These include:

- general economic, social and political conditions;
- the difficulty of enforcing agreements and collecting receivables through certain foreign legal systems;
- tax rates in some foreign countries may exceed those in the U.S.;
- foreign currency exchange rates may fluctuate, which could adversely affect our results of operations and the value of our international assets and investments;
- foreign earnings may be subject to withholding requirements or the imposition of tariffs, exchange controls or other restrictions;
- difficulties and costs of compliance with foreign laws and regulations that impose restrictions on our investments and operations, with penalties for noncompliance, including loss of licenses and monetary fines;

- difficulties in obtaining licenses or interconnection arrangements on acceptable terms, if at all; and
- changes in U.S. laws and regulations relating to foreign trade and investment.

Additional issuances of equity securities by us would dilute the ownership of our existing stockholders.

We may issue equity in the future in connection with acquisitions or strategic transactions, to adjust our ratio of debt to equity, including through repayment of outstanding debt, to fund expansion of our operations or for other purposes. To the extent we issue additional equity securities, the percentage ownership of our existing stockholders would be reduced.

If a large number of shares of our common stock is sold in the public market, the sales could reduce the trading price of our common stock and impede our ability to raise future capital.

We cannot predict what effect, if any, future issuances by us of our common stock will have on the market price of our common stock. In addition, shares of our common stock that we issue in connection with an acquisition may not be subject to resale restrictions. The market price of our common stock could drop significantly if certain large holders of our common stock, or recipients of our common stock in connection with an acquisition, sell all or a significant portion of their shares of common stock or are perceived by the market as intending to sell these shares other than in an orderly manner. In addition, these sales could impair our ability to raise capital through the sale of additional common stock in the capital markets.

Anti-takeover provisions in our charter and by-laws could limit the share price and delay a change of management.

Our restated certificate of incorporation and by-laws contain provisions that could make it more difficult or even prevent a third party from acquiring us without the approval of our incumbent board of directors. These provisions, among other things:

- prohibit stockholder action by written consent in place of a meeting;
- limit the right of stockholders to call special meetings of stockholders;
- limit the right of stockholders to present proposals or nominate directors for election at annual meetings of stockholders; and
- authorize our board of directors to issue preferred stock in one or more series without any action on the part of stockholders.

In addition, the terms of most of our long term debt require that upon a "change of control," as defined in the agreements that contain the terms and conditions of the long term debt, we make an offer to purchase the outstanding long term debt at either 100% or 101% of the aggregate principal amount of that long term debt.

These provisions could limit the price that investors might be willing to pay in the future for shares of our common stock and significantly impede the ability of the holders of our common stock to change management. Provisions and agreements that inhibit or discourage takeover attempts could reduce the market value of our common stock.

The market price of our common stock has been volatile and, in the future, the market price of our common stock may fluctuate substantially due to a variety of factors.

The market price of our common stock has been subject to volatility and, in the future, the market price of our common stock may fluctuate substantially due to a variety of factors, including:

- the depth and liquidity of the trading market for our common stock;
- quarterly variations in actual or anticipated operating results;
- changes in estimated earnings by securities analysts;
- market conditions in the communications services industry;
- announcement and performance by competitors;
- regulatory actions; and
- general economic conditions.

In addition, in recent months the stock market generally has experienced significant price and volume fluctuations. Those market fluctuations could have a material adverse effect on the market price or liquidity of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our headquarters are located on 46 acres in the Interlocken Advanced Technology Environment within the City and County of Broomfield, Colorado. The campus facility, which is owned by our wholly owned subsidiary HQ Realty, Inc., encompasses approximately 850,000 square feet of office space.

Additionally, we lease approximately 121,180 square feet of office and technical space in a building located at 180 Peachtree Street, NW in Atlanta, Georgia. We also lease approximately 213,594 square feet of office and technical space in the building known as One Technology Center located at 100 South Cincinnati Avenue in Tulsa, Oklahoma and approximately 54,000 square feet of office space in the Southpointe office park in Canonsburg, Pennsylvania, comprised of approximately 42,500 square feet in the building located at 121 Champion Way and approximately an additional 11,300 square feet in the building located at 601 Technology Drive. We also lease approximately 130,000 square feet of office space in a building located at 1122 South Capital of Texas Highway in Austin, Texas. In Europe, we have approximately 211,000 square feet of office space in the United Kingdom and approximately 3,000 square feet of office space in France.

Properties relating to our network operations in the communications business are described under "ITEM 1. BUSINESS—Our Communications Network" above.

Our Gateway facilities are designed to house local sales staff, operational staff, our transmission and IP routing/switching facilities and technical space to accommodate colocation of equipment by high-volume Level 3 customers. We ended 2007 with approximately 6.9 million square feet of space for our Gateway and transmission facilities and have completed construction on approximately 4.6 million square feet of this space. Our Gateway space is either owned by us or is held pursuant to long-term lease agreements.

We have entered into various agreements regarding our unused office and technical space in order to reduce our ongoing operating expenses regarding such space.

Properties relating to our coal mining segment are described under "ITEM 1. BUSINESS—Our Other Businesses" above. In connection with certain existing and historical operations, we are subject to environmental risks.

ITEM 3. LEGAL PROCEEDINGS

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

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

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

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

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

Part II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information. Our common stock is traded on the NASDAQ Global Select Market of The NASDAQ Stock Market LLC under the symbol "LVLT." As of February 26, 2008, there were 7,890 holders of record of our common stock, par value \$.01 per share. The table below sets forth, for the calendar quarters indicated, the high and low per share closing sale prices of our common stock as reported by the NASDAQ Global Select Market of The NASDAQ Stock Market LLC.

| Year Ended December 31, 2007 | High | Low |
|------------------------------|---------|---------|
| First Quarter | \$ 6.76 | \$ 5.57 |
| Second Quarter | 6.26 | 5.26 |
| Third Quarter | 6.41 | 4.46 |
| Fourth Quarter | 5.04 | 2.82 |
| Year Ended December 31, 2006 | High | Low |
| First Quarter | \$ 5.60 | \$ 2.73 |
| Second Quarter | 5.72 | 3.78 |
| Third Quarter | 5.46 | 3.44 |
| Fourth Quarter | 6.02 | 4.93 |

Equity Compensation Plan Information.

We have only one equity compensation plan—the 1995 Stock Plan, as amended—under which we may issue shares of our common stock to employees, officers, directors and consultants. This plan has been approved by our stockholders. The following table provides information about the shares of our common stock that may be issued upon exercise of awards under the 1995 Stock Plan as of December 31, 2007.

| Plan Category | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plans |
|--|---|---|--|
| Equity compensation plans approved by stockholders | 38,503,698 [†] | \$ 4.45 [‡] | 91,780,820 |
| Equity compensation plans not approved by stockholders | 0 | \$ 0.00 | 0 |

[†] Includes awards of nonqualified stock options, restricted stock, restricted stock units and outperform stock options or outperform stock appreciation units ("OSOs"). For purposes of this table, OSOs are considered to use a single share of our common stock from the total number of shares reserved for issuance under the 1995 Stock Plan.

[‡] Includes weighted-average exercise price of outstanding nonqualified stock options and OSOs at the date of grant. The exercise price of an OSO is subject to change based upon the performance of our common stock relative to the performance of the S&P 500® Index from the time of the grant of the award until the award has been exercised.

Recipients of OSOs do not realize any value from these awards unless our common stock price outperforms the S&P 500® Index during the life of the grant. When the stock price gain is greater than the corresponding gain on the S&P 500® Index (or less than the corresponding loss on the S&P 500® Index for grants awarded before September 30, 2005), the value received for awards under the OSO program is based on a formula involving a multiplier related to the level by which our common stock outperforms the S&P 500® Index. To the extent that our common stock outperforms the S&P 500® Index, the value of OSO units to a holder may exceed the value of nonqualified stock options.

The initial strike price, as determined on the day prior to the OSO grant date, is adjusted over time, which we refer to as the Adjusted Strike Price, until the exercise date or the vesting date, as the case may be. The adjustment is an amount equal to the percentage appreciation or depreciation in the value of the S&P 500® Index from the date of grant to the date of exercise or vesting, as the case may be. Beginning on April 1, 2007, OSO units are awarded monthly to employees in mid-management level and higher positions, have a three year life, will vest 100 percent on the third anniversary of the date of the award and will fully settle on that date. Recipients have no discretion on the timing to exercise OSO units granted on or after April 1, 2007.

The value of the OSO increases for increasing levels of outperformance. OSO units have a multiplier range from zero to four depending upon the performance of our common stock relative to the S&P 500® Index as shown in the following table.

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

The Pre-multiplier gain is our common stock price minus the Adjusted Strike Price on the date of exercise or the vesting date, as the case may be. Unlike the exercise of a non-qualified stock option, in the situation where the outperformance is 11 percent or greater, the number of shares of our common stock issued upon exercise or vesting of an OSO may be up to four times the number of OSOs awarded.

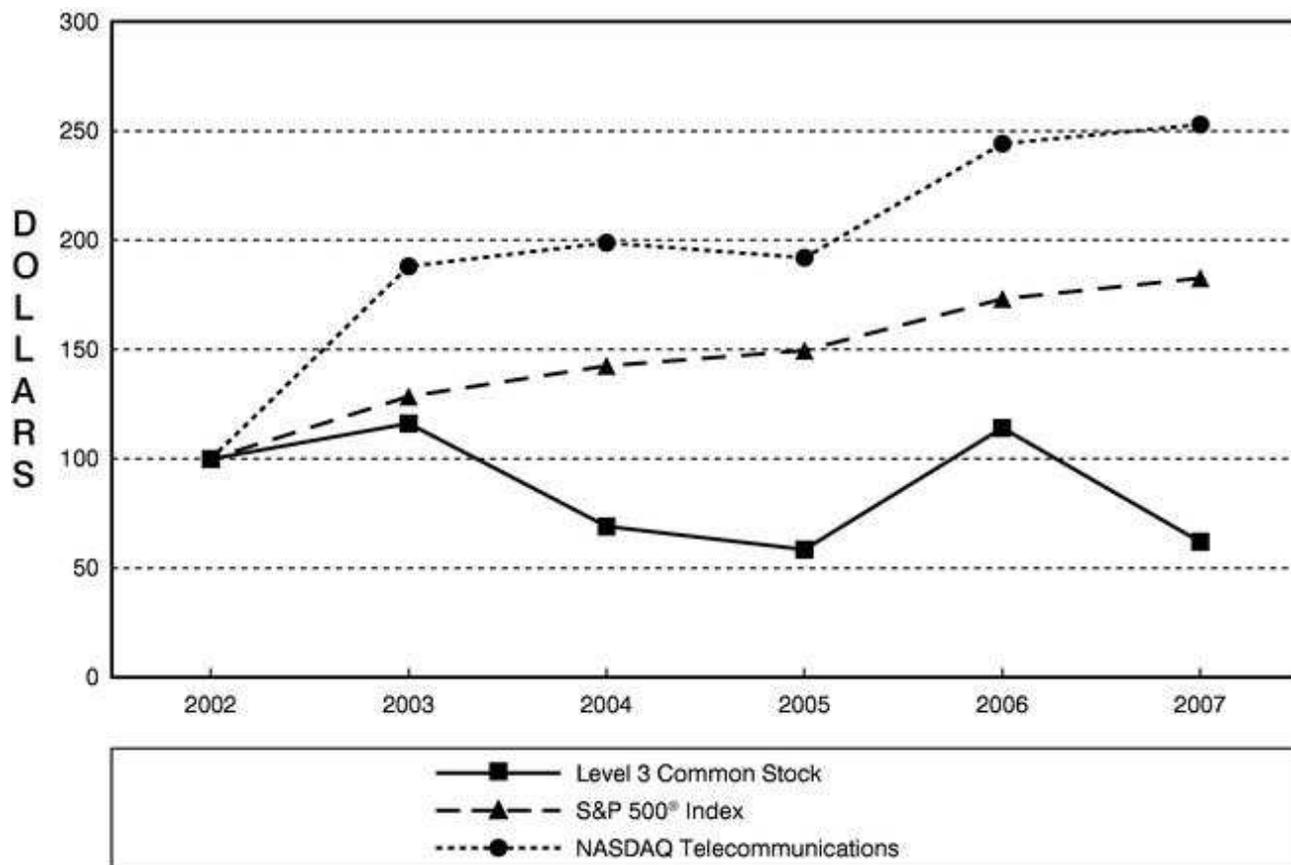
Dividend Policy. Our current dividend policy, in effect since April 1, 1998, is to retain future earnings for use in our business. As a result, our directors and management do not anticipate paying any cash dividends on shares of our common stock in the foreseeable future. In addition, under certain of our debt covenants we may be restricted from paying cash dividends on shares of our common stock.

Performance Graph.

The following performance graph shall not be deemed to be incorporated by reference by means of any general statement incorporating by reference this Form 10-K into any filing under the Securities Act of 1933, as amended or the Securities Exchange Act of 1934, except to the extent that the company specifically incorporates such information by reference, and shall not otherwise be deemed filed under such acts.

The graph compares the cumulative total return of our common stock for the five year period from 2003 through 2007 with the S&P® 500 Index and the Nasdaq Telecommunications Index. The graph assumes that the value of the investment was \$100 on December 31, 2002, and that all dividends and other distributions were reinvested.

**Comparison of Five Year Cumulative Total Return
Among Our Common Stock, the S&P® 500 Index
and the Nasdaq Telecommunications Index**



| | 12/02 | 12/03 | 12/04 | 12/05 | 12/06 | 12/07 |
|----------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Level 3 Common Stock | 100.00 | 116.33 | 69.18 | 58.57 | 114.29 | 62.04 |
| S&P 500® Index | 100.00 | 128.68 | 142.69 | 149.70 | 173.34 | 182.87 |
| NASDAQ Telecommunications | 100.00 | 188.26 | 199.05 | 192.21 | 244.42 | 253.15 |

ITEM 6. SELECTED FINANCIAL DATA

The Selected Financial Data of Level 3 Communications, Inc. and its subsidiaries appear below.

| | Fiscal Year Ended(1) | | | | |
|---|----------------------|----------|----------|----------|----------|
| | 2007 | 2006 | 2005 | 2004 | 2003 |
| (dollars in millions, except per share amounts) | | | | | |
| Results of Operations: | | | | | |
| Revenue | \$ 4,269 | \$ 3,378 | \$ 1,719 | \$ 1,776 | \$ 2,027 |
| Loss from continuing operations(2) | (1,114) | (790) | (707) | (478) | (695) |
| Income (loss) from discontinued operations(3) | — | 46 | 69 | 20 | (21) |
| Net loss | (1,114) | (744) | (638) | (458) | (711) |
| Per Common Share: | | | | | |
| Loss from continuing operations(2) | (0.73) | (0.79) | (1.01) | (0.70) | (1.23) |
| Income (loss) from discontinued operations(3) | — | 0.05 | 0.10 | 0.03 | (0.04) |
| Net loss | (0.73) | (0.74) | (0.91) | (0.67) | (1.26) |
| Dividends(4) | — | — | — | — | — |
| Financial Position: | | | | | |
| Total assets | 10,245 | 9,994 | 8,277 | 7,544 | 8,302 |
| Current portion of long-term debt(5) | 32 | 5 | — | 143 | 124 |
| Long-term debt, less current portion(5) | 6,832 | 7,357 | 6,023 | 5,067 | 5,249 |
| Stockholders' equity (deficit)(6) | 1,070 | 374 | (476) | (157) | 181 |

- (1) The operating results of Software Spectrum, Inc. ("Software Spectrum"), which was sold in 2006, (i)Structure, LLC ("(i)Structure"), which was sold in 2005, the Midwest Fiber Optic Network business acquired from Genuity, Inc. in 2003 and sold in 2003 are included in discontinued operations for all periods presented for which Level 3 owned each business.

The Company purchased substantially all of the assets and operations of Genuity, Inc. in February 2003. The Company also purchased Telveer Communications, Inc. in July 2003.

The Company acquired the managed modem businesses of ICG Communications, Inc. and Sprint Communications Company, L.P. on April 1, 2004 and October 1, 2004, respectively.

The Company purchased WilTel Communications Group, LLC ("WilTel") on December 23, 2005, and recorded approximately \$38 million of revenue attributable to this business in 2005.

The Company purchased Progress Telecom, LLC ("Progress Telecom") on March 20, 2006; ICG Communications, Inc. ("ICG Communications") on May 31, 2006; TelCove, Inc. ("TelCove") on July 24, 2006 and Looking Glass Networks Holding Co., Inc. ("Looking Glass") on August 2, 2006. The WilTel, Progress Telecom, ICG Communications, TelCove and Looking Glass results of operations and financial position are included in the consolidated financial statements from the respective dates of their acquisition. During 2006, the Company recorded revenue attributable to Progress Telecom of \$49 million, ICG Communications of \$46 million, TelCove of \$166 million and Looking Glass of \$33 million.

The Company purchased Broadwing Corporation ("Broadwing") on January 3, 2007; the Content Delivery Network services business of SAVVIS, Inc. (the "CDN Business") on January 23, 2007 and Servecast Limited on July 11, 2007. During 2007, the Company recorded revenue attributable to Broadwing of \$946 million, the CDN Business of \$17 million and Servecast of \$3 million.

- (2) In 2003, the Company recognized approximately \$346 million of termination and settlement revenue, \$45 million of impairment and restructuring charges, a gain of approximately \$70 million from the sale of "91 Express Lanes" toll road assets, \$200 million of induced conversion expenses

attributable to the exchange of the Company's convertible debt securities, and a gain of \$41 million as a result of the early extinguishment of long-term debt.

In 2004, the Company recognized a gain of \$197 million as a result of the early extinguishments of certain long-term debt and \$113 million of termination revenue.

In 2005, the Company recognized \$133 million of termination revenue and approximately \$23 million of impairment and restructuring charges.

In 2006, the Company recognized \$11 million of termination revenue, approximately \$13 million of impairment and restructuring charges, and a loss on early extinguishment of debt of \$83 million as a result of the amendment and restatement of its senior secured credit facility and certain debt exchanges and redemptions.

In 2007, the Company recognized \$10 million of termination revenue, approximately \$12 million of impairment and restructuring charges, and a loss on early extinguishment of debt of \$427 million as a result of the refinancing of its senior secured credit agreement and certain debt exchanges, redemptions and repurchases. The Company also recognized a gain of \$37 million on the sale of marketable equity securities and a tax benefit of \$23 million related to certain state tax matters.

- (3) In 2005, the Company sold (i)Structure and recognized a gain on the sale of \$49 million. For fiscal years 2005 and 2004, (i)Structure revenue approximated costs. The loss from operations was \$17 million in 2003 for (i)Structure.

In 2006, the Company sold Software Spectrum and recognized a gain on the sale of \$33 million. The income (loss) from the operations of Software Spectrum including the contact services business sold in 2003 were \$13 million, \$20 million, \$20 million and \$(16) million for the fiscal years 2006, 2005, 2004 and 2003, respectively.

- (4) The Company's current dividend policy, in effect since April 1998, is to retain future earnings for use in the Company's business. As a result, management does not anticipate paying cash dividends on shares of common stock in the foreseeable future. In addition, the Company is restricted under certain covenants from paying cash dividends on shares of its common stock.
- (5) In 2003, the Company received net proceeds of \$848 million from the issuance of \$374 million of 2.875% Convertible Senior Notes due 2010 and the issuance by its wholly owned subsidiary of \$500 million of 10.75% Senior Notes due 2011. The Company completed a debt exchange whereby the Company issued \$295 million (face amount) of 9% Convertible Senior Discount Notes due 2013 and common stock in exchange for \$352 million (book value) of long-term debt. In addition, Level 3 using cash on hand, restricted cash and the proceeds from the issuance of the 10.75% Senior Notes due 2011, repaid in full, the \$1.125 billion purchase money indebtedness outstanding under the Senior Secured Credit Facility. Also in 2003, the Company repurchased, using common stock, approximately \$1.007 billion face amount of its long-term debt and recognized a gain of approximately \$41 million as a result of the early extinguishment of debt.

In 2004, the Company received net proceeds of \$987 million from the issuance of a \$730 million Senior Secured Term Loan due 2011 and the issuance of \$345 million of 5.25% Convertible Senior Notes due 2011. The Company used the net proceeds to repay portions of its 9.125% Senior Notes due 2008, 11% Senior Notes due 2008, 10.5% Senior Discount Notes due 2008 and 10.75% Senior Euro Notes due 2008. The Company repurchased portions of the outstanding notes at prices ranging from 83 percent to 89 percent of the repurchased principal balances. The net gain on the early extinguishment of the debt, including transaction costs, realized foreign currency losses and unamortized debt issuance costs, was \$50 million for these transactions. Also in 2004, the Company paid approximately \$54 million and assumed certain obligations to extinguish a Genuity capital lease obligation and recognized a gain of \$147 million on the transaction.

In 2005, the Company received net proceeds of \$877 million from the issuance of \$880 million of 10% Convertible Senior Notes due 2011. Also in 2005, a wholly owned subsidiary of the Company received net proceeds of \$66 million from the completion of a refinancing of the mortgage of its corporate headquarters. The subsidiary entered into a new mortgage loan of \$70 million at an initial fixed rate of 6.86% through 2010.

In 2006, the Company received net proceeds of \$142 million from the issuance by its wholly owned subsidiary of \$150 million of Floating Rate Senior Notes due 2011, net proceeds of \$538 million from the issuance of \$550 million of 12.25% Senior Notes due 2013, net proceeds of \$326 million from its issuance of \$335 million of 3.5% Convertible Senior Notes due 2012 and net proceeds of \$1.239 billion (excluding prepaid interest) from the issuance by its wholly owned subsidiary of \$1.250 billion of 9.25% Senior Notes due 2014. Also in 2006, the Company exchanged a portion of its outstanding 9.125% Senior Notes due 2008, 11% Senior Notes due 2008 and 10.5% Senior Discount Notes due 2008 for \$46 million of cash and \$692 million aggregate principal of new 11.5% Senior Notes due 2010. In addition, the Company redeemed the remaining outstanding 9.125% Senior Notes due 2008 totaling \$398 million, 10.5% Senior Discount Notes due 2008 totaling \$62 million and repurchased 99.3% of its wholly owned subsidiary's 10.75% Senior Notes due 2011 totaling \$497 million.

In 2007, the Company received net proceeds of \$982 million from the issuance by its wholly owned subsidiary of 8.75% Senior Notes due 2017 and Floating Rate Senior Notes due 2015 and net proceeds of \$1.382 billion for the refinancing of its senior secured credit agreement. In connection with the refinancing of the senior secured credit agreement the borrower repaid its \$730 million Senior Secured Term Loan due 2011. In 2007, the Company redeemed \$488 million of its outstanding 12.875% Senior Notes due 2010, \$96 million of outstanding 11.25% Senior Notes due 2010 and \$138 million (€104 million) of outstanding 11.25% SeniorEuro Notes due 2010. Also in 2007, the Company's wholly owned subsidiary repurchased \$144 million of its outstanding Floating Rate Senior Notes due 2011, the Company repurchased \$59 million of its outstanding 11% Senior Notes due 2008, \$677 million of its outstanding 11.5% Senior Notes due 2010 and \$61 million (€46 million) of its outstanding 10.75% Senior Euro Notes due 2008. The Company also completed the exchange of \$605 million of its 10% Convertible Senior Notes due 2011 for a total of 197 million shares of common stock during 2007. The Company also converted or repurchased \$180 million of Broadwing's outstanding 3.125% Convertible Senior Debentures due 2026 through the issuance of 17 million shares of common stock and the payment of \$106 million in cash in 2007.

- (6) In 2003, the Company issued approximately 216 million shares of common stock, valued at approximately \$953 million, in exchange for long-term debt. Included in the value of common stock issued, are induced conversion premiums of \$200 million for convertible debt securities.

In 2004, the Company realized \$95 million of foreign currency losses on the repurchase of its Euro denominated debt.

In 2005, the Company issued 115 million shares of common stock, valued at approximately \$313 million, as the stock portion of the purchase price paid to acquire WilTel.

In 2006, the Company issued approximately 125 million shares of common stock in a public offering, valued at approximately \$543 million.

In 2006, the Company issued 20 million shares of common stock, valued at approximately \$66 million, as the stock portion of the purchase price paid to acquire Progress Telecom; 26 million shares of common stock, valued at approximately \$131 million, as the stock portion of the purchase price paid to acquire ICG Communications; 150 million shares of common stock, valued at approximately \$623 million, as the stock portion of the purchase price paid to acquire TelCove;

and 21 million shares of common stock, valued at approximately \$84 million, as the stock portion of the purchase price paid to acquire Looking Glass.

In 2007, the Company issued 197 million shares of common stock in exchange for \$605 million of its 10% Convertible Senior Notes due 2011. The Company also issued 123 million shares of common stock, valued at approximately \$688 million, as the stock portion of the purchase price to acquire Broadwing Corporation. Also in 2007, the Company issued 17 million shares of common stock in connection with the conversion of \$179 million of Broadwing's outstanding 3.125% Convertible Senior Debentures due 2026.

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

This document contains forward looking statements and information that are based on the beliefs of management as well as assumptions made by and information currently available to Level 3 Communications, Inc. and its subsidiaries ("Level 3" or the "Company"). When used in this document, the words "anticipate", "believe", "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.

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

Level 3 Communications, Inc., through its operating subsidiaries, is primarily engaged in the communications business, with additional operations in coal mining.

Communication Services

The Company is a facilities-based provider of a broad range of communications services. Revenue for communications services is recognized on a monthly basis as these services are provided. For contracts involving private line, wavelengths and dark fiber services, Level 3 may receive up-front payments for services to be delivered for a period of 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. At December 31, 2007, for contracts where up-front payments were received for services to be delivered in the future, the Company's weighted average remaining contract period was approximately 14 years.

The Company separates its communications services into three separate categories:

- Core Communications Services;
- Other Communications Services; and
- SBC Contract Services.

Each category of revenue is in a different phase of the service life cycle, requiring different levels of investment and focus and providing different contributions to the Company's Communications Adjusted EBITDA. Management of Level 3 believes that growth in revenue from its Core Communications Services is critical to the long-term success of its communications business. At the same time, the Company believes it must continue to manage effectively the positive cash flows from its SBC Contract Services and its Other Communications Services, including the Company's mature managed modem business and its related reciprocal compensation. For 2007, the Core Communications Services category included revenue from transport and infrastructure, IP and data services, voice and Level 3 Vyvx video and advertising distribution services. The Other Communications Services category

includes revenue from managed modem and related reciprocal compensation and the legacy managed IP service business. The SBC Contract Services category includes all the revenue related to the SBC Master Services Agreement, which was included in the acquisition of WilTel Communications Group, LLC ("WilTel").

The Company's transport and infrastructure services include metropolitan and intercity wavelengths, private line, ethernet private line, dark fiber, colocation services, professional services and transoceanic services. Growth in transport and infrastructure 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 up-front payments or monthly payments for primarily private line, wavelength or dark fiber services. An increase in demand may be partially offset by declines in unit pricing.

IP and data services primarily include the Company's high-speed Internet access service, dedicated Internet access ("DIA") service, ATM and frame relay services, IP and ethernet virtual private network ("VPN") services, and content delivery network ("CDN") services, which includes streaming services. Level 3's high-speed Internet access service is a high quality and high-speed Internet access service offered in a variety of capacities. The Company's VPN services permit 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 services also permit 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 Communications 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 usage by both enterprises and consumers 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. This market is currently characterized by significant price compression and very high levels of unit growth rates, resulting in growth in absolute revenue. The Company experienced price compression in the high-speed IP market of over 30% in 2007 and expects that its pricing for high-speed IP services will continue to decline in 2008 at similar rates.

The Company continues to experience pricing pressure for those transport and infrastructure customers that require simple, low quality, point-to-point services, as certain competitors aggressively pursued this business. However, Level 3 believes that competitors are less willing to discount these services if it requires investment in incremental capacity to meet the customer's requirements. For those customers that provide high quality content or require a combination of transport, IP and voice solutions on a regional or national platform, Level 3 is seeing moderate price compression and, in some cases, prices are increasing.

The Company offers voice services that target large and existing markets. The revenue potential for voice services is large; however, the revenue 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 voice services is being targeted by many competitors, several of which are larger and have more financial resources than the Company.

The Company, through its Level 3 Vyvx business, provides audio and video programming for its customers over the Company's fiber-optic network and via satellite. It uses the Company's fiber-optic network to carry live traditional broadcast and cable television events from the site of the event to the network control centers of the broadcasters of the event.

For live events where the location is not known in advance, such as breaking news stories in remote locations, the Company provides an integrated satellite and fiber-optic network-based service to transmit the content to its customers. Most of Level 3's Vyvx's customers for these services contract for the service on an event-by-event basis; however, there are some customers who have purchased a dedicated point-to-point service which enables these customers to transmit programming at any time.

Level 3 Vyvx also distributes advertising spots to radio and television stations throughout the U.S., both electronically and in physical form. Customers for these services can utilize a network-based method for aggregating, managing, storing and distributing content for content owners and rights holders.

On December 19, 2007, Level 3 announced that it had reached a definitive agreement to sell the advertising distribution business of Vyvx, LLC ("Vyvx Ads") to DG FastChannel, Inc. for \$129 million in cash. The sale is expected to close in the second quarter of 2008. Revenue from the Vyvx Ads business totaled approximately \$36 million, \$35 million and less than \$1 million for the years ended December 31, 2007, 2006 and 2005, respectively. The results of operations for the Vyvx Ads business are included in continuing operations from when it was acquired as part of the WilTel transaction in December 2005. The pending disposal of the Vyvx Ads business does not meet the criteria under Statement of Financial Accounting Standard ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144") for presentation as discontinued operations since the business is not considered an asset group as defined in SFAS No. 144.

The Company expects to continue to develop its content distribution services through the acquisition of the Content Delivery Network ("CDN") services business (the "CDN Business") which it purchased on January 23, 2007 from SAVVIS, Inc. for approximately \$133 million in cash (including transaction costs) and the acquisition of Dublin, Ireland based Servecast Limited, which it purchased on July 11, 2007, for approximately \$46 million in cash (including transaction costs). The Company believes that the addition of the CDN Business with its strong, broad portfolio of patents will help the Company secure its commercial efforts in the heavily patented CDN market in which a number of competitors have significant, patented intellectual property. In early 2007 we embarked on a strategy to refine our capabilities to address the communications needs of those organizations that produce the content that individuals want to view over the Internet. This service offering includes high speed IP services, colocation services and services that cost effectively distribute the content that is produced for consumption over the Internet. We believe that one of the largest sources of future incremental demand for communications services will be derived from customers that are seeking to distribute their feature rich content or video over the Internet.

The Company's Other Communications Services are mature services that are not areas of emphasis for the Company. Other Communications Services currently include managed modem, related reciprocal compensation and legacy managed IP services.

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. Additionally, America Online, a primary consumer of the Company's dial-up services, has been implementing a strategic change in its approach to its dial-up internet access business over the past 18 months that has accelerated the loss of its dial-up subscribers. During 2007, America Online's strategy accelerated the decline in Level 3 managed modem revenue and is expected to contribute to further declines in managed modem revenue in 2008. The Company recognized approximately \$179 million of managed modem revenue in 2007, an approximate 37% decline from the \$286 million of managed modem revenue recognized in 2006. The declines in managed modem revenue from America Online in 2007 have been offset to some extent by an increase in market share as a result of certain competitors exiting segments of this business in the second half of 2006 and the full year 2007. Level 3 believes that

the low-cost structure of its network will enable it to compete aggressively for new business in the declining, but still significant, managed modem market.

Level 3 receives compensation from other carriers when it terminates traffic originating on those carriers' networks. This reciprocal compensation is based on interconnection agreements with the respective carriers or rates mandated by the FCC. The Company earns the majority of its reciprocal compensation revenue from providing managed modem services. The Company also began to receive increasing amounts of reciprocal compensation from its voice services during 2007.

Legacy managed IP services primarily include low-speed services over ATM technology and frame technology, as well as managed security services. The Company's legacy Internet access business consists primarily of a business that was acquired in the Genuity transaction in 2003. To date, the Company has elected not to pursue additional customers and to limit the capital invested in this component of its business.

The SBC Master Services Agreement was an agreement between SBC Services Inc. and WilTel ("SBC Contract Services Agreement") and was obtained in the WilTel acquisition. SBC Services Inc. became a subsidiary of AT&T Inc., (together "SBC"). WilTel and SBC amended their agreement in June 2005 to run through 2009. The Company recognized \$303 million of revenue under the SBC Contract Services Agreement during 2007. The agreement provides a gross margin purchase commitment of \$335 million from December 2005 through the end of 2007, and \$75 million from January 2008 through the end of 2009 and stipulates that originating and terminating access charges paid to local phone companies get passed through to SBC in accordance with a formula that approximates costs and do not count against the gross margin purchase commitment. SBC fully satisfied the \$335 million gross margin purchase commitment during the third quarter of 2007. As a result of satisfying the initial gross margin purchase commitment, SBC's purchases of services that exceed the original \$335 million gross margin purchase commitment now count toward the \$75 million gross margin purchase commitment for the period from January 2008 through the end of 2009. As of December 31, 2007, SBC had satisfied \$39 million of the \$75 million gross margin purchase commitment. Level 3 expects that based on SBC's current level of spending, SBC will satisfy the remaining \$36 million of gross margin purchase commitment in the first half of 2008.

Additionally, the SBC Contract Services Agreement provides for the payment of \$50 million from SBC if certain performance criteria are met by Level 3. The Company met the required performance criteria and recorded annual revenue of \$25 million in both 2006 and 2007 under the agreement. Of the annual amounts, 50% was based on monthly performance criteria and the remaining 50% was based on performance criteria for the full years. The performance-based incentive provisions of the agreement ended on December 31, 2007. Level 3 will not earn performance-based incentives in 2008 under the SBC Contract Services Agreement.

As a result of the reductions in SBC Contract Services revenue and the overall increase in revenue from acquisition activity, concentration of revenue among a limited number of customers has decreased compared to previous periods. Level 3's top ten customers, including the SBC Contract Services revenue, represented 61% of total communications revenue in the first quarter of 2006, dropping to 36% of total communications revenue in the fourth quarter of 2007. Excluding the SBC Contract Services revenue, Level 3's top ten customers represented 39% of total communications revenue in the first quarter of 2006, dropping to 31% of total communications revenue in the fourth quarter of 2007. The Company expects the concentration of revenue from its top ten customers to continue to decline moderately in 2008 as the SBC Contract Services revenue continues to decline. However, if Level 3 would lose one or more major customers, or if one or more major customers significantly decreased its orders for Level 3 services, the Company's communications business would be materially and adversely affected.

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

The Company is focusing its attention on the following operational objectives:

- growing revenue in Core Communications Services;
- continuing to show improvements in Adjusted EBITDA as a percentage of revenue;
- achieving sustainable generation of free cash flow;
- completing the integration of acquired businesses;
- growing its content delivery network services;
- continuing to implement its metro network strategy; and
- managing cash flows provided by its Other Communications Services and SBC Contract Services.

Management of Level 3 believes the introduction of new services or technologies, as well as the further development of existing technologies, may reduce the cost or increase the supply of certain services similar to those provided by Level 3. The ability of the Company to anticipate, adapt and invest in these technology changes in a timely manner may affect the Company's future success.

The Company completed the initial planned deployment of the next generation of optical transport technology in its North American and European networks in the fourth quarter of 2005 and early in the first quarter of 2006, respectively. The Company decided to deploy the technology for additional routes in North America and Europe and completed the deployments on these routes in 2006. The Company completed an upgrade of its IP backbone technology in the fourth quarter of 2005. Level 3 believes that this deployment of new equipment to the existing network equipment will allow the Company to optimize the amount of traffic it carries over the network and lower its cost of providing its services.

To expand its service offerings in Europe, the Company invested approximately \$20 million for a dark fiber based expansion in Europe. During 2006, the Company obtained dark fiber primarily in those cities currently served by leased wavelength capacity and additionally in 2006 the Company completed an expansion of our European operations to nine additional cities. During 2007, the Company obtained dark fiber in three cities that had been served by leased wavelength capacity and additionally in 2007 the Company completed an expansion of its European operations to nine additional cities. In 2008, the Company expects to continue its European expansion to one additional city using leased wavelength capacity. The Company expects to use the dark fiber with appropriate transmission equipment to sell a full suite of transport and IP services.

The communications industry continues to consolidate. Level 3 has participated in this process with the acquisitions of WilTel in 2005; Progress Telecom, LLC ("Progress Telecom"); ICG Communications, Inc. ("ICG Communications"); TelCove, Inc. ("TelCove") and Looking Glass Networks Holding Co., Inc. ("Looking Glass") in 2006; and Broadwing Corporation ("Broadwing"); the CDN Business and Servecast in 2007. Level 3 will continue to evaluate consolidation opportunities and could make additional acquisitions in the future.

The successful integration of acquired businesses into Level 3 is important to the success of Level 3. The Company must integrate the networks and support organizations, while maintaining the service quality levels expected by customers in order to realize the anticipated benefits of these acquisitions. Successful integration of these acquired businesses will depend on the Company's ability to manage these operations, realize opportunities for revenue growth presented by strengthened service offerings and expanded geographic market coverage. If the Company is not able to efficiently and effectively integrate the acquired businesses or operations, the Company may experience material negative consequences to its business, financial condition or results of operations.

During the second and third quarters of 2007, the Company's service activation times increased as a result of the following issues.

- Continuing to use the multiple order entry and provisioning systems and processes that were operated by the acquired companies to provision end-to-end services.
- Insufficient training on the multiple systems for employees performing service activation functions.
- Lack of sufficient staffing levels in some service activation areas.
- Identifying and fixing service activation throughput issues was challenging as a result of decentralizing service activation functions across the customer facing groups.

This increase in service activation cycle time had a negative effect on the Company's service installation intervals and the rate of Core Communications Services revenue growth during the second, third and fourth quarters of 2007. During this same period, the Company also experienced challenges in its service management processes that resulted in longer response times to resolve customers' network service issues. As a result of consolidating key operational functions and organizations as part of the integration effort, the Company's operating environment became more complex in the first half of 2007.

During the second and third quarters, the Company implemented certain process and organizational changes that were expected to improve service activation times and allow it to achieve its previously forecasted revenue and Adjusted EBITDA growth. However these changes were not adequate to address the breadth of the problems encountered during the third quarter. As a result of these service activation and service management issues, the growth in Communications Services Revenue and Adjusted EBITDA was lower than expected for the full year 2007 and is expected to be lower than originally forecasted in 2007 for the full year 2008.

The Company has ongoing process and system development work that is being implemented as part of the integration efforts that is expected to address the service activation and service management issues described above as well as provide significant overall improvements to operations. The processes and systems under development remain largely on track with certain components deployed beginning in October 2007 and additional deployments scheduled through the end of 2008. While the operational benefits vary by each project, the Company expects to realize meaningful improvements in its operating environment during the second half of 2008. In addition, the Company is taking steps to improve its existing processes and systems to address the increase in service activation times and improve its service management. During the fourth quarter of 2007, the Company improved its provisioning capability by both increasing resources and through process improvement. The Company believes that its customers' experiences with Level 3 have improved and the Company continues to make process and organizational changes to improve its capabilities in 2008.

Level 3 has embarked on a strategy to expand its current metro presence. The strategy allows the Company to increasingly terminate traffic over its owned metro facilities rather than paying third parties to terminate the traffic. Level 3's ability to provide high-speed bandwidth directly to customer

facilities is expected to be a competitive advantage. The Company intends to offer a broad range of services in these markets and concentrate its sales efforts on the bandwidth intensive businesses. The expansion into new metro markets should also provide additional opportunities to sell services on the Company's national and international networks. This metro strategy included the acquisitions of Progress Telecom, ICG Communications, TelCove and Looking Glass. As part of its metro strategy and as a result of the acquisition of TelCove in 2006 and Broadwing in 2007, the Company is also targeting enterprise customers directly through its Business Markets Group described in more detail below. With the acquisition of the CDN Business and Servecast in 2007, Level 3 embarked on a strategy to expand its content delivery network services in both the United States and Europe.

The change in the composition of the Company's revenue requires the Company to manage operating expenses carefully and concentrate its capital expenditures on those technologies and assets that enable the Company to develop its Core Communications Services further and replace the decline in revenue and earnings from Other Communications Services and SBC Contract Services.

In the third quarter of 2006, Level 3 announced the formation of four customer-facing groups to better serve the changing needs of customers in growing markets and drive growth across the organization:

- The Wholesale Markets Group services the communications needs of the largest national and global service providers, including carriers, cable companies, wireless companies, and voice service providers. These customers typically integrate Level 3 services into their own products and services to offer to their end user customers. Revenue from the Wholesale Markets Group represented 56% of Core Communications Services revenue for 2007.
- The Business Markets Group targets enterprise customers and regional carriers who value a local, professional sales force. Specific customer markets include small, medium, and large businesses, local and regional carriers, state and local government entities, and higher education institutions and consortia. Revenue from the Business Markets Group represented 26% of Core Communications Services revenue for 2007.
- The Content Markets Group focuses on serving media and content companies with large and growing bandwidth needs. Customers in this market include video distribution companies, providers of gaming, mega-portals, software service providers, social networking providers, as well as more traditional media distribution companies such as broadcasters, television networks and sports leagues. Revenue from the Content Markets Group represented 11% of Core Communications Service revenue for 2007.
- The European Markets Group serves large European consumers of bandwidth, including the European and international carriers, large system integrators, voice service providers, cable operators, Internet service providers, content providers, and government and education sectors. Revenue from the European Markets Group represented 7% of Core Communications Services revenue for 2007.

The Company believes that the alignment around customer markets should allow it to drive growth while enabling it to better focus on the needs of its customers. Beginning in 2008, the Company will disclose Core Communications Services revenue in dollars and as a percentage of total Core Communications Services revenue for each of its market groups, Wholesale, Business, Content and Europe.

In addition to the operational objectives mentioned above, the Company has also been focused on improving its liquidity and financial condition, including efforts to extend the maturity dates of certain debt and lowering the effective interest rate on its outstanding debt.

In January 2007, in two separate transactions, the Company completed the exchange of \$605 million of outstanding principal of its 10% Convertible Senior Notes due 2011 for a total of 197 million shares of Level 3's common stock. The Company recognized a \$177 million loss on the exchanges in the first quarter of 2007.

In February 2007, Level 3 Financing, Inc., a wholly owned subsidiary of Level 3 ("Level 3 Financing") issued \$700 million of its 8.75% Senior Notes due 2017 and \$300 million of its Floating Rate Senior Notes due 2015 and received net proceeds of \$982 million. The proceeds from these private offerings were used to refinance certain Level 3 Financing debt and to fund the cost of construction, installation, acquisition, lease, development or improvement of other assets to be used in Level 3's communications business.

In March 2007, Level 3 Financing refinanced its senior secured credit agreement and received net proceeds of \$1.382 billion. The proceeds from this transaction were used to repay the existing \$730 million senior secured credit agreement and other debt. The effect of this transaction was to increase the amount of senior secured debt from \$730 million to \$1.4 billion, reduce the interest rate on that debt from the London Interbank Offering Rate ("LIBOR") plus 3.00% to LIBOR plus 2.25% and extend the final maturity from 2011 to 2014. The Company recognized a \$10 million loss on the extinguishment of the existing \$730 million Senior Secured Term Loan due 2011 due to recognition of the remaining unamortized debt issuance costs.

During the first quarter of 2007, the Company redeemed the entire outstanding principal of the following debt issuances totaling \$722 million:

- \$488 million of 12.875% Senior Notes due 2010 at a price equal to 102.146 of the principal amount;
- \$96 million of 11.25% Senior Notes due 2010 at a price equal to 101.875 of the principal amount; and
- \$138 million (€104 million) of 11.25% Senior Euro Notes due 2010 at a price equal to 101.875 of the principal amount.

Also during the first quarter of 2007, the respective issuers repurchased, through tender offers, \$941 million of the outstanding principal amounts of the following debt issuances:

- \$144 million of its outstanding Floating Rate Senior Notes due 2011 at a price equal to \$1,080 per \$1,000 principal amount of the notes, which included \$1,050 as the tender offer consideration and \$30 as a consent payment;
- \$59 million of its outstanding 11% Senior Notes due 2008 at a price equal to \$1,054.28 per \$1,000 principal amount of the notes, which included \$1,024.28 as the tender offer consideration and \$30 as a consent payment;
- \$677 million of its outstanding 11.5% Senior Notes due 2010 at a price equal to \$1,115.26 per \$1,000 principal amount of the notes, which included \$1,085.26 as the tender offer consideration and \$30 as a consent payment; and
- \$61 million (€46 million) of its outstanding 10.75% Senior Euro Notes due 2008 at a price equal to €1,061.45 per €1,000 principal amount of the notes, which included €1,031.45 as the tender offer consideration and €30 as a consent payment.

The Company recognized a \$240 million loss associated with the redemptions and repurchases in the first quarter of 2007. The cash portion of the loss on redemptions and tenders totaled \$165 million and the remaining \$75 million consisted of unamortized debt issuance costs and unamortized discounts.

In the first quarter of 2007, for total cash consideration of \$106 million and equity consideration of 17 million shares of common stock (valued at \$97 million) all of Broadwing's outstanding \$180 million aggregate principal amount of 3.125% Convertible Senior Debentures due 2026 were retired. These debentures were issued by Broadwing prior to Level 3's acquisition of Broadwing on January 3, 2007. There was no gain or loss recognized due to the fact that, under purchase accounting, the liability for the notes was valued at the total cost to retire the obligation.

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 communications business.

Coal Mining

Level 3, through its two 50% owned joint-venture surface mines in Montana and Wyoming, sells coal primarily through long-term contracts with public utilities. The long-term contracts for the delivery of coal establish the price, volume, and quality requirements of the coal to be delivered. Revenue under these and other contracts is recognized when coal is shipped to the customer.

Information Services

On November 30, 2005, the Company sold its wholly owned subsidiary, (i)Structure, LLC, which provided computer outsourcing services primarily to small and medium-sized businesses. The Company also completed the disposition of its remaining subsidiary in the information services business, Software Spectrum, Inc. on September 7, 2006. The results of operations and financial position for (i)Structure and Software Spectrum are reflected as discontinued operations for all periods presented in this report.

Critical Accounting Policies

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

Revenue

Revenue for communications services, including voice, private line, wavelengths, colocation, Internet access, managed modem, data services, video and dark fiber revenue is recognized monthly as the services are provided. Communications services are provided either on a usage basis, which can vary period to period, or at a contractually committed amount.

Reciprocal compensation revenue is recognized when an interconnection agreement is in place with another carrier, or if an agreement has expired, when the parties have agreed to continue operating under the previous agreement until a new agreement is negotiated and executed; or at rates mandated by the FCC. Periodically, the Company will receive payment for reciprocal compensation services in excess of FCC rates and before an agreement is in place. These amounts are included in other current liabilities on the consolidated balance sheet until a final agreement has been reached and the necessary regulatory approvals have been received at which time the reciprocal compensation revenue is recognized. These amounts were insignificant to the Company in 2007 and 2006.

Revenue attributable to leases of dark fiber pursuant to indefeasible rights-of-use agreements ("IRUs") that qualify for sales-type lease accounting, and were entered into prior to June 30, 1999, was recognized at the time of delivery and acceptance of the fiber by the customer. Certain sale and long-term IRU agreements of dark fiber and capacity entered into after June 30, 1999, are required to be accounted for in the same manner as sales of real estate with property improvements or integral

equipment. This accounting treatment results in the deferral of revenue for the cash that has been received and the recognition of revenue ratably over the term of the agreement (currently up to 20 years).

Termination revenue is recognized when a customer disconnects service prior to the end of the contract period, for which Level 3 had previously received consideration and for which revenue recognition was deferred. Termination revenue is also recognized when customers make termination penalty payments to Level 3 to settle contractually committed purchase amounts that the customer no longer expects to meet or when a customer and Level 3 renegotiate a contract under which Level 3 is no longer obligated to provide product or services for consideration previously received and for which revenue recognition has been deferred. Termination revenue is reported in the same manner as the original product or service provided.

Accounting practice and guidance with respect to the accounting treatment of revenue continues to evolve. Any changes in the accounting treatment could affect the manner in which the Company accounts for revenue within its communications and coal businesses.

Non-Cash Compensation

The Company adopted SFAS No. 123R, "Share-Based Payment" ("SFAS No. 123R") effective January 1, 2006. SFAS No. 123R requires that compensation cost relating to share-based payment transactions be recognized in the financial statements based on the fair value of equity or liability instruments issued. The Company adopted the expense recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), in 1998. Therefore, the effect of applying the change from the original provisions of SFAS No. 123 on the Company's financial position or results of operations was insignificant. Although the recognition of the value of the instruments results in compensation or professional expenses in an entity's financial statements, the expense differs from other compensation and professional expenses in that these charges, though generally permitted to be settled in cash, are typically settled through the issuance of common stock, which would have a dilutive effect upon earnings per share, if and when such options are exercised. The determination of the estimated fair value used to record the compensation or professional expenses associated with the equity or liability instruments issued requires management to make a number of assumptions and estimates that can change or fluctuate over time.

Long-Lived Assets

Property, plant and equipment is stated at cost, reduced by provisions to recognize economic impairment in value when management determines that events have occurred that require an analysis of potential impairment. Costs associated directly with network expansions and the development of business support systems, primarily employee-related costs, are capitalized. The Company capitalized \$102 million, \$72 million and \$51 million of cost, primarily direct labor and related employee benefits, in 2007, 2006 and 2005, respectively.

Intercity network segments, gateway facilities, local networks and operating equipment that have been placed in service are being depreciated over their estimated useful lives, primarily ranging from 2-40 years. The total cost of a business support system is amortized over a useful life of three years. The useful lives of the Company's assets are estimates and actual in-service periods for specific assets could differ significantly from these estimates. Due to changes in technology and the competitive environment, these estimates require a significant amount of judgment. Management monitors and evaluates these estimates on an annual basis or as circumstances change that may indicate a change in estimate is required. During 2006 the Company extended the useful lives of its existing fiber assets from seven to 12 years, its existing transmission equipment from five to seven years and its existing IP equipment from three to four years.

The Company at least annually, or as events or circumstances change that could affect the recoverability of the carrying value of its long-lived assets, conducts a comprehensive review of the carrying value of its assets to determine if the carrying amount of the assets are recoverable in accordance with SFAS No. 144. This review requires the identification of the lowest level of identifiable cash flows for purposes of grouping assets subject to review. The estimate of undiscounted cash flows includes long-term forecasts of revenue growth, gross margins and capital expenditures. All of these items require significant judgment and assumptions. An impairment loss may exist when the estimated undiscounted cash flows attributable to the assets are less than their carrying amount. If an asset is deemed to be impaired, the amount of the impairment loss recognized represents the excess of the long-lived asset's carrying value as compared to its estimated fair value, based on management's assumptions and projections.

The Company assessed its communications long-lived assets for impairment in the fourth quarter of 2007, and determined that an impairment charge was not required. The communications network includes network equipment, fiber, multiple conduits, customer premise equipment and colocation facilities. The impairment analysis is based on a long-term cash flow forecast to assess the recovery of the communications assets over their estimated useful lives.

Level 3 also assesses the carrying value of goodwill on an annual basis in accordance with SFAS No. 142 "Goodwill and Other Intangible Assets." (SFAS No. 142). The carrying value of the reporting unit is compared to its fair value. If the fair value does not exceed the carrying value of the reporting unit, an analysis is performed to determine if an impairment charge should be recorded. The Company also evaluates intangible assets with indefinite lives individually on an annual basis, or as events or circumstances change that could affect the recoverability of the carrying value of the asset, in accordance with SFAS No. 142. The Company did not record charges for the impairment of long-lived assets or goodwill in 2007, 2006 or 2005.

Management's estimate of the future cash flows attributable to its long-lived assets and the fair value of its businesses involve significant uncertainty. Those estimates are based on management's assumptions of future results, growth trends and industry conditions. The impairment analysis of long-lived assets also requires management to make certain subjective assumptions and estimates regarding the expected future use of certain additional conduits evaluated for impairment separately from the network asset group. Management will continue to assess the Company's assets for impairment as events occur or as industry conditions warrant. Given the significant uncertainty, judgment and assumptions involved in developing the estimates of future cash flows and the number of years of remaining useful life of certain of the Company's assets, it is possible that the Company may determine that an impairment charge is required in the future due to changes in these assumptions and estimates.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The most critical estimates and assumptions are made in determining the allowance for doubtful accounts, revenue reserves, recovery of long-lived assets, useful lives of long-lived assets, accruals for estimated tax and legal liabilities, cost of revenue disputes for communications services, unfavorable contracts recognized in purchase accounting and asset retirement obligations. Actual results could differ from those estimates and assumptions.

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109" ("FIN No. 48"), which was effective for Level 3 starting January 1, 2007. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes". FIN No. 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return that results in a tax benefit. Additionally, FIN No. 48 provides guidance on de-recognition, income statement classification of interest and penalties, accounting in interim periods and disclosure. The Company's policy is to recognize interest and penalty expense associated with uncertain tax positions as a component of income tax expense in the consolidated statements of operations. The adoption of FIN No. 48 did not have an effect on the Company's consolidated results of operations or financial condition as of and for the year ended December 31, 2007.

In June 2006, the FASB ratified the consensus on EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement" ("EITF No. 06-3"), which was effective for Level 3 starting January 1, 2007. The scope of EITF No. 06-3 includes any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, Universal Service Fund ("USF") contributions and some excise taxes. The Task Force concluded that entities should present these taxes in the income statement on either a gross or a net basis, based on their accounting policy, which should be disclosed pursuant to APB Opinion No. 22, "Disclosure of Accounting Policies". If such taxes are significant and are presented on a gross basis, the amounts of those taxes should be disclosed. The Company records USF contributions on a gross basis in its consolidated statements of operations, but records sales, use, value added and excise taxes billed to its customers on a net basis in its consolidated statements of operations. Communications revenue on the consolidated statements of operations includes USF contributions totaling \$45 million, \$19 million and \$7 million for the years ended December 31, 2007, 2006 and 2005, respectively. The adoption of EITF No. 06-3 did not have a material effect on the Company's consolidated results of operations or financial condition for year ended December 31, 2007, as the policy followed was consistent before and after adoption.

In September 2006, the FASB issued Statements of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS No. 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for fiscal years beginning after November 15, 2007 and interim periods within that fiscal year. The adoption of SFAS No. 157 is not expected to have a material effect on the Company's consolidated results of operations or financial condition upon adoption on January 1, 2008.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" ("SFAS No. 141R"), which replaces SFAS No. 141, "Business Combinations." SFAS No. 141R retains the underlying concepts of SFAS No. 141 in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting, but SFAS No. 141R will significantly change the accounting for business combinations. Under SFAS 141R, an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS No. 141R will change the accounting treatment for certain specific acquisition related items including: (1) expensing acquisition related costs as incurred; (2) expensing changes in deferred tax asset valuation allowances and income tax

uncertainties after the acquisition date; (3) valuing noncontrolling interests at fair value at the acquisition date; and (4) expensing restructuring costs associated with an acquired business. SFAS No. 141R also includes a substantial number of new disclosure requirements. SFAS No. 141R is to be applied prospectively to business combinations for which the acquisition date is on or after January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" ("SFAS No. 160"). SFAS No. 160 requires noncontrolling interests, previously referred to as minority interests, to be treated as a separate component of equity, not as a liability or other item outside of permanent equity and applies to the accounting for noncontrolling interests and transactions with noncontrolling interest holders in consolidated financial statements. SFAS No. 160 will be applied prospectively to all noncontrolling interests, including any that arose before the effective date except that comparative period information must be restated to classify noncontrolling interests in equity, attributed net income and other comprehensive income to noncontrolling interests, and provide other disclosures required by SFAS No. 160. This statement is effective for the Company beginning January 1, 2009. The Company is currently assessing the potential effect that the adoption of SFAS No. 160 will have on its consolidated results of operations or financial condition.

Results of Operations 2007 vs. 2006

| (dollars in millions) | Years Ended | | |
|--|----------------------|----------------------|--------------|
| | December 31, 2007 | December 31, 2006 | Change % |
| Revenue: | | | |
| Communications | \$ 4,199 | \$ 3,311 | 27% |
| Coal mining | 70 | 67 | 4% |
| Total revenue | 4,269 | 3,378 | 26% |
| Costs and Expenses: (exclusive of depreciation and amortization shown separately below) | | | |
| Cost of revenue: | | | |
| Communications | 1,769 | 1,460 | 21% |
| Coal mining | 64 | 57 | 12% |
| Cost of revenue | 1,833 | 1,517 | 21% |
| Depreciation and amortization | 942 | 730 | 29% |
| Selling, general and administrative | 1,723 | 1,258 | 37% |
| Restructuring and non-cash impairment charges | 12 | 13 | (8)% |
| Total costs and expenses | 4,510 | 3,518 | 28% |
| Operating Loss | (241) | (140) | (72)% |
| Other Income (Expense): | | | |
| Interest income | 54 | 64 | (16)% |
| Interest expense | (577) | (648) | 11% |
| Loss on extinguishment of debt, net | (427) | (83) | (414)% |
| Other, net | 55 | 19 | 189% |
| Total other income (expense) | (895) | (648) | (38)% |
| Loss from Continuing Operations Before Income Taxes | (1,136) | (788) | (44)% |
| Income Tax Benefit (Expense) | 22 | (2) | 1,200% |
| Loss from Continuing Operations | (1,114) | (790) | (41)% |
| Income from Discontinued Operations | — | 46 | (100)% |
| Net Loss | \$ (1,114) | \$ (744) | (50)% |

Communications Revenue is separated into three categories:

- Core Communications Services (including Transport and Infrastructure services, IP and Data services, Voice services and Level 3 Vyvx services);
- Other Communications Services (including Managed Modem and its related reciprocal compensation and legacy Managed IP services); and
- SBC Contract Services.

Revenue attributable to these service categories is provided in the following table:

| (dollars in millions) | Year Ended | | |
|---------------------------------------|----------------------|----------------------|--------------|
| | December 31, 2007 | December 31, 2006 | Change % |
| Core Communications Services: | | | |
| Transport and Infrastructure | \$ 1,716 | \$ 1,014 | 69% |
| IP and Data | 584 | 301 | 94% |
| Voice | 1,182 | 536 | 121% |
| Level 3 Vyvx | 140 | 122 | 15% |
| | <u>3,622</u> | <u>1,973</u> | <u>84%</u> |
| Other Communications Services: | | | |
| Managed Modem | 179 | 286 | (37)% |
| Reciprocal Compensation | 73 | 102 | (28)% |
| Managed IP | 22 | 57 | (61)% |
| | <u>274</u> | <u>445</u> | <u>(38)%</u> |
| SBC Contract Services | 303 | 893 | (66)% |
| Total Communications Revenue | \$ 4,199 | \$ 3,311 | 27% |

The 84% increase in Core Communications Services revenue for 2007 compared to 2006 is due to growth in the Company's revenue from existing services, as well as revenue from the Progress Telecom, ICG Communications, TelCove, Looking Glass, Broadwing, CDN Business and Servecast acquisitions. The Company purchased Progress Telecom in March 2006, ICG Communications in May 2006, TelCove in July 2006 and Looking Glass in August 2006. The Company purchased Broadwing and the CDN Business in January 2007 and Servecast in July 2007. From a financial reporting perspective, the Company integrated into the Level 3 business the operations of WilTel, Progress Telecom, ICG Communications, TelCove and Looking Glass in 2006, and Broadwing and the CDN Business in the first half of 2007. As a result, separate revenue information by revenue category for these acquired companies is no longer reported other than for the SBC Contract Services revenue acquired from WilTel.

As described earlier, the growth in Core Communications Services revenue was lower than expected during the second, third and fourth quarters of 2007 as a result of an increase in service activation times and challenges in service management processes. Service activation times increased during the second and third quarters as a result of the following issues.

- Continuing to use the multiple order entry and provisioning systems and processes that were operated by the acquired companies to provision end-to-end services.
- Insufficient training on the multiple systems for employees performing service activation functions.
- Lack of sufficient staffing levels in some service activation areas.
- Identifying and fixing service activation throughput issues was challenging as a result of decentralizing service activation functions across the customer facing groups in the third quarter of 2006.

The Company has ongoing process and systems development work that is being implemented as part of the integration efforts that is expected to address the service activation and service management issues described above and provide significant overall improvements to operations. The processes and systems under development remain largely on track with certain components deployed beginning in October 2007 and additional deployments scheduled through the end of 2008. While the operational

benefits vary by each project, the Company expects to realize meaningful improvements in its operating environment during the second half of 2008. In addition, the Company is taking steps to improve its existing processes and systems to address the increase in service activation times and improve its service management. With respect to the latter, the Company has seen improvements in its service response times in the fourth quarter of 2007 and expects to see further improvements in the future.

Transport and infrastructure revenue increased 69% for 2007 compared to 2006. The increase was the result of growth in existing services and the recognition of a full year of revenue in 2007 for Progress Telecom, ICG Communications, TelCove and Looking Glass acquisitions completed in 2006, as well as the revenue from the Broadwing acquisition completed in January 2007. Increased demand in the cable and wireless market segments for complex nationwide solutions and colocation capacity in large markets contributed to the revenue growth in existing services in 2007 as compared to 2006.

IP and data revenue increased 94% for 2007 compared to 2006. The increase was the result of growth in existing services and the recognition of a full year of revenue in 2007 for Progress Telecom, ICG Communications, TelCove and Looking Glass acquisitions completed in 2006, as well as a full year of revenue from the Broadwing acquisition completed in early January 2007. IP and data revenue also increased in 2007 as a result of the CDN Business acquisition completed in January 2007 and the Servecast acquisition completed in July 2007. IP and data revenue also increased due to traffic growth in North America from new and existing customers that exceeded the rate of price compression experienced in 2007. During the second quarter of 2007, the Company also implemented new, reduced pricing under the terms of a contract renewal for its largest IP and data customer which partially offset the overall growth of IP and data revenue in the last half of 2007. Continued revenue growth in the Company's VPN service also contributed to the increase in IP and data revenue during 2007.

Level 3's voice revenue increased 121% for 2007 compared to 2006. The increase is primarily attributable to the operations acquired in the TelCove and Broadwing acquisitions, particularly domestic and international voice termination services, and growth in Level 3's existing wholesale and VoIP-related services including voice termination, local inbound, enhanced local and toll free services.

Level 3 Vyx revenue increased 15% for 2007 compared to 2006. The increase was a result of an increase in advertising distribution revenue and the continued demand for high-definition broadcast services in sports, news and entertainment.

Core Communications Services revenue for 2007 and 2006 includes \$8 million and \$9 million of termination revenue, respectively. The Company expects to recognize termination revenue in the future if customers desire to renegotiate contracts or are required to terminate service. The Company is not able to estimate the specific value of these types of transactions until they occur, but does not currently expect to recognize significant termination revenue for the foreseeable future.

Managed modem revenue declined 37% to \$179 million for 2007 compared to 2006 as a result of the continued migration from narrow band dial-up services to higher speed broadband services by end user customers, especially in large metropolitan areas. This change has resulted in a decline in the demand for managed modem ports. In addition to the port cancellation provisions, the contracts with America Online contain market-pricing provisions that have the effect of lowering revenue as Level 3 is obligated to provide America Online a reduced per port rate if Level 3 offers another customer better pricing for a lower volume of comparable services. The declines in managed modem revenue from America Online have been partially offset by increases in market share as a result of certain competitors exiting segments of the managed modem business in the first half of 2007. The Company expects managed modem revenue to continue to decline in the future primarily due to an increase in the number of subscribers migrating to broadband services and potential pricing concessions as contracts are renewed.

Reciprocal compensation revenue from managed modem services declined 28% to \$73 million for 2007 compared to 2006 as a result of the continuing decline in demand for managed modem services. The Company has historically earned the majority of its reciprocal compensation revenue from managed modem services. Level 3 has interconnection agreements in place for the majority of traffic subject to reciprocal compensation. The majority of the Company's interconnection agreements provided rate structures through 2007. Level 3 continues to negotiate new interconnection agreements or amendments to its existing interconnection agreements with local carriers. As a result of the Company's acquisitions of WilTel, TelCove and Broadwing, the Company has started to generate a portion of its reciprocal compensation revenue from voice services. For the full year ending December 31, 2007, the Company recognized \$26 million of reciprocal compensation revenue earned from voice services, which are included in Core Communications Services revenue. To the extent that the Company is unable to sign new interconnection agreements or signs new agreements containing lower rates, or there is a significant decline in the Company's managed modem dial-up business, or FCC or state regulations change such that carriers are not required to compensate other carriers for terminating ISP-bound traffic, reciprocal compensation revenue may decline significantly over time.

Managed IP services revenue declined 61% to \$22 million for 2007 compared to 2006. As discussed earlier, to date the Company has not invested in this service and the decline in revenue is attributable to the disconnection of service by existing customers. The Company's legacy managed IP services business consists primarily of a business that was acquired in 2003. The Company expects this trend to continue in 2008.

SBC Contract Services revenue decreased 66% to \$303 million for 2007 compared to 2006 as expected due to the migration of the SBC traffic to the AT&T network. The SBC Contract Services agreement was obtained in December 2005 as part of the WilTel acquisition. Under the terms of the agreement, SBC has gross margin purchase commitments through 2009. SBC fully satisfied the \$335 million gross margin purchase commitment for the period from December 2005 through December 2007 during the third quarter of 2007. As a result of satisfying the initial gross margin purchase commitment, SBC's purchases of services that exceed the original \$335 million gross margin purchase commitment now count toward the \$75 million gross margin purchase commitment for the period from January 2008 through the end of 2009. As of December 31, 2007, SBC had satisfied \$39 million of the \$75 million gross margin purchase commitment. Level 3 expects that, based on SBC's current level of spending, the remaining \$36 million of gross margin purchase commitment will be satisfied by SBC in the first half of 2008.

Additionally, the SBC Contract Services Agreement provided for the payment of \$50 million from SBC if certain performance criteria were met by Level 3. The Company met the required performance criteria and recorded annual revenue of \$25 million in both 2006 and 2007 under the agreement. Of the annual amounts, 50% was based on monthly performance criteria and the remaining 50% was based on performance criteria for the full year. The Company is no longer eligible for performance bonuses under the SBC Contract Services agreement after December 31, 2007. The Company expects SBC revenue to continue to decline in 2008. However, SBC must still comply with the minimum gross margin commitments under the terms of the contract unless satisfied sooner.

Beginning in the first quarter of 2008, the Company will change the way it reports Core Communications Services revenue and will aggregate revenue from Transport and Infrastructure, IP and Data, non-wholesale Voice and Level 3 Vyvx services and report those results as Core Network Services revenue. Domestic voice termination, international voice termination and toll free services will be

totalled and reported as Wholesale Voice Services revenue. Using this categorization, quarterly and full year 2007 Communications Services revenue would have been reported as shown in the table below:

| (dollars in millions) | Quarter Ended | | | | Year Ended December 31, 2007 |
|--|-------------------|------------------|-----------------------|----------------------|------------------------------------|
| | March 31, 2007 | June 30, 2007 | September 30, 2007 | December 31, 2007 | |
| Communications Services Revenue: | | | | | |
| Core Network Services | \$ 720 | \$ 735 | \$ 756 | \$ 783 | \$ 2,994 |
| Wholesale Voice Services | 150 | 153 | 153 | 172 | 628 |
| Total Core Communications Services | 870 | 888 | 909 | 955 | 3,622 |
| Other Communications Services | 84 | 71 | 63 | 56 | 274 |
| SBC Contract Services | 83 | 76 | 71 | 73 | 303 |
| Total Communications Services Revenue | \$ 1,037 | \$ 1,035 | \$ 1,043 | \$ 1,084 | \$ 4,199 |

Core Network Services revenue represents higher margin services and Wholesale Voice Services represents lower margin services. The Company believes that given the increasing substitutability between Transport and Infrastructure services and IP and Data services, trends in the communications business are best gauged looking at revenue trends in Core Network Services.

Coal mining revenue increased 4% to \$70 million in 2007 compared to 2006. The increase was attributable to an increase in the tons of coal sold from the Black Butte mine, partially offset by a decrease in the tons of coal sold from the Decker mine. Overall, the price per ton for coal from both mines was up slightly in 2007 compared to 2006.

Cost of Revenue for the communications business, as a percentage of revenue, for 2007 and 2006 was 42% and 44%, respectively. The decrease in the 2007 cost of revenue, as a percentage of revenue, is primarily attributable to the continued decrease in SBC Contract Services revenue from 2006 to 2007. The margins for SBC Contract Services revenue are lower than the margins earned on other components included in Core and Other Communications Services revenue. Also contributing to the decrease in 2007 cost of revenue, as a percentage of revenue, are cost of revenue synergy savings that have been achieved as a result of acquisition integration efforts. The Company believes that cost of revenue synergy savings of \$80 million on an annualized basis have been achieved through integration efforts in 2007. The Company expects cost of revenue for the communications business, as a percentage of revenue, to decrease slightly in 2008 as compared to 2007.

Coal mining cost of revenue, as a percentage of revenue, increased to 91% for 2007 compared to 85% in 2006. The increase in cost of revenue, as a percentage of revenue, in 2007 as compared to 2006 was due to planned equipment maintenance costs at one mine and higher costs related to overburden removal at another mine.

Depreciation and Amortization expense increased 29% to \$942 million for 2007 compared to 2006. The increase is primarily attributable to the increased depreciation and amortization expense recognized on communications tangible and intangible assets that were acquired through acquisitions completed in 2006 and 2007, as well as depreciation expense on the approximately \$241 million increase in capital expenditures for 2007 compared to 2006.

In addition, during the second quarter of 2007, the Company reviewed and adjusted the estimated useful lives used for amortization of customer-related intangible assets for the ICG Communications, TelCove and Looking Glass acquisitions effective June 1, 2007. This resulted in increased amortization expense of \$9 million during the year ended December 31, 2007.

During the fourth quarter of 2007, the Company finalized the purchase price allocation for the Broadwing acquisition which resulted in reduced amortization expense related to intangible assets for the Broadwing acquisition from the date of acquisition totaling approximately \$18 million, as compared to the total amortization expense that would have been recognized for 2007 prior to the change in the valuation of the intangible assets.

The increase in depreciation expense for 2007 was partially offset by a \$44 million decrease in depreciation expense compared to the same period in 2006 attributable to the increase in estimated useful lives for network fiber and IP and transmission equipment implemented in the second and third quarters of 2006.

The Company expects depreciation and amortization expense to decrease in 2008 to a range of \$880 million to \$920 million compared to 2007 due to the offsetting effects of increased depreciation expense on incremental capital expenditures, overall reduced amortization expense on intangible assets as a result of the useful lives changes and valuation changes described above and reduced depreciation and amortization expense associated with shorter-lived tangible and intangible communications assets that were placed in service in prior years that are expected to become fully depreciated or amortized in 2008.

Selling, General and Administrative expenses increased 37% to \$1.723 billion in 2007 compared to 2006. This increase is primarily attributable to the expenses associated with the operations acquired in the Progress Telecom, ICG Communications, TelCove and Looking Glass transactions during 2006; the Broadwing and CDN Business transactions in January 2007; and the Servecast transaction in July 2007. Specifically, increases in compensation, bonus and employee related costs, network related costs and facility-based expenses all contributed to the increase in selling, general and administrative expenses in 2007. Offsetting the increases discussed above were selling, general and administrative expense synergy savings that have been achieved as a result of acquisition integration efforts. As of the end of 2007, the Company believes that it has achieved annualized run rate synergies in selling, general and administrative expenses totaling approximately \$105 million. Also offsetting the increase in selling, general and administrative expenses in 2007 compared to 2006 was a reduction in incentive-based compensation expense of \$32 million as a result of lower than expected financial performance in 2007.

Selling, general and administrative expenses for 2006 included a \$7 million property tax benefit related to the Company's facilities in the United Kingdom.

Included in selling, general and administrative expenses for 2007 and 2006 were \$122 million and \$84 million, respectively, of non-cash stock-based compensation expense related to grants of outperform stock options and restricted stock units and restricted stock shares. The increase in non-cash compensation expense in 2007 compared to 2006, is due to an increase in the number of restricted stock units and restricted stock shares issued to employees as a result of an increase in the number of employees eligible in 2007 compared to 2006, an increase in the 401(k) employee match and annual discretionary grant made to the 401(k) plan and an increase in non-cash compensation expense for those employees eligible for accelerated vesting of stock awards at retirement; with the overall increase partially offset by a reduction in the number of outperform stock options and units issued in 2007 compared to 2006. The number of employees eligible to participate in the Company's stock-based long-term incentive plan increased significantly from 2006 to 2007 as a result of the employees of acquired companies becoming eligible to participate in the long-term incentive plan at the beginning of 2007.

In 2007, the Company recognized additional non-cash stock-based compensation expense totaling approximately \$11 million for those employees eligible for accelerated vesting of stock awards at retirement. The Company provides accelerated vesting of stock awards at the date an employee retires if the employee meets certain age and years of service requirements and certain other requirements. Under SFAS No. 123R, the fair value of stock-based employee awards are expensed over the minimum

service period, which is from the grant date to the earliest vesting date. Therefore, the Company is required to fully expense at the grant date the value of stock awards made to those employees that already meet both the age and years of service requirements for accelerated vesting at retirement at the date of grant. If the employee will meet the age and years of service requirements for accelerated vesting at retirement sooner than the normal vesting period for the stock awards, then the Company is required to use that shorter period for recognition of the non-cash compensation expense associated with the grant.

Included in the 2006 non-cash compensation expense of \$84 million was \$6 million related to the revaluation of the October 2005 and January 2006 grants using May 15, 2006 as the revised grant date, in accordance with SFAS No. 123R. As stated in the Company's proxy materials for its 2006 Annual Meeting of Stockholders, over the course of the years since April 1, 1998, the compensation committee of the Company's Board of Directors had administered the 1995 Stock Plan under the belief that the action of the Company's Board of Directors to amend and restate that plan effective April 1, 1998 had the effect of extending the original term of the Plan to April 1, 2008. After a further review of the terms of the plan, however, the compensation committee determined that an ambiguity could exist as to the date of the expiration of the plan. To remove any ambiguity, the Board of Directors sought the approval of the Company's stockholders to amend the plan to extend the term of the plan by five years to September 25, 2010. This approval was obtained at the 2006 Annual Meeting of Stockholders held on May 15, 2006.

After taking into account the \$6 million increase in 2006 non-cash compensation expense for the grants revalued using a May 15, 2006 grant date and the \$11 million increase in 2007 non-cash compensation expense for the employees that are eligible for accelerated vesting at retirement as discussed above, non-cash compensation increased \$33 million for 2007 compared to 2006.

As part of a comprehensive review of its long-term compensation program completed in the first quarter of 2007, beginning with awards made on or after April 1, 2007, outperform stock options ("OSO") units are awarded monthly to employees in mid-management level and higher positions, have a three year life, will vest 100% on the third anniversary of the date of the award and will fully settle in net shares on that date. OSO units awarded beginning April 1, 2007 have exercise prices and are valued for non-cash compensation purposes based on the closing price of Level 3 common stock on the last day of each month. Recipients have no discretion on the timing to exercise OSO units granted on or after April 1, 2007, thus the expected life of all such OSO units is three years.

The Company expects selling, general and administrative expenses to decrease in 2008 on an overall basis compared to 2007. The expected reduction in overall 2008 selling, general and administrative expenses is a result of reduced selling, general and administrative expenses for integration activities, reductions in headcount related to continuing integration activities and the deployment of improved business processes and systems during 2008, offset by an increase in incentive-based compensation compared to 2007.

Restructuring and Non-Cash Impairment Charges declined 8% to \$12 million in 2007 compared to 2006. The Company recognized severance charges of \$11 million in 2007 and \$5 million in 2006, related to workforce reductions in the communications business in North America. The workforce reductions completed in 2007 were primarily related to the integration of companies acquired by Level 3 in 2006 and January 2007. As of December 31, 2007, the Company had remaining obligations of approximately \$4 million.

The Company recognized non-cash impairment charges of \$1 million and \$8 million in 2007 and 2006, respectively. The non-cash impairment charge of \$1 million in 2007 and \$4 million of the 2006 charge were primarily related to previously capitalized costs of certain information technology development projects no longer used by the Company. The costs incurred for these projects, including capitalized labor, were impaired as the Company did not expect to utilize the assets in the future. The

remaining \$4 million non-cash impairment charge in 2006 was related to excess land of the communications business deemed available for sale in Germany. This charge resulted from the difference between the recorded carrying value and the estimated market value of the land. During the third quarter of 2007, the Company reclassified the excess land in Germany to property, plant and equipment due to the fact the land had not been sold and was no longer being actively marketed for sale.

The Company expects to continue to record restructuring charges in 2008 in connection with the continued integration of businesses acquired in 2006 and 2007 and as a result of the deployment of improved business processes and systems during 2008 that should result in reduced headcount.

The Company continues to periodically conduct comprehensive reviews of the long-lived assets of its businesses, specifically communication assets deployed along its intercity and metro networks and in its gateway facilities. It is possible that assets may be identified as impaired and impairment charges may be recorded to reflect the realizable value of these assets in future periods.

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

Adjusted EBITDA is not a measurement under accounting principles generally accepted in the United States and may not be used 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 measures are 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. Management uses Adjusted EBITDA 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, income taxes and gain (loss) on extinguishment of debt 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 impact of capital investments which management believes should be evaluated through consolidated free cash flow. Adjusted EBITDA excludes total 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 taxes, depreciation and amortization, non-cash impairment charges, non-cash stock compensation expense, gain (loss) on early extinguishment of debt and total other income (expense). Adjusted EBITDA should not be considered a substitute for other measures of financial performance reported in accordance with GAAP.

Note 19 of the consolidated financial statements provides a reconciliation of net income (loss) to Adjusted EBITDA for each of the Company's operating segments.

Adjusted EBITDA for the communications business was \$823 million and \$677 million in 2007 and 2006, respectively. The increase is primarily attributable to the Adjusted EBITDA contribution from the

operations acquired in the Progress Telecom, ICG Communications, TelCove, Looking Glass, Broadwing, CDN Business and Servecast acquisitions, growth in the Company's Core Communications Services revenue and the benefits of cost of revenue and operating expense synergies realized in 2007 from integration activities, partially offset by declines in other communications services revenue, SBC Contract Services revenue and costs of integration incurred during 2007 as compared to 2006.

Adjusted EBITDA for the coal mining business decreased to \$5 million in 2007 from \$8 million in 2006. The decrease is primarily attributable to an increase in the amount of coal sold from the Black Butte mine which has higher stripping ratios that result in higher overall costs and a planned increase in maintenance costs for mining equipment in 2007.

The Company expects Adjusted EBITDA to increase in 2008 compared to 2007 to a range of \$950 million to \$1.1 billion. The expected increase in Adjusted EBITDA is based on continued growth in Core Communications Services revenue, expected improvements in service delivery times, and the benefit of integration synergies in cost of revenue and selling, general and administrative expenses realized from the Broadwing acquisition.

Interest Income decreased 16% to \$54 million in 2007 compared to 2006. The decrease in interest income was primarily due to a decrease in the average invested balance partially offset by an increase in the average return on the portfolio. The Company's average return on its portfolio increased to 4.8% in 2007 compared to 4.3% in 2006. The average portfolio balance decreased to \$1.0 billion in 2007 compared to \$1.5 billion in 2006.

Pending the utilization of cash and cash equivalents, the Company invests its funds primarily in government and government agency securities, money market funds and commercial paper. The investment strategy generally provides lower yields on the funds than would be obtained on alternative investments, but reduces the risk to principal in the short term prior to these funds being used in the Company's business.

Interest Expense decreased 11% to \$577 million in 2007 compared to 2006. Interest expense decreased primarily as a result of the refinancing activities that were completed by the Company in the first quarter of 2007. The overall reduction in interest expense is a result of the offsetting interest expense effects attributable to the following debt issuances, debt for equity exchanges, debt redemptions and debt repurchase transactions.

Interest expense increased as a result of the following debt issuances:

- \$1.250 billion of 9.25% Senior Notes due 2014 issued in October and December 2006;
- \$1 billion of Senior Notes issued in February 2007 consisting of \$700 million of 8.75% Senior Notes due 2017 and \$300 million of Floating Rate Senior Notes due 2015; and
- \$1.4 billion Senior Secured Term Loan due 2014 entered into in March 2007 to refinance the previously existing \$730 million Senior Secured Term Loan due 2011.

The increase in interest expense from debt issuances described above was more than offset by the following debt for equity exchanges, debt redemptions and debt repurchases completed during the fourth quarter of 2006 and the first quarter of 2007:

- \$497 million of 10.75% Senior Notes due 2011 repurchased in December 2006;
- \$605 million of 10% Convertible Senior Notes due 2011 exchanged in January 2007 for 197 million shares of common stock;
- \$488 million of 12.875% Senior Notes due 2010 redeemed in March 2007;
- \$96 million of 11.25% Senior Notes due 2010 redeemed in March 2007;

- \$138 million (€104 million) of 11.25% Senior Euro Notes due 2010 redeemed in March 2007;
- \$144 million of Floating Rate Notes due 2011 repurchased in March 2007;
- \$59 million of 11% Senior Notes due 2008 repurchased in March 2007;
- \$677 million of 11.5% Senior Notes due 2010 repurchased in March 2007; and
- \$61 million (€46 million) of 10.75% Senior Euro Notes due 2008 repurchased in March 2007.

Level 3 expects quarterly interest expense in 2008 to be consistent with the level of interest expense in the second and third quarters of 2007 of \$138 million per quarter based on outstanding debt balances as of December 31, 2007.

Loss on Extinguishment of Debt was \$427 million in 2007 compared to \$83 million in 2006. The loss on extinguishment of debt for 2006 was primarily the result of a \$54 million loss from the repurchase of certain debt and a \$55 million loss on the amendment and restatement of Level 3 Financing's Senior Secured Term Loan due 2011, partially offset by a \$27 million gain realized on a debt exchange. The loss on extinguishment of debt for 2007 resulted from the following transactions.

- \$177 million loss recognized for the January 2007 exchange of \$605 million of 10% Convertible Senior Notes due 2011 for approximately 197 million shares of the Company's common stock. The loss included \$1 million of unamortized debt issuance costs.
- \$10 million loss recognized for the March 2007 refinancing of the Company's \$730 million Senior Secured Term Loan due 2011 into a \$1.4 billion Senior Secured Term Loan due 2014. The loss consisted of unamortized debt issuance costs associated with the previous \$730 million Senior Secured Term Loan due 2011.
- \$54 million loss recognized on the redemption of \$722 million of outstanding debt consisting of the following debt issuances:
 - \$12 million loss on the redemption of \$488 million of outstanding 12.875% Senior Notes due 2010 consisting of a \$10 million cash loss and \$2 million in unamortized debt issuance costs.
 - \$3 million loss on the redemption of \$96 million of outstanding 11.25% Senior Notes due 2010 consisting of a \$2 million cash loss and \$1 million in unamortized debt issuance costs.
 - \$39 million loss on the redemption of \$138 million (€104 million) of outstanding 11.25% Senior Euro Notes due 2010 consisting of a \$38 million cash loss and \$1 million of unamortized debt issuance costs.
- \$186 million loss recognized on the repurchase through tender offers of \$941 million of outstanding debt consisting of the following debt issuances:
 - \$18 million loss on the repurchase of \$144 million of outstanding Floating Rate Senior Notes due 2011 consisting of a \$12 million cash loss and \$6 million in unamortized debt issuance costs and unamortized discount.
 - \$3 million loss on the repurchase of \$59 million of outstanding 11% Senior Notes due 2008 consisting of a \$3 million cash loss and less than \$1 million in unamortized debt issuance costs.
 - \$141 million loss on the repurchase of \$677 million of outstanding 11.5% Senior Notes due 2010 consisting of a \$78 million cash loss and \$63 million in unamortized debt issuance costs and unamortized discount.

- \$24 million loss on the repurchase of \$61 million (€46 million) of outstanding 10.75% Senior Euro Notes due 2008 consisting of a \$24 million cash loss and less than \$1 million in unamortized debt issuance costs.

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 increased 189% to \$55 million in 2007 compared to \$19 million in 2006. Other, net is primarily comprised of gains and losses on the sale of marketable securities and non-operating assets, realized foreign currency gains and losses and other income. The increase in 2007 compared to 2006 is primarily due to a gain of \$37 million recognized in the fourth quarter of 2007 on the sale of 80% of the Company's holdings of Infinera common stock.

Income Tax Benefit (Expense) was a \$22 million benefit in 2007 and was a \$2 million expense in 2006. The income tax benefit for 2007 was primarily the result of reversing \$23 million of the valuation allowance against the Company's deferred tax asset for certain state net operating loss carry forwards ("NOLs"). These state tax NOLs were converted to a state tax credit carry forward associated with a change in the state tax law that replaced the tax on net income with a tax on gross margin. The Company now expects it will be able to use this state tax credit carry forward against current and future state taxable gross margin.

The Company incurs income tax expense attributable to income in various Level 3 subsidiaries, including the coal business, 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 related to contingent tax benefits that have not been recognized in income tax expense, but have been recognized in the Company's tax returns.

As of December 31, 2007, Level 3 had net operating loss carry forwards of approximately \$9.5 billion for federal income tax purposes, including \$953 million of net operating loss carry forwards from acquired companies after limitations that existed at the date of acquisition or that resulted from the acquisitions or both. If certain transactions occur with respect to Level 3's capital stock that result in a cumulative ownership change of more than 50 percentage points by 5-percent stockholders over a three-year period as determined under rules prescribed by the U.S. Internal Revenue Code ("IRC") and applicable regulations, annual limitations would be imposed with respect to the Company's ability to utilize its net operating loss carry forwards and certain current deductions against any taxable income Level 3 achieves in future periods. Level 3 has entered into transactions over the last three years resulting in significant cumulative changes in the ownership of its capital stock. Additional transactions could cause the Company to incur a 50 percentage point ownership change by 5-percent stockholders and, if the Company triggers the above-noted IRC imposed limitations, could prevent it from fully utilizing net operating loss carry forwards and certain current deductions to reduce income taxes.

Income (Loss) from Discontinued Operations in 2006 of \$46 million was related to the discontinued operations of the Company's Information Services segment. The Company sold Software Spectrum, Inc. ("Software Spectrum") to Insight Enterprises, Inc. ("Insight") in September 2006. There were no gains or losses from discontinued operations recognized in 2007. Software Spectrum, Inc.'s results of operations resulted in income from discontinued operations of \$13 million in 2006. In addition, Level 3 recognized a gain on the sale of Software Spectrum to Insight in 2006 of \$33 million.

Results of Operations 2006 vs. 2005

| (dollars in millions) | Years Ended | | |
|--|----------------------|----------------------|--------------|
| | December 31, 2006 | December 31, 2005 | Change % |
| Revenue: | | | |
| Communications | \$ 3,311 | \$ 1,645 | 101% |
| Coal mining | 67 | 74 | (9)% |
| Total revenue | 3,378 | 1,719 | 97% |
| Costs and Expenses: (exclusive of depreciation and amortization shown separately below) | | | |
| Cost of revenue: | | | |
| Communications | 1,460 | 463 | 215% |
| Coal mining | 57 | 53 | 8% |
| Cost of revenue | 1,517 | 516 | 194% |
| Depreciation and amortization | 730 | 647 | 13% |
| Selling, general and administrative | 1,258 | 769 | 64% |
| Restructuring and non-cash impairment charges | 13 | 23 | (43)% |
| Total costs and expenses | 3,518 | 1,955 | 80% |
| Operating Loss | (140) | (236) | 41% |
| Other Income (Expense): | | | |
| Interest income | 64 | 35 | 83% |
| Interest expense | (648) | (530) | (22)% |
| Loss on extinguishment of debt, net | (83) | — | 100% |
| Other, net | 19 | 29 | (34)% |
| Total other income (expense) | (648) | (466) | (39)% |
| Loss from Continuing Operations Before Income Taxes | (788) | (702) | (12)% |
| Income Tax Expense | (2) | (5) | 60% |
| Loss from Continuing Operations | (790) | (707) | (12)% |
| Income from Discontinued Operations | 46 | 69 | (33)% |
| Net Loss | \$ (744) | \$ (638) | (17)% |

Communications Revenue for 2006 and 2005 is summarized as follows:

| (dollars in millions) | Year Ended | | |
|---------------------------------------|----------------------|----------------------|-------------|
| | December 31, 2006 | December 31, 2005 | Change % |
| Core Communications Services: | | | |
| Transport and Infrastructure | \$ 1,014 | \$ 653 | 55% |
| IP and Data | 301 | 186 | 62% |
| Voice | 536 | 120 | 347% |
| Level 3 Vyvx | 122 | 3 | 3,967% |
| | 1,973 | 962 | 105% |
| Other Communications Services: | | | |
| Managed Modem | 286 | 396 | (28)% |
| Reciprocal Compensation | 102 | 100 | 2% |
| Managed IP | 57 | 83 | (31)% |
| DSL Aggregation | — | 79 | (100)% |
| | 445 | 658 | (32)% |
| SBC Contract Services | 893 | 25 | 3,472% |
| Total Communications Revenue | \$ 3,311 | \$ 1,645 | 101% |

The Company's Core Communications Services revenue increased 105% in 2006 compared to 2005. The growth in the Company's existing services as well as the acquisitions of WilTel, Progress Telecom, ICG Communications, TelCove and Looking Glass contributed to the increase. During 2006, the Company recorded revenue, from the date of acquisition, attributable to Progress Telecom of \$49 million, ICG Communications of \$46 million, TelCove of \$166 million and Looking Glass of \$33 million. During 2006, the Company integrated a significant portion of WilTel into the business. As a result, separate revenue information for former WilTel customers is no longer available other than for SBC Contract Services.

Transport and infrastructure revenue increased 55% in 2006 primarily due to the acquisitions of WilTel, Progress Telecom, ICG Communications, TelCove and Looking Glass. In addition, increased demand for complex nationwide solutions and colocation capacity in large markets contributed to the revenue growth in 2006. Termination revenue related to transport and infrastructure services decreased approximately \$129 million from \$131 million in 2005 to \$2 million in 2006. The termination revenue in 2005 was primarily attributable to the termination of dark fiber lease agreements with two customers.

IP and data revenue increased 62% in 2006 primarily due to customers obtained in the acquisitions of WilTel, Progress Telecom, ICG Communications, TelCove and Looking Glass. IP and data revenue also increased due to traffic growth in North America from new and existing customers that exceeded the approximately 25% rate of price compression in 2006. Traffic growth was mitigated by one customer's migration of traffic to its own network which was acquired via a merger with another carrier. Improved market acceptance of the Company's VPN service and the continued growth of previously awarded contracts also contributed to the increase in IP and data revenue. IP and data revenue includes \$7 million of termination revenue in 2006.

Level 3's voice revenue increased 347% in 2006. The increase is primarily attributable to the operations acquired in the WilTel, TelCove and ICG Communications acquisitions, particularly domestic and international voice termination services, and growth in Level 3's existing wholesale and VoIP-related services including voice termination, local inbound, enhanced local and toll free services. On a combined basis, voice services experienced a 321% increase in minutes of use in the fourth quarter of 2006 compared to the same period in 2005.

Level 3 Vyvx revenue increased to \$122 million in 2006 as a result of including a full year of Level 3 Vyvx revenue in the Company's results. Vyvx was acquired in December 2005 as part of the WilTel acquisition.

Managed modem revenue declined 28% in 2006 as a result of the continued migration from narrow band dial-up services to higher speed broadband services by end user customers. This change has resulted in a decline in the demand for managed modem ports. Managed modem revenue also declined in 2006 as a result of certain contracts being renewed or renegotiated at prices lower than were in effect in 2005. The declines in managed modem revenue have been partially offset by increases in market share as a result of certain competitors exiting segments of the managed modem business in the second half of 2006.

The Company did not recognize DSL aggregation revenue in 2006 due to the fact that the Company's primary DSL aggregation customer completed the migration of its DSL subscribers to its own network in the third quarter of 2005. In addition, the Company's other DSL contracts expired in 2005 and were not renewed.

Reciprocal compensation revenue increased \$2 million in 2006. The Company has historically earned the majority of its reciprocal compensation revenue from managed modem services. Level 3 has interconnection agreements in place for the majority of traffic subject to reciprocal compensation.

SBC Contract Services revenue increased significantly in 2006 as a result of including a full year of SBC Contract Services revenue in the Company's results. The SBC Contract Services agreement was acquired in December 2005 as part of the WilTel acquisition. Under the terms of the agreement, SBC has gross margin purchase commitments through 2009. As of December 31, 2006, the remaining minimum gross margin commitment under the agreement to be utilized during 2007 was approximately \$67 million, and \$75 million from January 2008 through the end of 2009. Additionally, the SBC Contract Services agreement provides for the payment of \$50 million if certain performance criteria are met by Level 3. Level 3 was eligible to earn \$25 million in 2006 and 2007. Of the annual amount, 50% is based on monthly performance and the remaining 50% is based on performance criteria for the full year. The Company met the required performance criteria and earned \$25 million in 2006.

Coal mining revenue decreased to \$67 million in 2006 compared to \$74 million in 2005. The decline in revenue for 2006 is attributable to a decline in the average price per ton of coal sold, partially offset by a slight increase in tons shipped. The price decline is attributable to coal sold under a contract that was renewed in 2005 and contained lower price per ton than the original contract.

Cost of Revenue for the communications business, as a percentage of revenue for 2006 and 2005 was 44% and 28%, respectively. The increase in 2006 cost of revenue, as a percentage of revenue, is primarily attributable to the recognition of termination revenue in 2005, with no corresponding cost of revenue, and the significant voice and SBC Contract Services revenue obtained in the WilTel acquisition. The margins for the voice and SBC Contract Services revenue are lower than the margins earned on other components included in Core and Other Communications Services revenue. Partially offsetting the lower WilTel margins were the margins earned by Progress Telecom, ICG Communications, TelCove and Looking Glass. Margins for these businesses were slightly higher in 2006 than those reported by the Company in 2005. In 2005, the Company recognized \$133 million of termination revenue with no corresponding cost of revenue, favorably affecting the cost of revenue percentage. Excluding the termination revenue, cost of revenue as a percentage of revenue would have been 31% in 2005.

Cost of revenue as a percentage of revenue for the coal mining business increased to 85% in 2006 from 72% in 2005. The increase in cost of revenue as a percentage of revenue for the coal mining business is due to a decline in the average price per ton of coal sold in 2006 compared to 2005 and due to increased product costs in 2006 related to changes in stripping ratios and increased tire and fuel

costs. In addition, in the second quarter of 2005, the Company was able to favorably resolve certain production tax issues. The resolution of this matter resulted in a \$5 million reduction in cost of revenue. Cost of revenue as a percentage of revenue for 2005 was 78% after excluding the effect of the \$5 million reduction in cost of revenue for the period.

Depreciation and Amortization expense was \$730 million in 2006, a 13% increase from 2005 depreciation and amortization expense of \$647 million. The increase is primarily attributable to the communications tangible and intangible assets that were acquired in the WilTel acquisition in December 2005, the Progress Telecom acquisition in March 2006, the ICG Communications acquisition in May 2006, the TelCove acquisition in July 2006 and the Looking Glass acquisition in August 2006. This increase was partially offset by an \$80 million decrease in depreciation expense attributable to the increase in estimated useful lives for network fiber and IP and transmission equipment.

Selling, General and Administrative expenses increased 64% to \$1.258 billion in 2006 from \$769 million in 2005. This increase is primarily attributable to the inclusion of expenses associated with the operations acquired in the WilTel, Progress Telecom, ICG Communications, TelCove and Looking Glass transactions in December 2005, March 2006, May 2006, July 2006 and August 2006, respectively. Specifically, increases in compensation, bonus and employee related costs, network related costs and facility-based expenses all contributed to the increase in selling, general and administrative expenses in 2006.

Included in operating expenses for 2006 and 2005 were \$84 million and \$51 million, respectively, of non-cash compensation and professional expenses recognized under SFAS No. 123R and SFAS No. 123, respectively, related to grants of outperform stock options, warrants and other stock-based compensation awards. The \$33 million increase in non-cash compensation expense in 2006 is primarily attributable to an increase in the number of outperform stock options granted to employees and an increase in the value of the options granted to employees associated with the increasing price of Level 3 common stock in 2006. These increases were partially offset by a reduction in the amount of restricted stock and restricted stock units granted in 2006 compared to 2005.

In addition, during the second quarter of 2006, the October 2005 and January 2006 outperform stock option grants were revalued using May 15, 2006 as the grant date, in accordance with SFAS No. 123R, and resulted in a \$6 million increase in non-cash compensation expense during the second quarter of 2006. As stated in the Company's proxy materials for its 2006 Annual Meeting of Stockholders, over the course of the years since April 1, 1998, the compensation committee of the Company's Board of Directors had administered the 1995 Stock Plan under the belief that the action of the Company's Board of Directors to amend and restate that plan effective April 1, 1998 had the effect of extending the original term of the Plan to April 1, 2008. After a further review of the terms of the plan, however, the compensation committee determined that an ambiguity could have existed that may have resulted in an interpretation that the expiration date of the plan was September 25, 2005. To remove any ambiguity, the Board of Directors sought the approval of the Company's stockholders to amend the plan to extend the term of the plan by five years to September 25, 2010. This approval was obtained at the 2006 Annual Meeting of Stockholders held on May 15, 2006 which resulted in a final measurement date of May 15, 2006 for the outperform options granted in October 2005 and January 2006.

Restructuring and Impairment Charges were \$13 million in 2006 and \$23 million in 2005. In 2006, the Company recognized \$5 million of restructuring charges related to workforce reductions in the communications business in North America. The employees impacted by this workforce reduction were Level 3 employees affected by the integration of companies acquired in 2005 and 2006. As of December 31, 2006, the Company had remaining obligations of less than \$1 million.

In 2005, the Company recognized \$15 million related to the workforce reductions in the communications business in North America and Europe. The employees affected by this workforce reduction provided support functions or worked directly on mature services. All obligations attributable to the 2005 restructuring activities were paid by December 31, 2005.

The Company recognized non-cash impairment charges of \$4 million in 2006 and \$9 million in 2005 resulting from the decision to terminate projects for certain voice services and IT projects in the communications business. In addition, 2005 included a \$1 million reduction in expected lease impairment obligations. These projects have identifiable costs which Level 3 can evaluate separately for impairment. The costs incurred for these projects, including capitalized labor, were impaired as the Company did not expect to utilize the assets in the future. In addition, during the second quarter of 2006, Level 3 recognized \$4 million of non-cash impairment charges related to excess land of the communications business deemed available for sale in Germany. This charge resulted from the difference between the recorded carrying value and the estimated market value of the land.

Adjusted EBITDA for the communications business was \$677 million and \$458 million for 2006 and 2005, respectively. The increase is primarily attributable to the Adjusted EBITDA contribution from the operations acquired in the WiTel, Progress Telecom, ICG Communications, TelCove and Looking Glass transactions and growth in the Company's Core Communications Services revenue partially offset by related costs. Partially offsetting these increases was a \$122 million reduction in termination and settlement revenue from 2005 to 2006.

Adjusted EBITDA for the coal mining business decreased to \$8 million in 2006 from \$16 million in 2005. The decrease is primarily attributable to the favorable resolution of certain production tax issues, which resulted in a \$5 million decrease in the cost of revenue for the mining business in the second quarter of 2005 and a decline in the average price per ton of coal sold in 2006 compared to 2005.

Interest Income was \$64 million in 2006, increasing \$29 million from \$35 million in 2005. The increase in interest income was due to an increase in the Company's average return on its portfolio to 4.3% in 2006 compared to 2.8% in 2005. The average portfolio balance was \$1.5 billion and \$1.2 billion in 2006 and 2005, respectively.

Interest Expense increased by \$118 million to \$648 million in 2006 compared to 2005. Interest expense increased primarily as a result of interest expense attributable to the issuance of \$880 million of 10% Convertible Senior Notes due 2012 issued in the second quarter of 2005, \$550 million of 12.25% Senior Notes due 2013 issued in the first half of 2006, \$150 million of Floating Rate Senior Notes due 2011 issued on March 14, 2006 and \$335 million of 3.5% Convertible Senior Notes due 2012 issued on June 13, 2006 and \$1.250 billion of 9.25% Senior Notes due 2014 issued in the fourth quarter of 2006. In addition, the Company exchanged portions of its 9.125% Senior Notes due 2008, 11% Senior Notes due 2008 and 10.5% Senior Discount Notes due 2008 for new 11.5% Senior Notes due 2010 during the first quarter of 2006, thereby increasing the effective interest expense on this debt. The increase in interest expense from new debt issuances was partially offset by the July 13, 2006 redemption of the 9.125% Senior Notes due 2008 and 10.5% Senior Discount Notes due 2008 and a 400 basis-point reduction in the interest rate on the \$730 million Senior Secured Term Loan due 2011 subsequent to its amendment in late June of 2006.

Loss on Extinguishment of Debt was \$83 million in 2006 and zero in 2005. In the fourth quarter of 2006, the Company realized a \$54 million loss from the repurchase of the \$497 million principal amount of Level 3 Financing's 10.75% Senior Notes due 2011 and in the second quarter of 2006, Level 3 realized a \$55 million loss on the amendment and restatement of Level 3 Financing's Senior Secured Term Loan due 2011. These losses were partially offset by the \$27 million gain realized on the debt exchange in the first quarter of 2006.

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

Income Tax Expense was \$2 million in 2006 compared to \$5 million in 2005.

Income from Discontinued Operations was \$46 million for 2006 and is comprised of \$13 million from the operations of Software Spectrum and a \$33 million gain from the sale of Software Spectrum to Insight in September, 2006. Income from discontinued operations was \$69 million for 2005 and is comprised of \$20 million from Software Spectrum and a \$49 million gain from the sale of (i)Structure to Infocrossing.

Income from Discontinued Operations declined in 2006 versus the same period in 2005 due to the sale of Software Spectrum on September 7, 2006. Software Spectrum earns a disproportionate share of its revenue at the end of the quarter but incurs operating expenses ratably during the quarter. As a result of the sale in September 2006, operating expenses for Software Spectrum exceeded the gross profits earned on sales through the transaction date due to the cyclical nature of the Software Spectrum business.

Software Spectrum increased its sales and marketing efforts and resources targeting mid-market businesses over the last 18 months of its ownership by the Company resulting in higher revenue and profits for the period ending September 7, 2006 compared to the twelve months ended December 31, 2005. The increase in gross profits was partially offset by an increase in operating expenses, primarily for employee related costs, and the disproportionate level of operating expenses recognized for the partial third quarter of 2006.

Level 3 received gross proceeds of approximately \$353 million and recognized a gain on the sale of Software Spectrum, after transaction costs, of approximately \$33 million in the third quarter of 2006. During the fourth quarter of 2006, Level 3 paid \$2 million to Insight as a final post-closing working capital adjustment.

Financial Condition—December 31, 2007

Cash flows provided by (used in) operating activities of continuing operations, investing activities and financing activities for the year ended December 31, 2007 and 2006, respectively are summarized as follows (dollars in millions):

| (dollars in millions) | Years Ended | | |
|--|----------------------|----------------------|------------|
| | December 31, 2007 | December 31, 2006 | Change |
| Net Cash Provided by Operating Activities of Continuing Operations | \$ 231 | \$ 221 | \$ 10 |
| Net Cash Used in Investing Activities | (961) | (648) | (313) |
| Net Cash (Used in) Provided by Financing Activities | (243) | 1,689 | (1,932) |
| Net Cash (Used in) Provided by Discontinued Operations | — | (43) | 43 |
| Effect of Exchange Rates on Cash and Cash Equivalents | 6 | 10 | (4) |
| Net Change in Cash and Cash Equivalents | \$ (967) | \$ 1,229 | \$ (2,196) |

Operating Activities of Continuing Operations

Cash provided by operating activities of continuing operations increased by \$10 million in 2007 compared to 2006. The increase in cash provided by operating activities of continuing operations was primarily due to an increase in Adjusted EBITDA generated by the communications business in 2007 as compared to 2006, partially offset by fluctuations in working capital balances which resulted in an

incremental use of cash of \$153 million for working capital items in 2007 compared to 2006. The increase in cash used for working capital items is primarily due to the changes in accounts receivable, accounts payable and other current liabilities, partially offset by an increase in deferred revenue. The Company expects that cash provided by operating activities of continuing operations will increase over the course of 2008.

Investing Activities

Cash used in investing activities increased by \$313 million in 2007 compared to 2006. The increase in cash used in investing activities was primarily due to the fact that 2006 included cash totaling \$325 million related to the sale of the Software Spectrum business in September 2006. Cash used for acquisitions decreased \$73 million to \$676 million in 2007 compared to \$749 million for 2006. Cash used for acquisitions during 2007 includes the acquisitions of Broadwing for \$492 million (net of cash acquired of \$257 million), the CDN business for \$133 million, Servecast for \$45 million (net of cash acquired of \$1 million) and a minority investment in a private company for \$6 million. In addition, capital expenditures increased \$241 million from \$392 million in 2006 to \$633 million in 2007. The increase in capital expenditures was primarily for success based capital related to new customer installations and integration activities in the communications business. During 2007, \$288 million of marketable securities held by the Company matured, the Company received proceeds of \$45 million from the sale of approximately 80% of its investment in Infinera and restricted securities decreased by \$12 million. During 2006, the Company had net purchases of marketable securities totaling \$182 million. In 2007, an arbitrator ruled that Level 3 owed Infocrossing approximately \$2 million for working capital adjustments pertaining to the sale of (i)Structure completed in 2005.

Financing Activities

Cash provided by financing activities decreased \$1.932 billion to a \$243 million use of cash in 2007 compared to 2006. Included in cash flows from financing activities is \$2.349 billion of net proceeds from the issuance of:

- \$300 million of Floating Rate Senior Notes due 2015 in February 2007;
- \$700 million of 8.75% Senior Notes due 2017 in February 2007; and
- \$1.4 billion Senior Secured Term Loan due 2014 in March 2007.

The Company used proceeds from these offerings along with cash on hand to retire or refinance approximately \$2.497 billion aggregate principal amount of debt. Total cash consideration paid to retire or refinance this debt was \$2.618 billion. Financing activities also include proceeds of \$26 million from the exercise of warrants associated with the Broadwing transaction and other equity-based instruments. During 2006, the Company raised \$543 million in net proceeds from an equity offering, raised \$2.256 billion in net proceeds from long-term debt offerings and repaid \$1.110 billion of debt.

The Company also issued approximately 214 million shares of its common stock, valued at \$879 million, to retire \$702 million of debt.

Liquidity and Capital Resources

The Company incurred operating losses from continuing operations of \$1.114 billion and \$790 million in 2007 and 2006, respectively. The Company used \$402 million and \$171 million of cash for operating activities and capital expenditures in 2007 and 2006, respectively. The Company expects that the communications business will consume cash in 2008, with the largest use of cash occurring in the first quarter of 2008 as a result of reduced Adjusted EBITDA and increased use of cash for working capital in the quarter. The Company expects that the use of cash by the communications

business will be modest in subsequent quarters and decline overall by the end of 2008. The Company expects that the communications business will generate cash for the full year 2009.

The Company expects that to the extent it does consume cash in 2008, it will be primarily due to interest payments and capital expenditures. The Company expects Adjusted EBITDA to improve in 2008 to a range of \$950 million to \$1.1 billion primarily as a result of a full year of benefit from the integration related synergies associated with the acquisitions completed in 2006 and 2007, as well as moderate growth in Core Communications Services revenue that is expected to be partially offset by reductions in Other Communications Services and SBC Contract Services revenue. Interest payments are expected to be slightly lower than the \$545 million incurred in 2007 based on current debt outstanding and the financing and other capital markets transactions completed in 2007. Capital expenditures for 2007 are expected to be in the range of 12% to 14% of revenue and significantly lower than the \$633 million incurred in 2007 due to much lower integration-related capital expenditures. The majority of the Company's ongoing capital expenditures are expected to be success-based, or tied to incremental revenue. The Company does not have any significant principal amounts due on its outstanding debt until 2010. As of December 31, 2007, the Company had debt of \$32 million and \$366 million that matures in 2008 and 2009, respectively.

Level 3 has approximately \$723 million of cash, cash equivalents and marketable securities on hand at December 31, 2007. In addition, \$124 million of current and non-current restricted securities are used to collateralize outstanding letters of credit, long-term debt, certain operating obligations of the Company or certain reclamation liabilities associated with the coal business. Based on information available at this time, management of the Company believes that the Company's current liquidity and anticipated future cash flows from operations will be sufficient to fund its business for at least the next twelve months.

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 then 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 January 2007, in two separate transactions, the Company completed the exchange of \$605 million of its 10% Convertible Senior Notes due 2011 for a total of 197 million shares of Level 3's common stock. The Company recognized a \$177 million loss on the exchanges in the first quarter of 2007.

In February 2007, Level 3 Financing issued \$700 million of its 8.75% Senior Notes due 2017 and \$300 million of its Floating Rate Senior Notes due 2015 and received net proceeds of \$982 million. The proceeds from these private offerings were used to refinance certain Level 3 Financing debt and to fund the cost of construction, installation, acquisition, lease, development or improvement of other assets to be used in Level 3's communications business.

In March 2007, Level 3 Financing refinanced its senior secured credit agreement and received net proceeds of \$1.382 billion. The proceeds from this transaction were used to repay the existing \$730 million Senior Secured Term Loan due 2011 and other debt. The effect of this transaction was to increase the amount of senior secured debt from \$730 million to \$1.4 billion, reduce the interest rate on that debt from LIBOR plus 3.00% to LIBOR plus 2.25% and extend the final maturity from 2011 to 2014. The Company recognized a \$10 million loss on this transaction related to unamortized debt issuance costs.

During the first quarter of 2007, the Company redeemed the outstanding principal amount of the following debt issuances totaling \$722 million:

- \$488 million of 12.875% Senior Notes due 2010 at a price equal to 102.146 of the principal amount;
- \$96 million of 11.25% Senior Notes due 2010 at a price equal to 101.875 of the principal amount; and
- \$138 million (€104 million) of 11.25% Senior Euro Notes due 2010 at a price equal to 101.875 of the principal amount.

Also during the first quarter of 2007, the respective issuers repurchased, through tender offers, \$941 million of the outstanding principal amounts of the following debt issuances:

- \$144 million of outstanding Floating Rate Senior Notes due 2011 at a price equal to \$1,080 per \$1,000 principal amount of the notes, which included \$1,050 as the tender offer consideration and \$30 as a consent payment;
- \$59 million of outstanding 11% Senior Notes due 2008 at a price equal to \$1,054.28 per \$1,000 principal amount of the notes, which included \$1,024.28 as the tender offer consideration and \$30 as a consent payment;
- \$677 million of outstanding 11.5% Senior Notes due 2010 at a price equal to \$1,115.26 per \$1,000 principal amount of the notes, which included \$1,085.26 as the tender offer consideration and \$30 as a consent payment; and
- \$61 million (€46 million) of outstanding 10.75% Senior Euro Notes due 2008 at a price equal to €1,061.45 per €1,000 principal amount of the notes, which included €1,031.45 as the tender offer consideration and €30 as a consent payment.

The Company recognized a \$240 million loss associated with the redemptions and repurchases in the first quarter of 2007. The cash portion of the loss on redemptions and tenders totaled \$165 million and the remaining \$75 million consisted of unamortized debt issuance and discounts.

In the first quarter, for total cash consideration of \$106 million and equity consideration of 17 million shares of common stock (valued at \$97 million) all of Broadwing's outstanding \$180 million aggregate principal amount of 3.125% Convertible Senior Debentures due 2026 were retired. These debentures were issued by Broadwing prior to Level 3's acquisition of Broadwing on January 3, 2007. There was no gain or loss recognized due to the fact that under purchase accounting, the liability for the notes was valued at the total cost to retire the obligation.

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. In 2005 and 2006, the Company completed the sale of its two businesses that comprised its Information Services segment for total cash proceeds of \$433 million and common stock from one of the purchasers valued at \$3 million.

On December 19, 2007, Level 3 announced that it had reached a definitive agreement to sell the advertising distribution business of Vyvx, LLC ("Vyvx Ads") to DG FastChannel, Inc. for \$129 million in cash. The sale is expected to close in the second quarter of 2008. Revenue from the Vyvx Ads business totaled approximately \$36 million, \$35 million and less than \$1 million for the years ended December 31, 2007, 2006 and 2005, respectively. The results of operations for the Vyvx Ads business are included in continuing operations from when it was acquired as part of the WiTel transaction in December 2005.

The communications industry continues to consolidate. Level 3 has participated in this process with the acquisitions of several companies in 2006, as well as Broadwing, the CDN Business and Servecast

during 2007. Level 3 will continue to evaluate consolidation opportunities and could make additional acquisitions in the future.

On January 3, 2007, Level 3 acquired Broadwing, a publicly held provider of optical network communications services. Under the terms of the merger agreement dated October 16, 2006, Level 3 paid \$8.18 of cash plus 1.3411 shares of Level 3 common stock for each share of Broadwing common stock outstanding at closing. In total, Level 3 initially paid approximately \$753 million of cash (including transaction costs) and issued approximately 123 million shares of Level 3 common stock, valued at \$688 million. As part of the transaction, approximately 4 million previously issued Broadwing warrants (valued at approximately \$4 million) became exercisable into approximately 5 million shares of Level 3 common stock. In the second quarter of 2007, the Company subsequently reduced the total consideration paid by \$4 million for insurance proceeds received in June 2007 that related to the settlement of an insurance claim that occurred prior to acquisition. In the fourth quarter of 2007, the Company incurred additional transaction costs of \$2 million related to the transaction.

On January 23, 2007, the Company acquired the Content Delivery Network services business of SAVVIS, Inc. Under the terms of the agreement, Level 3 paid \$133 million in cash (including transaction costs) to acquire certain assets, including network elements, customer contracts, and intellectual property used in the CDN Business.

On July 11, 2007, Level 3 acquired Servecast Limited, a Dublin, Ireland based provider of live and on-demand video management services for broadband and mobile platforms. Level 3 paid approximately €34 million, or \$46 million, including \$1 million of transaction costs, in cash to complete the acquisition of Servecast.

Off-Balance Sheet Arrangements

Level 3 has not entered into off-balance sheet arrangements that have had, or are likely to have, a current or future material effect to its results of operations or its financial position.

Contractual Obligations

The following table summarizes the contractual obligations and commercial commitments of the Company at December 31, 2007, as further described in the notes to the consolidated financial statements.

Payments Due by Period

| | Total | Less than 1 Year | 1 - 3 Years | 4 - 5 Years | After 5 Years |
|---|----------|---------------------|----------------|----------------|------------------|
| Contractual Obligations | | | | | |
| Long-Term Debt, including current portion | \$ 6,857 | \$ 32 | \$ 1,337 | \$ 968 | \$ 4,520 |
| Interest Expense Obligations | 3,075 | 532 | 1,002 | 849 | 692 |
| Asset Retirement Obligations | 231 | 4 | 18 | 18 | 191 |
| Operating Leases | 727 | 126 | 193 | 147 | 261 |
| Right of Way Agreements | 1,352 | 101 | 176 | 157 | 918 |
| Purchase Obligations | 285 | 285 | — | — | — |
| Other Commercial Commitments | | | | | |
| Letters of Credit | 36 | 9 | 3 | — | 24 |

The Company's debt instruments contain certain covenants which, among other things, limit additional indebtedness, dividend payments, certain investments and transactions with affiliates. If the Company should fail to comply with these covenants, amounts due under the instruments may be accelerated at the note holder's discretion after the declaration of an event of default.

Long-term debt obligations reflect only amounts recorded on the balance sheet as of December 31, 2007 and exclude issue discounts and fair value adjustments.

Interest expense obligations assume interest rates on variable rate debt do not change from December 31, 2007. In addition, interest is calculated based on debt outstanding as of December 31, 2007 and on existing maturity dates.

Certain right of way agreements include provisions for increases in payments in future periods based on the rate of inflation as measured by the consumer price index. The Company has not included estimates for these increases in future periods in the amounts included above.

Certain right of way agreements are cancellable or can be terminated under certain conditions. However, in most cases cancellation or termination of the right of way agreement requires removal of the Company's network. Because the Company considers it unlikely that it would cancel or terminate its right of way agreements and remove its network, the payments due under these agreements have been included in the table above. Certain of these right of way agreements provide for automatic renewal on a periodic basis. For purposes of presenting future payment commitments under these agreements, the Company has included 18 years of future payments from January 1, 2008 in the table above.

Purchase obligations represent all outstanding purchase order amounts of the Company as of December 31, 2007.

The table above does not include other long-term liabilities, such as reserves for legal matters and income taxes, that are not contractual obligations by nature. The Company cannot determine with any degree of reliability the years in which these liabilities might ultimately be paid.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Level 3 is subject to market risks arising from changes in interest rates and foreign exchange rates. As of December 31, 2007, the Company had borrowed a total of \$1.706 billion under a Senior Secured Term Loan due 2014, Floating Rate Senior Notes due 2015 and Floating Rate Senior Notes due 2011 that bear interest at LIBOR rates plus an applicable margin. As the LIBOR rates fluctuate, so too does the interest expense on amounts borrowed under the debt instruments. The weighted average interest rate on the variable rate instruments at December 31, 2007 was approximately 7.80%.

On March 13, 2007, Level 3 Financing 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 are effective beginning April 13, 2007 and mature on January 13, 2014. Under the terms of the interest rate swap agreements, Level 3 Financing, Inc. 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. Level 3 has designated the interest rate swap agreements as a cash flow hedges on the interest payments for \$1 billion of floating rate debt.

For the remaining variable rate debt, a hypothetical increase in the variable portion of the weighted average interest rate by 1 point (i.e. a weighted average rate of 8.80%) would increase annual interest expense of the Company by approximately \$7 million. At December 31, 2007, the Company had \$5.150 billion (excluding discounts) of fixed rate debt bearing a weighted average interest rate of 7.84%. A decline in interest rates in the future will not benefit the Company with respect to the fixed rate debt due to the terms and conditions of the loan agreements that would require the Company to repurchase the debt at specified premiums if redeemed early.

The Company's business plan includes operating telecommunications network businesses in Europe. As of December 31, 2007, the Company had invested significant amounts of capital in the

region for its communications business. The Company does not make use of financial instruments to minimize its exposure to foreign currency fluctuations.

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.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, ("Exchange Act"). Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report.

Management's Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, management assessed the effectiveness of internal controls over financial reporting as of December 31, 2007 based on the guidelines established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Our internal control over financial reporting includes policies and procedures that provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

Based on our assessment, management believes that our internal control over financial reporting was effective as of December 31, 2007. The results of management's assessment have been reviewed with the Audit Committee of the Company's Board of Directors.

The Company's independent registered public accounting firm, KPMG LLP, has issued an audit report on its assessment of the Company's internal control over financial reporting at December 31, 2007. This report appears on page F-3.

Changes in Internal Control over Financial Reporting.

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

ITEM 9B. OTHER INFORMATION

None.

Part III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item 10 is incorporated by reference to our definitive proxy statement for the 2008 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission, however certain information is included in ITEM 1. BUSINESS above under the caption "Directors and Executive Officers."

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item 11 is incorporated by reference to our definitive proxy statement for the 2008 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

For information as of December 31, 2007, with respect to compensation plans (including individual compensation arrangements) under which our equity securities are authorized for issuance, please see "Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER REPURCHASES OF EQUITY SECURITIES" above.

The information required by this Item 12 is incorporated by reference to our definitive proxy statement for the 2008 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item 13 is incorporated by reference to our definitive proxy statement for the 2008 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item 14 is incorporated by reference to our definitive proxy statement for the 2008 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission.

Part IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

- (a) Financial statements and financial statement schedules required to be filed for the registrant under Items 8 or 15 are set forth following the index page at page F-1. Exhibits filed as a part of this report are listed below. Exhibits incorporated by reference are indicated in parentheses.
- 3.1 Certificate of Amendment to the Level 3 Communications, Inc. Certificate of Incorporation and the Level 3 Communications, Inc. Restated Certificate of Incorporation. (Exhibit 3 to the Registrant's Current Reports on Form 8-K filed on May 27, 2005 and May 17, 2006).
- 3.2 Specimen Stock Certificate of Common Stock, par value \$.01 per share (Exhibit 3 to the Registrant's Form 8-A filed on March 31, 1998).
- 3.3 Amended and Restated By-laws of Level 3 Communications, Inc. (Exhibit 3(ii) to the Registrant's Current Report on Form 8-K dated August 17, 2007).
- 4.1.1 Form of Senior Indenture (incorporated by reference to Exhibit 4.1 to Amendment 1 to the Registrant's Registration Statement on Form S-3 (File No. 333-68887) filed with the Securities and Exchange Commission on February 3, 1999).
- 4.1.2 First Supplemental Indenture, dated as of September 20, 1999, between the Registrant and IBJ Whitehall Bank & Trust Company as Trustee relating to the Registrant's 6% Convertible Subordinated Notes due 2009 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated September 20, 1999).
- 4.1.3 Second Supplemental Indenture, dated as of February 29, 2000, between the Registrant and The Bank of New York as Trustee relating to the Registrant's 6% Convertible Subordinated Notes due 2010 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated February 29, 2000).
- 4.2 Indenture, dated as of February 29, 2000, between the Registrant and The Bank of New York as Trustee relating to the Registrant's 11% Senior Notes due 2008 (Exhibit 4.1 to the Registrant's Registration Statement on Form S-4 File No. 333-37362).
- 4.3 Indenture, dated as of February 29, 2000, between the Registrant and The Bank of New York as Trustee relating to the Registrant's 10³/₄% Senior Euro Notes due 2008 (Exhibit 4.1 to the Registrant's Registration Statement on Form S-4 File No. 333-37364).
- 4.4 Amended and Restated Indenture dated as of July 8, 2003, by and between the Company and The Bank of New York, as successor to IBJ Whitehall Bank & Trust Company, as trustee (amends and restates the Senior Debt Indenture, a Form of which was filed as an Exhibit to the Company's Registration Statement on Form S-3-File No. 333-68887) (Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed July 8, 2003).
- 4.5 First Supplemental Indenture, dated as of July 8, 2003, by and between the Company and The Bank of New York, as successor to IBJ Whitehall Bank & Trust Company, as Trustee (Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed July 8, 2003).
- 4.6 Indenture, dated as of October 1, 2003, by and between Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc. as Issuer and The Bank of New York as Trustee relating to the Level 3 Financing, Inc. 10.75% Senior Notes due 2011 (Exhibit 4.11 to the Registrant's Annual Report on Form 10-K for the year ending December 31, 2003).

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- 4.7.1 Indenture, dated as of October 24, 2003, by and between the Registrant and The Bank of New York as Trustee relating to the Registrant's 9% Convertible Senior Discount Notes due 2013 (Exhibit 4.12 to the Registrant's Annual Report on Form 10-K for the year ending December 31, 2003).

- 4.7.2 First Supplemental Indenture, dated as of February 7, 2005, by and between the Company and The Bank of New York, as Trustee relating to the Registrant's 9% Convertible Senior Discount Notes due 2013. (Exhibit 4.12.2 to the Registrant's Annual Report on Form 10-K for the year ending December 31, 2005).
- 4.8 Supplemental Indenture, dated as of October 20, 2004, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of October 1, 2003, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 10.75% Senior Notes due 2014. (Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed October 22, 2004).
- 4.9 Supplemental Indenture, dated as of October 20, 2004 among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of October 1 2003, among Level 3 Financing, Inc. as Issuer, Level 3 Communications, Inc. as Guarantor and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 10.75% Senior Notes due 2011. (Exhibit 99.1 to the Registrant's Current Report on Form 8-K/A-1 filed October 22, 2004).
- 4.10 Indenture, dated December 2, 2004, among Level 3 Communications, Inc. and The Bank of New York. (Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 4.11 Supplemental Indenture, dated December 1, 2004, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York, as Trustee, relating to the Level 3 Financing 10.75% Senior Notes due 2011. (Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 4.12 Second Supplemental Indenture dated as of April 4, 2005, by and between Level 3 Communications, Inc. and the Bank of New York, as trustee (Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed April 8, 2005).
- 4.13 Indenture, dated as of January 13, 2006, among Level 3 Communications, Inc. as Issuer and The Bank of New York, as Trustee relating to the 11.50% Senior Notes Due 2010 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated January 17, 2006).
- 4.14 Indenture, dated as of March 14, 2006, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer and The Bank of New York, as Trustee, relating to the Floating Rate Senior Notes due 2011 of Level 3 Financing, Inc. (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated March 16, 2006).
- 4.15 Indenture, dated as of March 14, 2006, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer and The Bank of New York, as Trustee, relating to the 12.25% Senior Notes due 2013 of Level 3 Financing, Inc. (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated March 16, 2006).
- 4.16 Third Supplemental Indenture between Level 3 Communications, Inc. and The Bank of New York, as Trustee, relating to up to \$345,000,000 aggregate principal amount of 3.5% Convertible Senior Notes due 2012, dated as of June 13, 2006 supplement to the Amended and Restated Indenture dated as of July 8, 2003 (Senior Debt Securities) (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated June 13, 2006).

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- 4.17 Supplemental Indenture, dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes due 2011 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated October 17, 2006).
- 4.18 Supplemental Indenture, dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, Supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes due 2011 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated October 17, 2006).

- 4.19 Supplemental Indenture, dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 12.25% Senior Notes due 2013 (Exhibit 4.3 to the Registrant's Current Report on Form 8-K dated October 17, 2006).
- 4.20 Supplemental Indenture, dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 12.25% Senior Notes due 2013 (Exhibit 4.4 to the Registrant's Current Report on Form 8-K dated October 17, 2006).
- 4.21 Indenture, dated as of October 30, 2006, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer, and The Bank of New York, as Trustee, relating to the 9.25% Senior Notes due 2014 of Level 3 Financing, Inc. (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated October 30, 2006).
- 4.22 Supplemental Indenture, dated as of December 27, 2006, among Level 3 Communications, Inc., Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of October 1, 2003, among Level 3 Financing, Inc., as Issuer, Level 3 Communications, Inc., as Guarantor, and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 10.75% Senior Notes due 2011 2014 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated December 28, 2006).
- 4.23 Indenture, dated as of February 14, 2007, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer and The Bank of New York, as Trustee, relating to the Floating Rate Senior Notes due 2015 of Level 3 Financing, Inc. (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated February 20, 2007).
- 4.24 Indenture, dated as of February 14, 2007, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer and The Bank of New York, as Trustee, relating to the 8.75% Senior Notes due 2017 of Level 3 Financing, Inc. (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated February 20, 2007).

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- 4.25 Supplemental Indenture, dated as of February 23, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC, Broadwing Financial Services, Inc. and The Bank of New York, as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., as Issuer, Level 3 Communications, Inc., as Guarantor, and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 12.25% Senior Notes due 2013 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed February 26, 2007).
- 4.26 Supplemental Indenture, dated as of March 1, 2007, among Level 3 Communications, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated as of February 29, 2000, among Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Communications, Inc.'s 11% Senior Notes Due 2008 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated March 2, 2007).
- 4.27 Supplemental Indenture, dated as of March 1, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC, Broadwing Financial Services, Inc., together with Level 3 Communications, Inc. and Level 3 Communications, LLC, as Guarantors and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, the supplemental Indenture dated as of October 12, 2006, by and among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, the supplemental Indenture dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, and the supplemental Indenture dated as of January 4, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC, Broadwing Financial Services, Inc. and The Bank of New York as Trustee relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes Due 2011 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated March 2, 2007).

- 4.28 Supplemental Indenture, dated as of March 6, 2007, among Level 3 Communications, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated as of February 29, 2000, among Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Communications, Inc.'s 10³/₄ % Senior Euro Notes Due 2008 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated March 7, 2007).
- 4.29 Amended and Restated Supplemental Indenture, dated as of March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, the supplemental Indenture dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, and the supplemental Indenture dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes Due 2011 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated March 16, 2007).

- 4.30 Amended and Restated Supplemental Indenture, dated as of March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Broadwing Financial Services, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, the supplemental Indenture dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, and the supplemental Indenture dated as of January 4, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC, Broadwing Financial Services, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes Due 2011 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 4.31 Amended and Restated Supplemental Indenture, dated as of March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, the supplemental Indenture dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, and the supplemental Indenture dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 12.25% Senior Notes Due 2013 (Exhibit 4.3 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 4.32 Amended and Restated Supplemental Indenture, dated as of March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Broadwing Financial Services, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, and the supplemental Indenture dated as of January 4, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC, Broadwing Financial Services, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 12.25% Senior Notes Due 2013 (Exhibit 4.4 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 4.33 Amended and Restated Supplemental Indenture, dated as of March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of October 1, 2003, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, the supplemental Indenture dated as of October 20, 2004 among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, and the supplemental Indenture dated December 1, 2004, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 10.75% Senior Notes Due 2011 (Exhibit 4.5 to the Registrant's Current Report on Form 8-K dated March 16, 2007).

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- 4.34 Amended and Restated Supplemental Indenture, dated as of March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Broadwing Financial Services, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated as of October 30, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, the supplemental Indenture dated as of January 4, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, and the supplemental Indenture dated as of January 4, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 9.25% Senior Notes Due 2014 (Exhibit 4.6 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 4.35 Supplemental Indenture, dated as of March 13, 2007, among Level 3 Communications, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated as of January 13, 2006, among Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Communications, Inc.'s 11.5% Senior Notes Due 2010 (Exhibit 4.7 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 4.36 Supplemental Indenture, dated as of April 9, 2007, among Level 3 Communications, LLC, Level 3 Communications, Inc., Level 3 Financing, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated October 30, 2006, among Level 3 Financing, Inc., Level 3

Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 9.25% Senior Notes Due 2014 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated April 11, 2007).

- 4.37 Supplemental Indenture, dated as of April 9, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated October 30, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 9.25% Senior Notes Due 2014 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated April 11, 2007).
- 4.38 Supplemental Indenture, dated as of January 4, 2007, among Broadwing Financial Services, Inc., Level 3 Communications, Inc., Level 3 Financing, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated October 30, 2006 among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 9.25% Senior Notes Due 2014 (Exhibit 4.2 to the Registrant's Registration Statement on Form S-4/A File No. 333-139123-01).
- 4.39 Supplemental Indenture, dated as of May 29, 2007, among Level 3 Communications, LLC, Level 3 Communications, Inc., Level 3 Financing, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated February 14, 2007 among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 8.75% Senior Notes Due 2017 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated May 31, 2007).
- 4.40 Supplemental Indenture, dated as of May 29, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated February 14, 2007 among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 8.75% Senior Notes Due 2017 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated May 31, 2007).

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- 4.41 Supplemental Indenture, dated as of May 29, 2007, among Level 3 Communications, LLC, Level 3 Communications, Inc., Level 3 Financing, Inc. and The Bank of New York as Trustee, supplementing the Indenture dated February 14, 2007 among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes Due 2015 (Exhibit 4.3 to the Registrant's Current Report on Form 8-K dated May 31, 2007).
 - 4.42 Supplemental Indenture, dated as of May 29, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated February 14, 2007 among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes Due 2015 (Exhibit 4.4 to the Registrant's Current Report on Form 8-K dated May 31, 2007).
 - 10.1 Separation Agreement, dated December 8, 1997, by and among Peter Kiewit Sons', Inc., Kiewit Diversified Group Inc., PKS Holdings, Inc. and Kiewit Construction Group Inc. (Exhibit 10.1 to the Registrant's Form 10-K for 1997).
 - 10.2 Amendment No. 1 to Separation Agreement, dated March 18, 1997, by and among Peter Kiewit Sons', Inc., Kiewit Diversified Group Inc., PKS Holdings, Inc. and Kiewit Construction Group Inc. (Exhibit 10.1 to the Registrant's Form 10-K for 1997).
 - 10.3 Form of Aircraft Time-Share Agreement (Exhibit 10.7 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001).
 - 10.4 Warrant Agreement, dated as of April 15, 2002, between the Registrant and Walter Scott, Jr. (Exhibit 10.9 to the Registrant's Annual Report on Form 10-K for 2002).
 - 10.5 Confirmation of OTC Convertible Note Hedge, dated December 2, 2004, from Merrill Lynch International to Level 3 Communications, Inc. (Exhibit 10.8 to the Registrant's Current Report on

Form 8-K filed December 7, 2004).

- 10.6 Confirmation of OTC Warrant, dated December 2, 2004, from Merrill Lynch International to Level 3 Communications, Inc. (Exhibit 10.9 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 10.7 Securities Purchase Agreement, dated as of February 18, 2005, among Level 3 Communications, Inc. and the Investors named therein (Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed February 22, 2005).
- 10.8 1995 Stock Plan of Level 3 Communications, Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated December 20, 2007).
- 10.9.1 Outperform Stock Option Amended and Restated Master Award Agreement of Level 3 Communications, Inc. (Exhibit 10.2 to the Registrant's Current Report on Form 8-K dated December 20, 2007).
- 10.9.2 Form of OSO Master Award Agreement of Level 3 Communications, Inc. (Exhibit 10.3 to the Registrant's Current Report on Form 8-K dated December 20, 2007).
- 10.10 Form of Amended Master Deferred Issuance Stock Agreement of Level 3 Communications, Inc. (Exhibit 10.4 to the Registrant's Current Report on Form 8-K dated December 20, 2007).

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- 10.11 Form of Registration Rights and Transfer Restriction Agreement by and among Level 3 Communications, Inc., PT Holding Company LLC, Progress Telecommunications Corporation, Caronet, Inc., and EPIK Communications Incorporated to be entered into on the closing of the transaction contemplated by the Purchase Agreement 2006 (Exhibit 10.2 to the Registrant's Current Report on Form 8-K dated January 30, 2006).
 - 10.12 Registration Rights and Transfer Restriction Agreement, dated May 31, 2006, by and among Level 3 Communications, Inc., MCCC ICG Holdings LLC, Columbia Capital Equity Partners III(QP), L.P., Columbia Capital Partners III (Cayman), L.P., Columbia Capital Equity Partners III (AI), L.P., Columbia Capital Investors III, L.L.C., Columbia Capital Employees Investors III, L.L.C., M/C Venture Partners V, L.P., M/C Venture Investors, L.L.C., Chestnut Venture Partners, L.P., and Bear Investments, LLLP. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated June 1, 2006).
 - 10.13 Stock Purchase Agreement, dated July 20, 2006, among Level 3 Communications, Inc., Technology Spectrum, Inc. and Insight Enterprises, Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated July 26, 2006).
 - 10.14 Registration Rights Agreement, dated as of August 2, 2006, between Level 3 Communications, Inc. and Cheshire Holding Corp., as agent for the security holders of Looking Glass Networks Holding Co., Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated August 3, 2006).
 - 10.15 Consent, dated as of August 7, 2006, by Level 3 Communications, Inc. relating to that certain Securities Purchase Agreement, dated as of February 18, 2005, by and among Level 3 Communications, Inc. and the Investors named on Exhibit A Thereto (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated August 7, 2006).
 - 10.16 Registration Agreement, dated October 30, 2006, among Level 3 Communications, Inc., Level 3 Financing, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. Incorporated, Credit Suisse Securities (USA) LLC, J.P. Morgan Securities Inc. and Wachovia Capital Markets, LLC relating to Level 3 Financing, Inc.'s 9.25% Senior Notes due 2014 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated October 30, 2006).
 - 10.17 Registration Agreement, dated December 28, 2006, among Level 3 Communications, Inc., Level 3 Financing, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. Incorporated, Credit Suisse Securities (USA) LLC, Citigroup Global Markets Inc. and Wachovia Capital Markets, LLC relating to Level 3 Financing, Inc.'s 9.25% Senior Notes due 2014 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated December 28, 2006).

- 10.18 Exchange Agreement, dated as of January 11, 2007, among Level 3 Communications, Inc., Southeastern Asset Management, Inc., on behalf of its investment advisory clients, and Legg Mason Opportunity Trust, a series of Legg Mason Investment Trust, Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated January 17, 2007).
- 10.19 Registration Agreement, dated February 14, 2007, among Level 3 Communications, Inc., Level 3 Financing, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Credit Suisse Securities (USA) LLC, Citigroup Global Markets Inc., Morgan Stanley & Co. Incorporated and Wachovia Capital Markets, LLC relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes due 2015 (Exhibit 4.3 to the Registrant's Current Report on Form 8-K dated February 20, 2007).

- 10.20 Registration Agreement, dated February 14, 2007, among Level 3 Communications, Inc., Level 3 Financing, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Credit Suisse Securities (USA) LLC, Citigroup Global Markets Inc., Morgan Stanley & Co. Incorporated and Wachovia Capital Markets, LLC relating to Level 3 Financing, Inc.'s 8.75% Senior Notes due 2017 (Exhibit 4.4 to the Registrant's Current Report on Form 8-K dated February 20, 2007).
- 10.21 Credit Agreement, dated as of March 13, 2007, among Level 3 Communications, Inc., Level 3 Financing, Inc. and Merrill Lynch Capital Corporation (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.22 Guarantee Agreement, dated as of March 13, 2007, among Level 3 Communications, Inc., the Subsidiaries of Level 3 Communications, Inc. and Merrill Lynch Capital Corporation (Exhibit 10.2 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.23 Collateral Agreement, dated as of March 13, 2007, among Level 3 Communications, Inc., Level 3 Financing, Inc., the Subsidiaries of Level 3 Communications, Inc. and Merrill Lynch Capital Corporation (Exhibit 10.3 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.24 Indemnity, Subrogation and Contribution Agreement, dated as of March 13, 2007, among Level 3 Communications, Inc., Level 3 Financing, Inc., the Subsidiaries of Level 3 Communications, Inc. and Merrill Lynch Capital Corporation (Exhibit 10.4 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.25 Omnibus Offering Proceeds Note Subordination Agreement, dated as of March 13, 2007, among Level 3 Communications, Inc., Level 3 Financing, Inc., Level 3 Communications, LLC, the Subsidiaries (Exhibit 10.5 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.26 Supplement No. 1 to Omnibus Offering Proceeds Note Subordination Agreement, dated as of March 13, 2007, among Level 3 Communications, Inc., Level 3 Communications, LLC, Level 3 Financing, Inc., the Subsidiaries (Exhibit 10.6 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.27 Amended and Restated Loan Proceeds Note, dated March 13, 2007, issued by Level 3 Communications, LLC to Level 3 Financing, Inc. (Exhibit 10.7 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.28 Amended and Restated Loan Proceeds Note Collateral Agreement, dated March 13, 2007, among Level 3 Financing, Inc., Level 3 Communications, LLC and Merrill Lynch Capital Corporation (Exhibit 10.8 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.29 Amended and Restated Loan Proceeds Note Guarantee Agreement, dated March 13, 2007, among Broadwing Financial Services, Inc., and Level 3 Financing, Inc. (Exhibit 10.9 to the Registrant's Current Report on Form 8-K dated March 16, 2007).
- 10.30 Retention Agreement, dated October 15, 2007, by and between Level 3 Communications, LLC and Sunit S. Patel (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated October 17, 2007).
- 10.31 Standstill Agreement, dated November 19, 2007, by and between Level 3 Communications, Inc. and Southeastern Asset Management, Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated November 19, 2007).

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

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 29th day of February, 2008.

LEVEL 3 COMMUNICATIONS, INC.

By: /s/ JAMES Q. CROWE

Name: James Q. Crowe
Title: *Chief Executive Officer*

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

| | | |
|-------------------------|---|-------------------|
| /s/ WALTER SCOTT, JR. | | |
| _____ | Chairman of the Board | February 29, 2008 |
| Walter Scott, Jr. | | |
| /s/ JAMES Q. CROWE | | |
| _____ | Chief Executive Officer and Director | February 29, 2008 |
| James Q. Crowe | | |
| /s/ SUNIT S. PATEL | | |
| _____ | Group Vice President and Chief Financial Officer (Principal Financial Officer) | February 29, 2008 |
| Sunit S. Patel | | |
| /s/ ERIC J. MORTENSEN | | |
| _____ | Senior Vice President and Controller (Principal Accounting Officer) | February 29, 2008 |
| Eric J. Mortensen | | |
| /s/ DOUGLAS C. EBY | | |
| _____ | Director | February 29, 2008 |
| Douglas C. Eby | | |
| /s/ JAMES O. ELLIS, JR. | | |
| _____ | Director | February 29, 2008 |
| James O. Ellis, Jr. | | |
| /s/ RICHARD R. JAROS | | |
| _____ | Director | February 29, 2008 |
| Richard R. Jaros | | |
| /s/ ROBERT E. JULIAN | | |
| _____ | Director | February 29, 2008 |
| Robert E. Julian | | |
| /s/ MICHAEL J. MAHONEY | | |
| _____ | Director | February 29, 2008 |
| Michael J. Mahoney | | |
| /s/ ARUN NETRAVALI | | |
| _____ | Director | February 29, 2008 |
| Arun Netravali | | |
| /s/ JOHN T. REED | | |
| _____ | Director | February 29, 2008 |
| John T. Reed | | |
| /s/ MICHAEL B. YANNEY | | |
| _____ | Director | February 29, 2008 |
| Michael B. Yanney | | |
| /s/ ALBERT C. YATES | | |
| _____ | Director | February 29, 2008 |

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

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