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April 18, 2011

## VIA E-MAIL/BY HAND

Honorable Jaclyn A. Brillling  
Secretary  
New York State Public Service Commission  
Three Empire State Plaza  
Albany, NY 12223-1350

2011 APR 18 PM 3:15

EXIT  
PUBLIC SERVICE  
COMMISSION  
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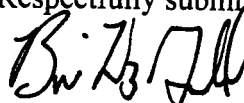
Re: Case 11-C- - Verified Joint Petition of Level 3 Communications, Inc., Apollo Amalgamation Sub, Ltd., Level 3 Communications, LLC, Broadwing Communications, LLC, WilTel Communications, LLC, TelCove Operations, LLC And Global Crossing North America, Inc., Global Crossing Telecommunications, Inc., Global Crossing Local Services, Inc., For Approval of the Transfer of Control and Related Transactions Including Certain Financing Arrangements

Dear Secretary Brillling:

Please find enclosed for filing the Verified Joint Petition of Level 3 Communications, Inc., Apollo Amalgamation Sub, Ltd., Level 3 Communications, LLC, Broadwing Communications, LLC, WilTel Communications, LLC, TelCove Operations, LLC And Global Crossing North America, Inc., Global Crossing Telecommunications, Inc., Global Crossing Local Services, Inc., For Approval of the Transfer of Control and Related Transactions Including Certain Financing Arrangements.

Should you have any questions regarding this filing, please contact me.

Respectfully submitted,



Brian T. FitzGerald

BTF:cd (104417)  
Enclosures

cc: Gregory C. Pattenaude  
Richard E. Thayer  
Paul Kouroupas  
Gregory G. Nickson

Dewey & LeBoeuf LLP is a New York limited liability partnership.

BEFORE THE  
NEW YORK STATE  
PUBLIC SERVICE COMMISSION

Verified Joint Petition of )  
)

Level 3 Communications, Inc., )  
Apollo Amalgamation Sub, Ltd., )  
Level 3 Communications, LLC, )  
Broadwing Communications, LLC, )  
WilTel Communications, LLC, )  
TelCove Operations, LLC )

Case 11-C- \_\_\_\_\_

And )  
)

Global Crossing North America, Inc., )  
Global Crossing Telecommunications, Inc., )  
Global Crossing Local Services, Inc., )  
)

For Approval of the Transfer of Control and )  
Related Transactions Including )  
Certain Financing Arrangements )  
)

**VERIFIED JOINT PETITION**

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BEFORE THE  
NEW YORK STATE  
PUBLIC SERVICE COMMISSION

_____	)	
Verified Joint Petition of	)	
	)	
Level 3 Communications, Inc.,	)	
Apollo Amalgamation Sub, Ltd.,	)	
Level 3 Communications, LLC,	)	
Broadwing Communications, LLC,	)	
WilTel Communications, LLC,	)	
TelCove Operations, LLC	)	Case 11-C- _____
	)	
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Global Crossing North America, Inc.,	)	
Global Crossing Telecommunications, Inc.,	)	
Global Crossing Local Services, Inc.,	)	
	)	
For Approval of the Transfer of Control and	)	
Related Transactions Including	)	
Certain Financing Arrangements	)	
_____	)	

**VERIFIED JOINT PETITION**

Level 3 Communications, Inc. (“Level 3”), and its direct and indirect subsidiaries Apollo Amalgamation Sub, Ltd. (“Apollo Sub”), Level 3 Communications, LLC (“Level 3 LLC”), Broadwing Communications, LLC (“Broadwing”), WilTel Communications, LLC (“WilTel”), and TelCove Operations, LLC (“TelCove” and collectively with Level 3 LLC, Broadwing and WilTel, the “Level 3 Companies”) and Global Crossing North America, Inc. (“Global Crossing”), and its indirect subsidiaries Global Crossing Telecommunications, Inc. (“GC Telecommunications”) and Global Crossing Local Services, Inc. (“GC Local” and together with GC Telecommunications, the “GC Companies”) (collectively, Level 3, Apollo Sub, the Level 3 Companies, Global Crossing, and the GC Companies, the “Petitioners”), through their undersigned counsel, submit this Joint Petition pursuant to Sections 100 and 101 of the New

York State Public Service Law. Petitioners herein request New York State Public Service Commission (“Commission”) approval, or such authority as may be necessary or required, to enable the parties to consummate the proposed transaction whereby Level 3, the ultimate parent of Apollo Sub, will acquire indirect control of the GC Companies. Approval is also requested for the related transfer of an indirect minority ownership interest in the Level 3 Companies.<sup>1</sup> In addition, Petitioners request approval, to the extent required, for the participation of Petitioners in certain financing arrangements necessary to accomplish the acquisition of the GC Companies, as well as the participation of the GC Companies in certain existing financing arrangements put in place by Level 3’s subsidiary Level 3 Financing, Inc. (“Level 3 Financing”).<sup>2</sup>

The Level 3 Companies and the GC Companies are each competitive telecommunications carriers authorized to provide intrastate telecommunications service, including competitive local exchange services, in New York. As discussed in Section IV below, the proposed transactions will produce certain important public interest benefits. The proposed transactions will involve a change in the ultimate ownership of the GC Companies only and the transfer of indirect minority ownership of the Level 3 Companies. Notably, the proposed transactions will not result in any assignment of any certificates, assets or customers. The Level 3 Companies and the GC Companies will continue to serve their existing customers in New York pursuant to their respective authorizations under the same rates, terms and conditions. Accordingly, for all practical purposes, the proposed transactions will be transparent to the customers of the Level 3 Companies and the GC Companies.

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<sup>1</sup> The precise distribution of ownership interest in the Level 3 Companies is currently contemplated to be approximately 24-34%, although the exact percentages will not be known until the transactions discussed herein are consummated.

<sup>2</sup> The Level 3 Companies have previously obtained Commission authority to participate in these financing arrangements. See footnote 7.

Petitioners request that the Commission act expeditiously to grant the approval requested herein by June 16, 2011, so that Petitioners can timely consummate the proposed transactions.

In support of this Joint Petition, the Petitioners state:

**I. DESCRIPTION OF THE PETITIONERS**

**A. Level 3, Apollo Sub and the Level 3 Companies**

Level 3 is a publicly traded (NASDAQ: LVLT) Delaware corporation with principal offices located at 1025 Eldorado Boulevard, Broomfield, CO 80021. Apollo Sub, a Bermuda company and wholly owned subsidiary of Level 3, was recently formed for the purpose of accomplishing the proposed transaction. Level 3 provides high-quality voice and data services to carriers, internet service providers (“ISPs”), and other business customers over its IP-based network through its wholly owned indirect subsidiaries, the Level 3 Companies. The Level 3 Companies are non-dominant carriers that are authorized to provide resold and/or facilities-based telecommunications services nationwide pursuant to certification, registration or tariff requirements, or on a deregulated basis. The Level 3 Companies are also authorized by the Federal Communications Commission (“FCC”) to provide international and domestic interstate services as non-dominant carriers.

In New York, Level 3 LLC is authorized to operate as a facilities-based common carrier and reseller of telephone services, including local exchange services (local dial-tone) within New York pursuant to authority granted by the Commission in Case No. 97-C-2183 on March 6, 1998. Broadwing is authorized to provide resold and facilities-based local exchange and interexchange telecommunications services pursuant to authority granted by the Commission in Case No. 04-C-0981 on October 4, 2004. TelCove is authorized to provide facilities-based common carrier and resold local exchange and interexchange services pursuant to authority

granted by the Commission in Case No. 00-C-0623 on June 29, 2000. WilTel is authorized to provide facilities-based common carrier and resold local exchange and interexchange services pursuant to authority granted by the Commission in Case No. 98-C-0815 on August 14, 1998.

**B. Global Crossing and the GC Companies**

Global Crossing, a New York corporation, is headquartered at 225 Kenneth Drive, Rochester, New York 14623. Global Crossing's indirect operating subsidiaries, the GC Companies, together with its other U.S. and international affiliates, provide telecommunications solutions over the world's first integrated global IP-based network. Its core network connects more than 300 major cities in twenty-nine countries worldwide, and delivers services to more than 600 cities in sixty countries and six continents around the globe. The GC Companies and their affiliates offer a full range of managed data and voice products to enterprise customers, carriers, mobile operators and ISPs.

The GC Companies are Michigan corporations and wholly owned indirect subsidiaries of Global Crossing. The GC Companies are authorized to provide telecommunications services as competitive, non-dominant carriers pursuant to certification, registration or tariff requirements, or on a deregulated basis in all fifty states and the District of Columbia. The GC Companies operate as non-dominant domestic interstate telecommunications carriers under the FCC's blanket authority. GC Telecommunications also operates as an international telecommunications carrier through FCC authority held by Global Crossing. In New York, GC Telecommunications is authorized to provide intrastate telecommunications services pursuant to authority granted by the Commission in Case No. 95-C-0391 on August 9, 1995. GC Local is authorized to provide intrastate telecommunications services pursuant to authority granted by the Commission in Case No. 95-C-0069 on June 5, 1995.



## **II. CONTACT INFORMATION**

For the purposes of this Joint Petition, contacts for the Petitioners are as follows:

For Level 3, Apollo Sub and the Level 3 Companies:

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For Global Crossing and the GC Companies:

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and:

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Tel: (720) 888-2516  
Fax: (720) 888-5134

## **III. REQUEST FOR APPROVAL OF TRANSFER OF CONTROL AND RELATED TRANSACTIONS**

### **A. Transfer of the GC Companies**

On April 11, 2011, Level 3, Apollo Sub, and Global Crossing's indirect parent company, Global Crossing Limited ("GCL"), entered into an Agreement and Plan of Amalgamation (the

“Agreement”) whereby Apollo Sub and GCL will be merged (“amalgamated”) under Bermuda Law. Pursuant to the Agreement, each issued and outstanding common share and convertible preferred stock of GCL (other than any shares owned by Level 3, GCL, or their respective subsidiaries and any dissenting shares) will be exchanged for shares of common stock of Level 3. In total, Level 3 currently expects to issue approximately 1.3 billion shares.

Following the merger of GCL and Apollo Sub, the separate corporate existence of Apollo Sub and GCL will cease, and the combined company, renamed Level 3 GC Limited, will exist as a wholly owned subsidiary of Level 3 Financing and ultimately a wholly owned subsidiary of Level 3 LLC.<sup>3</sup> As a result of the transaction, Level 3 will indirectly control the GC Companies. For the Commission’s convenience, pre- and post-transaction organizational charts are provided as Exhibit A. A copy of the Agreement is included in the SEC Form 8-K filed by Level 3 and is available at <http://lvl.client.shareholder.com/sec.cfm>.

Following consummation of the transaction, the GC Companies will continue to operate their facilities and provide service to their customers at the same rates, terms, and conditions, ensuring a seamless transition of ownership. Petitioners also request authority for the indirect transfer of control of the GC Companies to Level 3.

**B. Indirect Minority Ownership Transfer of the Level 3 Companies**

Petitioners request approval for an indirect minority transfer of ownership of the Level 3 Companies that will occur as a consequence of the merger transaction. As a result of the exchange of shares in connection with the merger, STT Crossing Ltd, a current direct investor in GCL and an indirect investor in Global Crossing and the GC Companies, will obtain a minority interest of

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<sup>3</sup> Immediately following the merger, Level 3 GC Limited will be a direct subsidiary of Level 3 Financing. Applicants request approval, to the extent required, for a *pro forma* intracorporate transaction whereby Level 3 GC Limited will become a direct subsidiary of Level 3 LLC.



approximately 24% to 26% in Level 3, and indirectly in the Level 3 Companies.<sup>4</sup> In addition, Southeastern Asset Management, Inc., which is currently the largest Level 3 stockholder with an approximate 30% interest, will hold approximately 15% of Level 3. Other than STT Crossing Ltd. and Southeastern Asset Management, Inc., no other individual or entity is expected to hold 10% or more of Level 3.<sup>5</sup> The majority of the Level 3 stock will continue to be held by current investors.

### **C. Participation in Certain Financing Arrangements of Level 3 Financing**

Petitioners request approval to authorize the Level 3 Companies and the GC Companies to participate in certain financing arrangements in connection with the transfer of control transaction described herein.<sup>6</sup> First, Level 3 Financing, a wholly owned unregulated non-carrier subsidiary of Level 3, plans to enter into a \$650 million Term Loan with a six-year maturity date. Level 3 Financing plans to lend the net proceeds it receives to its subsidiary, Level 3 LLC, in return for an intercompany demand note, and in turn, Level 3 LLC may lend the net proceeds to Level 3 GC

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<sup>4</sup> Pursuant to the Agreement, STT Crossing Ltd. has the option to increase its interest in Level 3 up to 34%.

<sup>5</sup> As noted above, the exact percentage distribution of the indirect ownership interest in the Level 3 Companies will not be known until the transactions discussed herein are consummated. In the unlikely event that any other individual or entity obtains over a 10% indirect ownership interest as a result of the proposed transactions, Petitioners respectfully request approval for all indirect ownership interests that exist at the time the proposed transactions close.

<sup>6</sup> Level 3 LLC has sought Commission approval to act as a guarantor of certain Senior Notes recently issued by Level 3 Financing (for \$500 million at 9.375%). See Matter No. 11-00507. For the avoidance of any confusion, Level 3 clarifies that the issuance of those Senior Notes described in the pending application is not directly related to Level 3's proposed acquisition of the GC Companies. Rather, it is a part of a pre-existing refinancing plan that will enable Level 3 to extend significantly the maturity dates of certain obligations at reasonable terms thus reducing the future refinancing risk associated with its 2014 scheduled maturities. The refinancing described in the pending financing application is a part of the Level 3 Companies' ongoing efforts to strengthen their overall credit profile and efficiently manage their maturity profile.

The GC Companies also have a request for approval of a financing arrangement pending before the Commission. See Matter No. 11-00541. In a March 14, 2011 application, the GC Companies sought approval to provide guarantees and security for one or more new financings of up to \$700 million by Global Crossing UK Limited, a wholly owned indirect subsidiary of GCL. The proceeds of the anticipated financing were to be used to repay debt, for general corporate purposes and working capital. In light of the proposed merger, Global Crossing's business plans have changed and it no longer plans to complete this financing. Accordingly, the GC Companies plan to withdraw their March 14, 2011 request for financing authority.

Limited in return for an intercompany demand note. The Level 3 Companies and the GC Companies seek approval to pledge assets and act as guarantors in support of the \$650 million Term Loan.

Second, in support of the merger transaction, Level 3 Financing also plans to either (a) issue \$1.1 billion in Senior Notes in a registered public offering or a private placement or (b) enter into a \$1.1 billion Bridge Loan with a one-year maturity date from closing (“Bridge Loan”). Pursuant to either arrangement, Level 3 Financing will lend the net proceeds it receives to its subsidiary, Level 3 LLC, in return for an intercompany demand note, and in turn, Level 3 LLC may lend the net proceeds to Level 3 GC Limited in return for an intercompany demand note. The proceeds from the \$1.1 billion Senior Note or Bridge Loan financing arrangement will be used to repay the existing indebtedness of Level 3 GC Limited. The Level 3 Companies and the GC Companies seek approval to act as guarantors for the \$1.1 billion financing arrangement. Should Level 3 Financing enter into the \$1.1 billion Bridge Loan, Level 3 Financing has the option at maturity of the Bridge Loan to either (1) refinance the Bridge Loan by entering into a Rollover Loan with a six-year maturity date, or (2) replace the Bridge Loan by issuing Exchange Notes with a six-year maturity date. The Level 3 Companies and the GC Companies also seek approval, as necessary, to act as guarantors for either the Rollover Loan or the Exchange Notes.

Finally, upon closing of the merger, it is expected that the GC Companies will be required to provide a guaranty for existing unsecured indebtedness of Level 3 Financing including certain Senior Notes and an existing credit facility.<sup>7</sup> It is also anticipated that the GC Companies will

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<sup>7</sup> The Level 3 Companies have previously obtained Commission authority for these financing arrangements: *See Case 06-C-1282 - Joint Petition of Level 3 Communications, Inc., Broadwing Corporation, and Broadwing Communications Group, LLC for Approval of the Transfer of Control of Broadwing Communications Group, LLC and Related Transactions Including the Participation of Broadwing Communications Group, LLC in Certain Existing Financing Arrangements of Level 3 Financing, Inc., Pursuant to Sections 100 and 101 of the New York State Public Service Law, Approved As Recommended And So Ordered By The Commission* (Dec. 13, 2006); *Matter 09-00570 - Petition of Level 3 Communications, LLC, Broadwing Communications, LLC,*

pledge their assets as security for the credit facility. Petitioners request authority, to the extent necessary, for the GC Companies to participate in these financing arrangements.

**D. Level 3's Qualifications**

Level 3 has the technical, managerial, and financial qualifications to acquire control of the GC Companies. Level 3, through its operating subsidiaries, is a leading global communications company, operating one of the world's newest and most advanced telecommunications platforms. The Level 3 network spans over 27,000 route miles and delivers services to customers in major markets across the United States and Europe. It serves a substantial number of the world's largest and most sophisticated communications companies, including interexchange carriers, local phone companies, European PTTs, cable operators, ISPs, wireless companies, and Internet content providers. In 2010, Level 3 had worldwide communications revenues of \$3.591 billion and total revenues of \$3.651 billion. A copy of Level 3's most recent financial statements from its Form 10-K for the year ended December 31, 2010 are attached hereto as Exhibit B.

Level 3 is operated by a highly qualified management team, all of whom have extensive backgrounds in telecommunications. Information concerning the legal, technical, managerial and financial qualifications of Level 3 was submitted with the various applications filed with the Commission with respect to its operations in New York, and is, therefore, already a matter of record. Petitioners request that the Commission take official notice of these existing descriptions of Level 3's qualifications and incorporate them by reference herein. In addition, Level 3 has a history of successfully acquiring and integrating network facilities and customers from other

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*TelCove Operations, LLC, and WilTel Communications, LLC for Approval to Participate in a Financing Arrangement, Deemed Approved by Operation of Law (May 21, 2009); and Matter 10-00028 - Verified Petition of Level 3 Communications, LLC for Approval to Participate in a Financing Arrangement, Deemed Approved by Operation of Law (Feb. 20, 2010).*

companies including: (1) the acquisition of the dial-up Internet businesses of McLeodUSA, ICG, and Sprint; (2) the acquisition of Genuity, a Tier 1 Internet Protocol communications company; (3) the acquisition of substantially all of 360networks' nationwide long-haul transport business; and (4) the acquisitions of Broadwing, WilTel, and other telecommunications providers. Petitioners note that the Commission found that Level 3 was qualified to acquire Broadwing, WilTel, and other telecommunications providers when it approved those transactions;<sup>8</sup> there is no new information regarding Level 3 that could lead the Commission to determine otherwise in this case.

#### **IV. PUBLIC INTEREST CONSIDERATIONS**

Petitioners submit that the transactions described herein will serve the public interest. Petitioners expect that the merger will enable the combined entity to better meet the local, national and global needs of enterprises, wholesale buyers, and other customers. The transactions will bring together two successful carrier organizations that have proven themselves in a highly competitive marketplace. The transactions will help create a stronger competitor by bringing together each organization's respective strengths. Operation as an integrated company will allow each of the operating companies to be more competitive and to deliver greater value and variety of services to their customers than they do individually.

Moreover, the transactions will be conducted in a manner that will be largely transparent to customers of the Level 3 Companies and the GC Companies. The transactions will not result in a change of carrier for customers or any assignment of authorizations, and in no event will it

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<sup>8</sup> See e.g., *Case 06-C-1282*, Approved As Recommended And So Ordered By The Commission (Dec. 13, 2006); *Case 06-C-0577 - Joint Petition of Level 3 Communications, Inc. and TelCove, Inc. for Approval of the Transfer of Control of TelCove Investment, LLC, TelCove Operations, Inc. and TelCove Atlantic, Inc. and Related Transactions*, Approved As Recommended And So Ordered By The Commission (Jul. 21, 2006); and *Case 05-C-1432 - Joint Petition of Level 3 Communications, LLC and WilTel Communications Group, LLC for Approval of an Indirect Transfer of Control*, Approved As Recommended And So Ordered By The Commission (Dec. 14, 2005).



result in the discontinuance, reduction, loss, or impairment of service to customers. Following consummation of the transaction, the Level 3 Companies and the GC Companies will continue to provide high-quality communications services to their customers without interruption and without immediate change in rates, terms or conditions.

The public interest will also be served by expeditious consideration and approval of the transactions no later than June 16, 2011. For various important business, tax and financial reasons, Petitioners require that the transaction be closed as quickly as possible. Delay in the regulatory approval process – and thus in the ability of the Petitioners to move forward promptly with the integration process – risks creating uncertainty and competitive harm. In particular, the competitive telecommunications marketplace continues to be a very challenging business environment. The proposed transaction is aimed at strengthening the competitive position of the combined entities and, therefore, delay in the regulatory approval process prevents the parties from realizing the economic benefits of integration of the carriers' networks or offering the expanded combined network footprint to customers as quickly as the parties otherwise could. Accordingly, Petitioners request that the Commission commence its examination of the proposed transaction as soon as possible and complete its review no later than June 16, 2011.

V. CONCLUSION

For the reasons stated above, Petitioners respectfully submit that the public interest, convenience, and necessity would be furthered by a grant of this Verified Joint Petition for the transfer of control and related transactions, including certain financing arrangements. Petitioners respectfully request expedited treatment by June 16, 2011.

Respectfully submitted,

By: \_\_\_\_\_

  
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[brian.murray@lw.com](mailto:brian.murray@lw.com)

Counsel for Global Crossing North America, Inc., Global Crossing Telecommunications, Inc. and Global Crossing Services, Inc.

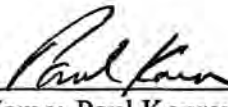
Dated: April 18, 2011



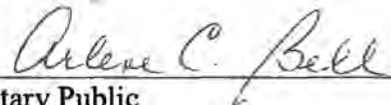
**VERIFICATION**

STATE OF NEW JERSEY           §  
  §  
COUNTY OF MORRIS           §

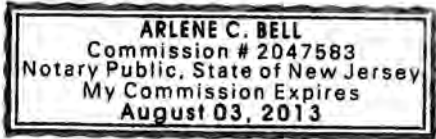
I, Paul Kouroupas, state that I am Vice President Regulatory Affairs for Global Crossing North America, Inc. and its operating subsidiaries; that I am authorized to make this Verification on behalf of Global Crossing North America, Inc. and its operating subsidiaries; that the foregoing filing was prepared under my direction and supervision; and that the statements in the foregoing document are true and correct to the best of my knowledge, information, and belief.

  
Name: Paul Kouroupas  
Title: Vice President Regulatory Affairs  
Global Crossing North America, Inc.

SWORN TO AND SUBSCRIBED before me on the 15<sup>th</sup> day of April, 2011.

  
Notary Public

My commission expires: August 3, 2013



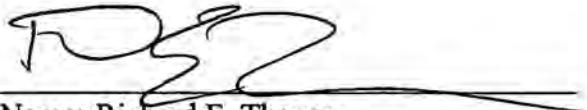
**VERIFICATION**

STATE OF COLORADO

§  
§  
§

COUNTY OF BROOMFIELD

I, Richard E. Thayer, state that I am Senior Counsel for Level 3 Communications, LLC; that I am authorized to make this Verification on behalf of Level 3 Communications, LLC and its subsidiaries; that the foregoing filing was prepared under my direction and supervision; and that the statements in the foregoing document are true and correct to the best of my knowledge, information, and belief.



Name: Richard E. Thayer  
Title: Senior Counsel  
Level 3 Communications, LLC

SWORN TO AND SUBSCRIBED before me on the 15 day of April, 2011.

  
\_\_\_\_\_  
Notary Public

My commission expires: May 9, 2015

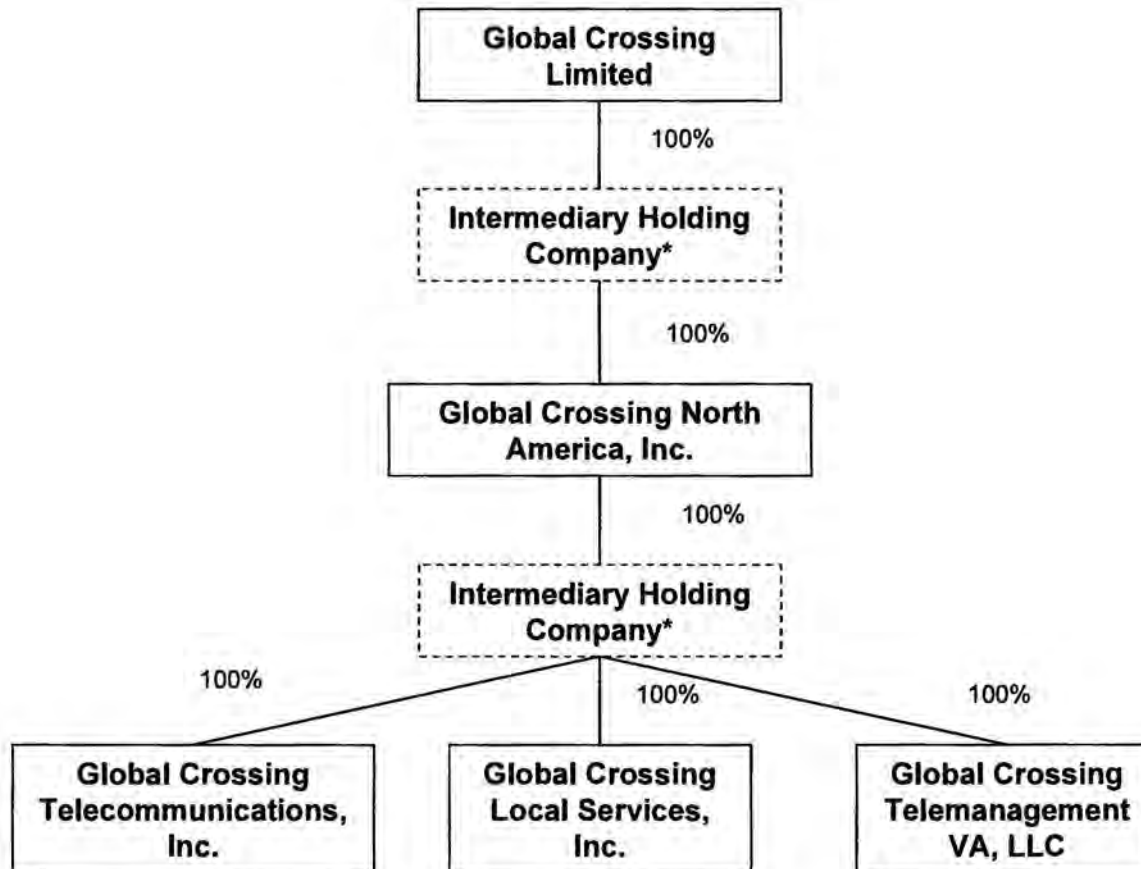


My Commission Expires May 9, 2015

**Exhibit A**

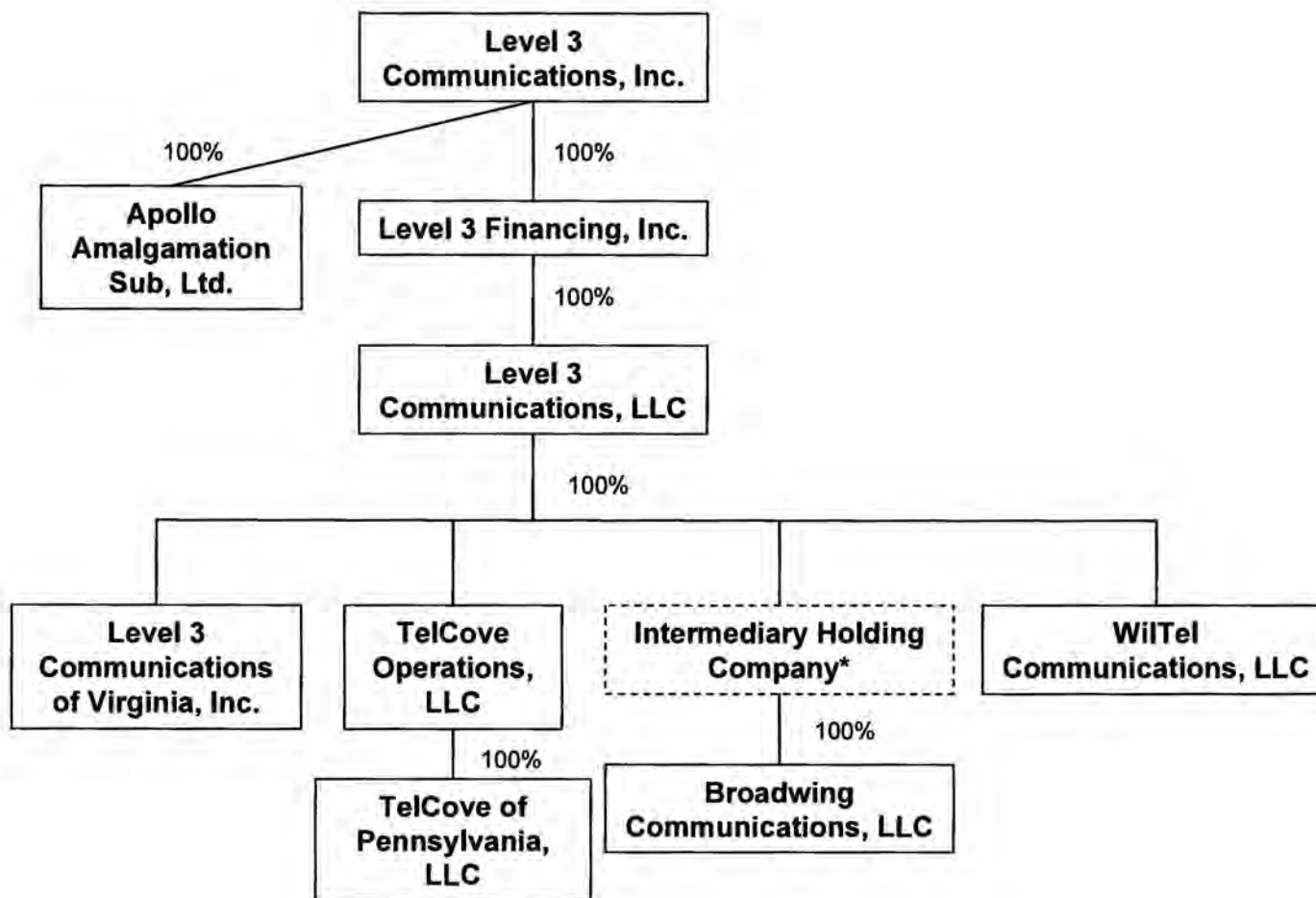
**Organizational Charts**

## Pre-Transaction Global Crossing Corporate Structure



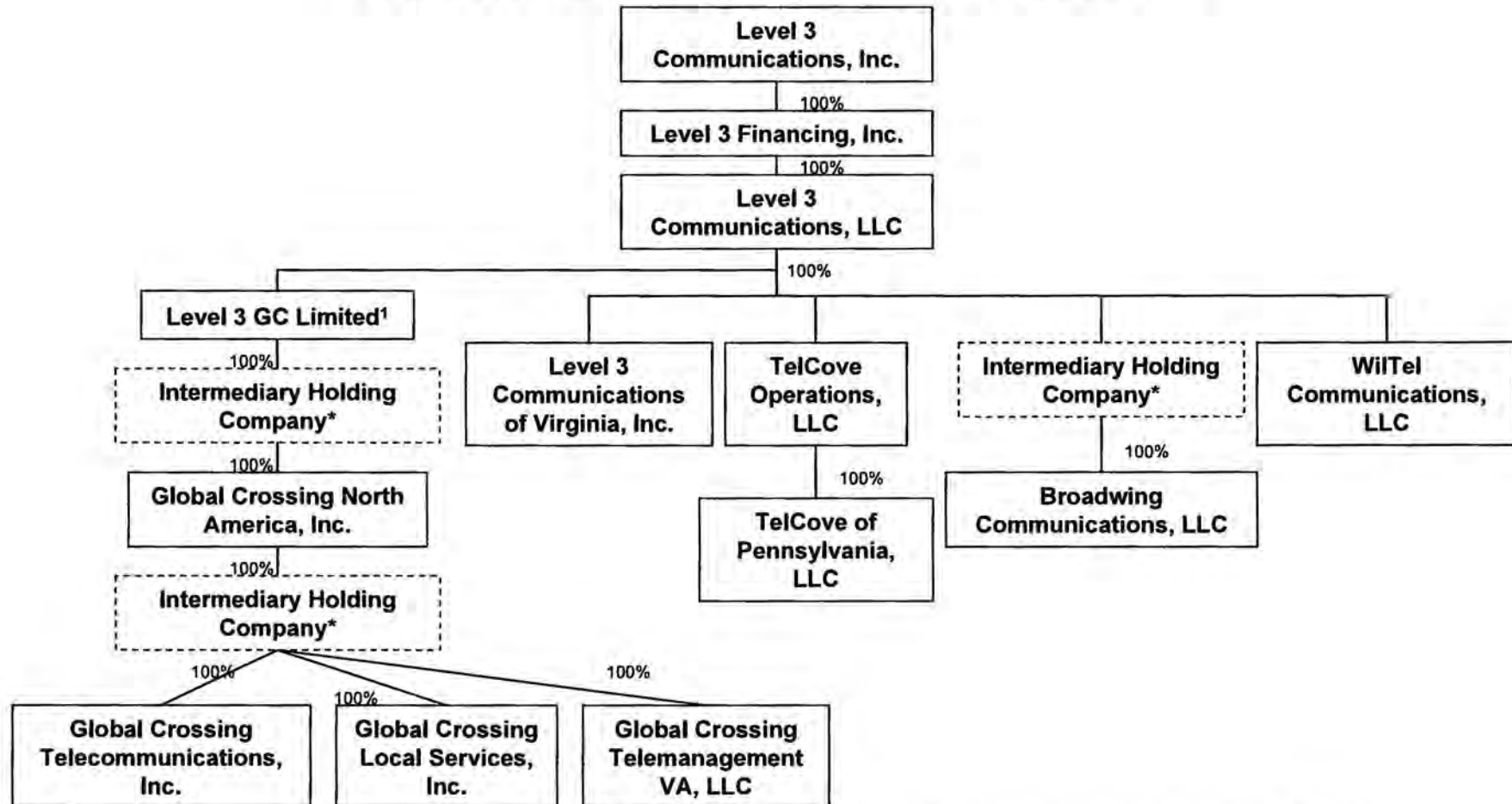
\*Intermediary holding companies omitted for purposes of clarity--none are certificated telecommunications service providers. Each of Global Crossing Telecommunications, Inc., Global Crossing Local Services, Inc., and Global Crossing Telemangement VA, LLC are 100% indirectly owned by Global Crossing North America, Inc.

### Pre-Transaction Level 3 Corporate Structure



\*Intermediary holding companies omitted for purposes of clarity--none are certificated telecommunications service providers. Broadwing Communications, LLC is 100% *indirectly* owned by Level 3 Communications, LLC. Level 3 Communications of Virginia, Inc., Telcove Operations, LLC and WiITel Communications, LLC are each 100% *directly* held by Level 3 Communications, LLC.

## Post-Transaction Level 3 Corporate Structure



\*Intermediary holding companies omitted for purposes of clarity--none are certificated telecommunications service providers. Broadwing Communications, LLC is 100% *indirectly* owned by Level 3 Communications, LLC. Level 3 Communications of Virginia, Inc., Telcove Operations, LLC and WiTel Communications, LLC are each 100% *directly* held by Level 3 Communications, LLC.

<sup>1</sup> Immediately following the merger, Level 3 GC Limited (the new company formed upon completion of the combination of Apollo Amalgamation Sub Ltd. and Global Crossing Limited) will be 100% directly held by Level 3 Financing, Inc., and ultimately will become a wholly owned subsidiary of Level 3 Communications, LLC.



**Exhibit B**

**Financial Statements of Level 3**

# LEVEL 3 COMMUNICATIONS INC

## FORM 10-K (Annual Report)

Filed 02/25/11 for the Period Ending 12/31/10

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

Use these links to rapidly review the document

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[LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES](#)

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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, 2010

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

Indicate by check mark 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, 2010 the aggregate market value of common stock held by non-affiliates of the registrant approximated \$1.23 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	1,673,680,085 as of February 22, 2011

### 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 2011 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.*

*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;
- 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:

- increase and maintain the volume of traffic on our network and the resulting revenue;
  - successfully use new technology and information systems to support new and existing services;
  - prevent system failures that significantly disrupt the availability and quality of the services that we provide;
  - provide services that do not infringe the intellectual property and proprietary rights of others;
  - 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 have enabled 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.

### **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 Broad Range of Communications Services Over Our End-to-End Network.* We provide a broad 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 the acquisitions we completed 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, 2010, we have:

- approximately 81,000 intercity route miles in North America and Europe, which we expect to ultimately reduce to approximately 54,000 intercity route miles, connecting 23 countries; and
- approximately 125 markets having metropolitan fiber networks containing approximately 27,000 route miles in the United States and Europe.

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, 2010, 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 Efficient and Effective Backbone Services Through An End to End Backbone Network.* Many portions of our originally constructed intercity and metropolitan networks were designed to provide high quality communications services at an efficient cost structure. Our network and business processes 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 the unit cost of delivering our services. 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 Communications Global Customers.* With respect to our top global communications customers, our primary distribution strategy is to use a national, direct sales force. In addition to large wholesale carriers, such as 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, voice service providers and system integrators, these customers also include the U.S. government, very large enterprises and certain other businesses that purchase communications services in a manner that is consistent with traditional wholesale customers. Providing communications services to many of these businesses is at the core of our strategy.
- *Further Develop Existing Enterprise Customer Business.* With respect to our enterprise customers that would not be considered among the top global communications customers, our primary distribution strategy is to use a locally based direct sales force to target business customers, state

governments, and higher education institutions with high demands for mission critical communications services. We also complement our locally based direct sales force with an inside or call center based sales force as well as an indirect sales channel of third party agent partners.

- *Develop Market Leading Content Distribution Service Offerings.* At December 31, 2010, 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 focus 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, or CDN 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 new 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.* 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 provides significant cost synergy opportunities.

As we seek to expand the addressable market for our services, we also evaluate opportunities that would expand the geographic reach of our network and/or 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 cost 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 Broad Range of Communications Services.* We provide a broad 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, 2010, we have metropolitan fiber networks in approximately 125 markets in North America and Europe, which contain approximately 27,000 route miles. 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.* Our patent portfolio includes patents covering technologies ranging from data and voice services, to content distribution, to transmission and networking equipment. 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 optonics simultaneously as a system to provide an efficient cost structure for the services that we deliver 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**

### *Service Offerings*

We offer a broad range of communications services, which currently include the following services. All of these services are available to all of our customers, 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. Our Network and Internet Services include the following.



- *Transport Services.* Transport services include wavelengths and private lines. 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 a range of speeds from 1 Gpbs to 40 Gpbs. 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 include SONET or SDH protection to provide resiliency to fiber or equipment outages. Private line services are available in a wide range of speeds, including electrical, optical and Ethernet interfaces.

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 offers wholesale and content provider customers with high speed access to the Internet over one of the largest international Internet backbones. 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 High Speed Internet Protocol Service. Level 3's Dedicated Internet Access service offers a wide variety of access methods and speeds. The service is available stand-alone or in conjunction with managed services offerings, such as Managed Router where we deploy and manage a router that is on the customer premise or our network-based Distributed Denial of Service, or DDS, Mitigation, which protects our business customers from Internet based DDS attacks.
- *VPN Services.* Built on our optical transport network, 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, Ethernet Virtual Private Line, or EVPL, or MPLS VPN technologies. These services allow service providers, enterprises and government entities 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, while delivering high quality of service and security. These services 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. VPN services are sold stand-alone or in conjunction with our managed services offerings.
- *Converged Business Network.* Our Converged Business Network service enables customers to use the bandwidth that they purchase from us for a variety of services. The Converged Business Network service combines a customer's services over a single access circuit. As a result, we are able to offer service bundles made up of VPN, DIA and Voice services in a cost efficient manner. Converged services are sold stand alone or in conjunction with our managed services offerings
- *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.

- *Managed Modem.* 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 Managed Modem and are provided a fully managed dial up network infrastructure. As part of this service, we arrange 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 our Gateway facility.
- *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.
- *Media Services.* Our primary services that encompass our Media Services offerings for the capturing and distribution of digital content include the following.
  - *Vyvx 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. Super Bowl XLV® marked the 22nd consecutive year that the NFL used these services, and the seventh year anniversary of the first live broadcast event ever carried using our 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.
  - *CDN Services.* 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.

- *Voice Services.* We offer a broad range of local and long distance voice services targeted to both enterprise and wholesale customers including VoIP (Voice over Internet Protocol) services and traditional circuit-switch based services. Our Voice services include the following.
  - *VoIP Enhanced Local.* VoIP Enhanced Local is a VoIP service 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 services via any broadband connection. The service is also used by enterprises who self-provide their own local voice features and call routing within premises-based IP PBX equipment. The service includes the essential building blocks required for residential or business voice service such as local phone numbers, local number portability, local and long distance calling, 911, operator assistance, directory listings, and directory assistance.
  - *SIP Trunking ("SIPT").* SIPT is a VoIP-based local phone service offered to medium and large enterprises as a replacement for traditional fully featured enterprise TDM voice services. SIPT allows customers with an IP PBX to manage calls to and from the PSTN without having to purchase traditional access lines dedicated to voice. SIPT includes basic local phone service components such as local phone numbers, 911, operator assistance, directory listings, local and long distance calling. In addition, customers select from a full set of feature packages that provide core call control features such as call forwarding, call waiting and call transfer, as well as advanced features such as unified messaging and one-number identity.
  - *Local Inbound.* Local Inbound service terminates traditional telephone network originated calls to Internet Protocol termination points. Customers, such as call centers, conferencing providers, voice over IP service providers and enterprises, 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.
  - *Primary Rate Interface ("PRI").* Level 3 offers traditional enterprise TDM local phone services that can be configured in multiple ways. Enterprise customers typically use PRI services with traditional PBX equipment. PRI services come with telephone numbers, operator services, directory assistance and directory listing, 911, as well as routing features such as inbound redirect and remote call forwarding. Customers are able to utilize our PRI services to access long distance and toll free calling as well.
  - *Long Distance.* The Long Distance services portfolio consists of local and long distance transport and termination services offered to both enterprise and wholesale customers. Our wholesale offerings include domestic and international voice termination services targeted to IXCs, wireless providers, local phone companies, cable companies, resellers and voice over IP providers. Medium and large enterprises also purchase our long distance services for their corporate calling or outbound contact center needs. All Level 3 long distance services are offered at the customer's option over circuit switch or Softswitch technologies.
  - *Toll Free.* The Toll Free services portfolio consists of wholesale and enterprise 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, voice over IP providers and enterprises. Within this portfolio are Advanced Toll Free services that provide contact center customers the ability to define and control call handling and advanced routing between the Level 3 network and multiple customer contact center locations. Customers may also combine

advanced routing with network-based Intelligent Voice Response, or IVR, services that drive call routing and handling based on the caller's interaction with the IVR.

For a discussion of certain geographic information regarding our revenue from external customers and long-lived assets and a discussion of financial information and industry segments, 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 in the ordinary course of our business and would also take place with respect to any integration activities. 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.

#### *Distribution Strategy*

Our customers generally include the following.

- 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;
- large enterprises that purchase communications services in a manner similar to carriers;
- broadband cable television operators;
- major ISPs;
- system integrators;
- video distribution companies;
- mega portals;
- providers of online gaming;
- software service providers;
- social networking providers;
- research and educational consortia;
- traditional media distribution companies including broadcasters, television networks and sports leagues;
- the U.S. federal government and its agencies;
- state and local governments;
- enterprises that purchase communications services on a regional or local basis;
- regional services providers; and
- traditional broadcasters.

To implement our communications services strategy and reach our target customers, we use a combination of a direct sales force, an inside or call center based sales force, and indirect sales channels of third party agent partners. The specific elements that we use depends upon the nature of the customers that are being targeted.

We also use a direct sales force to target those business customers and other customers that make communications purchasing decisions on a local or regional basis. Smaller opportunities are serviced by an inside or call center based sales force generally selling pre-defined bundles of services. The customers that we target with this combination are generally those in the mid-market, which we define as including medium enterprises that are generally outside the Fortune® 1000, small regional service providers, some educational institutions and some state governments. We also complement our direct and inside sales forces that targets these customers with an indirect sales channel of third party agent partners and from time to time system integrators.

We are seeking to expand our indirect sales channel to include expanded relationships with systems integrators. We have worked with systems integrators to provide services to those companies, which the system integrator than bundles into the services that it is providing to the ultimate end user customer. We are working with systems integrators to develop a model through which we will provide services to the customer directly, rather than through the system integrator. We are looking to apply this expanded relationship to both large and mid-market enterprise customers.

Our sales functions are supported by dedicated employees in sales and customer target marketing. These sales functions are also supported by centralized service or product management and development, general or corporate marketing, network services, engineering, information technology, and corporate functions including legal, finance, strategy and human resources.

We have 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 downturn 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, 2010, our top ten communications customers represented approximately 27% of our total communications revenue.

Beginning in the first quarter of 2010, we modified our revenue disclosure based on the manner in which certain customers are classified within customer-facing groups. In our financial results, we discuss our Core Network Services revenue in terms of wholesale, large enterprise and federal, mid-market, and European customers.

- Wholesale includes revenue from international and domestic carriers, cable companies, wireless companies, voice service providers and the vast majority of the customers that were formerly classified in our content market group.
- Large enterprise and federal includes Fortune® 300 and other large enterprises that purchase communications services in a manner similar to carriers, including financial services, healthcare and systems integrators, Federal Government agencies and academic consortia, plus certain large former content markets group customers.

- Mid-market includes medium enterprises generally outside the Fortune® 300, regional service providers, certain academic institutions and some state and local governments.
- European, which did not change from the 2009 financial presentation includes the largest European consumers of bandwidth, including the largest European and international carriers, large system integrators, voice service providers, cable operators, Internet service providers, content providers, enterprises, and government and education sectors.

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 communications network**

Our network is an advanced, international, facilities based communications network. Today, we primarily provide services over our own facilities. At December 31, 2010, our network encompasses:

- approximately 68,000 intercity route miles in North America, which we expect to reduce to approximately 44,000 intercity route miles based upon our determinations on whether to retain or eliminate overlapping routes;
- an intercity network covering approximately 13,000 miles across Europe;
- metropolitan fiber networks in approximately 125 markets containing approximately 27,000 route miles in the United States and Europe;
- 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.

*Terrestrial Intercity Networks.* Our approximately 68,000 mile fiber optic intercity network in North America, which we expect will be reduced to approximately 44,000 miles, include the following characteristics.

- **Multiple Conduits.** In approximately 26,000 miles of our intercity network, we have installed groups of multiple conduits. We believe that the availability of spare conduits 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, or DWDM 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 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.

Our intercity network covering approximately 13,000 miles across Europe incorporates a multiple conduit structure in approximately 4,000 miles and many of the same characteristics as described above with respect to our North American intercity network in a multiple ring architecture.

*Local Market Infrastructure.* Our local facilities include fiber optic metropolitan networks connecting our intercity network and Gateways to buildings housing communications intensive end users, enterprise customers 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. 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, 2010, and had completed the build out 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, 2010, we had operational, facilities based, local metropolitan networks in 116 U.S. markets and 9 European markets.

As of December 31, 2010, we also had approximately 145 markets in service in North America and approximately 45 markets in service in Europe.

*Transoceanic Networks.* 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 has been upgraded and our two fiber pairs now have capacity of 1.8 Tbps.

We acquired additional capacity on Atlantic Crossing 1, to serve as redundant capacity for our fiber pairs on the Yellow system. We also own capacity in the TAT-14 cable system. In connection with our acquisition of WilTel Communications, LLC, or WilTel, we 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 acquiring an additional 1 Terabit of capacity on the Apollo South cable system, which will be drawn down over a multi-year period. We are also an owner on the Japan-US, and China-US cable systems, an indefeasible right of use, or 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. In 2009, we also secured 30 Gigabits of additional capacity on the Atlantic Crossing I cable system.

### **Our Patent Portfolio**

Through acquisitions and through our own research and development, we have approximately 850 patents and patent applications in the United States and around the world, as of December 31, 2010. Our patent portfolio includes patents covering technologies ranging from data and voice services to content distribution to transmission and networking equipment.

In addition to the patents and patent applications we own, we have received licenses to patents held by others, including through a cross-license agreement with IBM entered into in December 2007, giving us access to technology covered by IBM's approximately (at that time) 42,000 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. Most of the patent infringement suits brought against us to date 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 Acquisition and Delivery Networks**

We believe that our Vyx and Content Distribution Network, or CDN, assets combined with our other network infrastructure provide us with a competitive advantage in the content acquisition and distribution business. This belief is based on several factors.

- *Network Scale.* Because we are a facilities based provider, 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.* We believe our customers' content reaches global Internet destinations using an average number of "hops" that are fewer than with most other CDN providers, which enables our customers to easily reach their audiences and provide a better viewing experience. The fewer number of hops required to reach Internet destinations serves to reduce latency and jitter.
- *Low Cost Position.* Because we own or control much of the underlying network infrastructure required to deliver our CDN services, 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.



- *Network Performance.* Because we own or control much of the underlying network infrastructure, we believe that we are positioned to optimize end user performance as we are the operators of that infrastructure.

### *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 game downloads, applications updates and delivery of demos and trailers through CDN.

### *Content Acquisition and Distribution Services Architecture*

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.

The Vyvx platform transmits 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.

The CDN platform directs network traffic across our existing physical network and infrastructure. The CDN platform is composed of the edge server or computer that provides caching and streaming functions, and the global server that provides load balancing—that is, a computer that directs the traffic to the most efficient edge 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 that stored content. 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.

### **Business Support Systems**

In order to pursue our business 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 our business support systems, 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 have been designed to streamline and synchronize our service, sales and operational functions. These processes and systems have 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 this platform at the end of 2009, and we are now focusing 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 third party sales channel partners 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.

## Competition

The communications industry has been and remains highly competitive. In the late 1990s and the early 2000s, significant new capacity was deployed by both existing and new entrants. This oversupply led to a period of financial restructuring and industry consolidation. We believe that these occurrences have led to an improved industry structure. However, given the significant economies of scale inherent in the communications industry, we believe further consolidation may occur.

Our primary competitors are long distance carriers, ILECs, CLECs, PTTs, Content Delivery Network companies, and other companies that provide communications services. The following information identifies some key competitors for each of our service offerings.

Our key competitors for our wholesale voice service offerings are other providers of wholesale communications services including AT&T, Verizon, Qwest (which is in the process of being acquired by CenturyLink, Inc.), Global Crossing and Competitive Local Exchange Carriers.

For our IP and Data services, we compete with companies that include Verizon, AT&T, Global Crossing, Tata 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, Abovenet and XO. In Europe, our key competitors are other carriers such as PTTs, Telia International, Colt, Interoute, 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 and Internap. In Europe, competitors include Equinix, Global Switch, InterXion, Telecity and Telehouse Europe.

In the enterprise and government markets, our key competitors include ILECs (such as AT&T, Verizon and Qwest/Centurylink) and CLECs (such as tw telecom).

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, periodic 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. 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.

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.

*Special Access Regulation.* Special access services are "lit" loop or transport facilities that support the transmission of data on a point-to-point basis, often referred to as "private lines." Level 3 purchases a substantial amount of special access services from ILECs and other telecommunications carriers to reach customer premises and, less frequently, to support interoffice transport requirements. In addition, Level 3 provides special access services to end user customers and to other carriers via its own network and/or through the resale of other carriers' special access services.

In January 2005, the FCC commenced an examination of the regulatory framework governing the rates, terms, and conditions under which ILECs subject to "price cap" regulation provide interstate special access services. In this rulemaking, the FCC is reviewing both the price cap regime by which ILEC special access rates are set in most areas, as well as the "pricing flexibility" regime under which ILECs have obtained the ability to enter into more individualized relationships with customers based upon certain threshold showings of the presence of competitors in a specific geographic and product market. We have requested as a measure of interim relief that the FCC prohibit (or "freeze") any increases by ILECs in the rates applicable to special access services pending the gathering of data and adoption of final rules in this proceeding. Others have advocated for additional relief, including a revocation altogether of ILEC pricing flexibility and/or reduction of "price cap" ILEC interstate special access rates. The FCC has not yet ruled on Level 3's request for interim relief or the other pending

requests. The FCC is reviewing the voluminous record in this proceeding, but we do not anticipate that the FCC will issue a comprehensive ruling in this rulemaking until at least mid- to late-2011.

*Network Neutrality and Open Internet.* In 2005, the FCC adopted its *Internet Policy Statement* seeking to safeguard and promote unimpeded access to the Internet by announcing the following four general Internet policy principles that, subject to reasonable network management, would guide the FCC's interpretation of its statutory responsibilities to encourage broadband deployment and preserve and promote the open and interconnected nature of the public Internet. Specifically, consumers are entitled to:

- access the lawful Internet content of their choice;
- run applications and use services of their choice, subject to the needs of law enforcement;
- connect their choice of legal devices that do not harm the network; and
- competition among network providers, application and service providers, and content providers.

In 2008, the FCC issued an order finding that Comcast violated the *Internet Policy Statement* and engaged in "unreasonable network management practices" by blocking BitTorrent and other peer-to-peer Internet traffic. The FCC required Comcast to disclose details of its network management practices, commit to a plan to cease such practices, and provide details of a new nondiscriminatory network management practice. Comcast appealed the FCC's decision to the United States Court of Appeals for the District of Columbia Circuit, which in April of 2010, held that the FCC had failed to show that it had the legal authority to issue the ruling. On December 21, 2010, the FCC issued a Report and Order entitled "*Preserving the Open Internet: Broadband Industry Practices*" (the "Open Internet Order"), which provided, among other things, that broadband providers must: 1) be transparent about, and therefore disclose, their network management practices; ii) not block lawful content; and 3) not unreasonably discriminate in transmitting lawful content. The Open Internet Order may be subject to both court and legislative challenge. We cannot predict the nature and extent of the effect that further action by the FCC in this area may have on the Company and its operations.

In November 2010, in connection with Level 3's request to augment interconnection capacity with Comcast, Comcast demanded that Level 3 enter into an agreement and pay Comcast for interconnection capacity. Level 3 agreed to Comcast's demand under protest, and initiated steps to bring the issue to the attention of federal policy makers. Our dispute with Comcast has not yet been resolved. There is a risk that, if Comcast prevails in its claims that such a charge is not prohibited under applicable law (including the Open Internet Order), other retail Internet service providers may make similar demands for payment relating to interconnection with their networks.

*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 November 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 Court of Appeals for the United States in the District of Columbia upheld the FCC's order in January 2010. Despite their breadth, some carriers continue to argue that certain types of ISP bound traffic are not covered by the 2001 and 2008 orders. Findings of this nature could affect the Company's charges for ISP bound traffic.

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 expired on January 11, 2011, but is continuing on a month to month basis. Level 3's agreement with Verizon expired 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. Some carriers assert that VoIP traffic is local in nature and thereby subject to local compensation rates, while other carriers 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.

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. 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 considering changing the method by which our contributions are assessed to a flat-fee charge, such as a per-line or per-number charge. Additionally, the FCC recently ruled that states may assess contributions to their state Universal Service Fund from Voice over Internet Protocol providers. 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 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. We 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.

There are initiatives in several state legislatures to lower intrastate access rates, aligning them with interstate rates. While we believe that rate adjustment initiatives such as this are generally better considered holistically by the FCC as part of its overall intercarrier compensation reforms, some states have and may continue to determine otherwise. Depending on whether we are a net collector or a net payer of any adjusted rate, such rate adjustments could have a negative effect on the Company.

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 in the future.

*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. 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 affect 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 federal-state regulatory scheme, the European Union has adopted a more systematic approach to the convergence of networks and the regulation of telecommunications services. The European Commission oversees the implementation by its Member States of various directives developed to regulate electronic communications in a technology and platform neutral manner. 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. Pursuant to that framework, the licensing regime was replaced with a general authorization. Our existing licenses were canceled and replaced with a general authorization.

Notwithstanding a synchronized approach to regulation in Europe, the 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.

### *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. 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 all other Canadian telecommunications market segments, we believe that the ILECs will 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 favor 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 statute. 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. In October 21, 2009, the CRTC released a policy framework dealing with Internet Traffic Management Practices for Internet Service Providers. The policy requires ISPs to disclose their network management practices, to implement those practices in a manner that addresses only the offending conduct; and must be competitively neutral. The CRTC said that it would implement its policy on a case-by-case review. At this time, the Company cannot predict the effect that this policy might have on its operations.

## **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."

In November 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. In September 2006, we completed the sale of 100% of the capital stock of our indirect, wholly owned subsidiary, Software Spectrum, Inc. ("Software Spectrum"), 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. ("KCP"). KCP has a 50% interest in two mines, which are operated by a subsidiary of Peter Kiewit Sons', Inc. ("PKS"). Decker Coal Company ("Decker") is a joint venture with Western Minerals, Inc., which is a subsidiary of Cloud Peak Energy Inc. Black Butte Coal Company ("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 to a limited number of customers, including PacifiCorp (Black Butte), Idaho Power (Black Butte), Sierra Pacific (Black Butte), The Detroit Edison Company (Decker), Virginia Power (Decker), Wolf Mountain (Decker) and Minnesota Power (Decker). The Black Butte mine has commitments to deliver approximately 15.4 million tons of coal through 2015 under contracts with PacifiCorp, Idaho Power and Sierra Pacific. The Decker mine has sales commitments to deliver approximately 7.7 million tons of coal through 2013 with The Detroit Edison Company and Wolf Mountain. Under a mine management agreement, KCP pays a subsidiary of PKS an annual fee equal to 30% of KCP's adjusted operating income. The management fee for 2010 was less than \$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 2009, 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 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 customer base may be negatively affected if legislation is enacted to limit greenhouse gas emissions.

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. 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, 2010 was approximately \$4 million. KCP's share of accrued estimated reclamation costs was \$105 million at December 31, 2010. We were not required to make significant capital expenditures for environmental compliance with respect to the coal business in 2010. 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.

The operation of our mines is subject to regulation by the Federal Mine Safety and Health Administration ("MSHA") under the Federal Mine Safety and Health Act of 1977 (the "Mine Safety Act"). The following disclosures are provided pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd Frank Act"), which was enacted in July 2010; Section 1503 of the Dodd Frank Act requires certain disclosures by companies required to file periodic reports under the Securities Exchange Act of 1934, as amended, that operate mines regulated under the Mine Safety Act. Under the Dodd Frank Act, the SEC is authorized to issue rules and regulations to carry out the purposes of these provisions, but has not done so as of the date of this report. While we believe the following disclosures meet the requirements of the Dodd Frank Act, it is possible that any rule-making by the SEC will require disclosures to be presented in a form that differs from this presentation. All of our mining operations are located within the western United States.

### Annual Reporting Pursuant to Wall Street Reform and Consumer Protection Act Section 1503

For 2010, in accordance with Section 1503 of the Dodd Frank Act, we present the following information with respect to the mines that we operate and those in which we have a 50 percent joint venture ownership interest:

<u>Item</u>	<u>Big Horn Mine</u>	<u>Black Butte Mine</u>	<u>Decker Mine</u>	<u>Rosebud Mine</u>
Section 104 S&S citations(1)	—	6	2	—
Section 104(b) orders(2)	—	—	—	—
Section 104(d) citations and orders(3)	—	—	1	—
Section 110(b)(2) violations(4)	—	—	—	—
Section 107(a) orders(5)	—	—	—	—
Proposed MSHA assessments(6)	—	\$ 14,310	\$ 31,365	—
Fatalities(7)	—	—	—	—
Section 104(e) notices(8)	—	—	—	—
Pending Mine Safety Commission legal actions (including any contested penalties for citations issued)(9)	—	35	1	—

- (1) Total number of violations of mandatory health or safety standards that could significantly and substantially contribute to the cause and effect of a coal mine safety or health hazard under section 104 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 814) (the "Mine Safety Act") for which we received a citation from MSHA.
- (2) Total number of orders issued under section 104(b) of the Mine Safety Act (30 U.S.C. 814(b)).
- (3) Total number of citations and orders for unwarrantable failure of Level 3 to comply with mandatory health or safety standards under section 104(d) of the Mine Safety Act (30 U.S.C. 814(d)).
- (4) Total number of flagrant violations under section 110(b)(2) of the Mine Safety Act (30 U.S.C. 820(b)(2)).
- (5) Total number of imminent danger orders issued under section 107(a) of the Mine Safety Act (30 U.S.C. 817(a)).
- (6) Total dollar value of proposed assessments from MSHA under the Mine Safety Act (30 U.S.C. 801 et seq.).

- (7) Total number of mining-related fatalities.
- (8) Any coal mines owned and operated by us that received written notice from MSHA of (A) a pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal mine health or safety hazards under section 104(e) of such Mine Safety Act (30 U.S.C. 814(e)); or (B) the potential to have such a pattern.
- (9) The information in the table reflects the pending legal actions before the Federal Mine Safety and Health Review Commission as of December 31, 2010. The following list includes legal actions that were initiated prior to the current reporting period and that do not necessarily relate to citations, orders or proposed assessments issued by MSHA during the year ending December 31, 2010. Of the 35 pending legal actions at the Black Butte mine, 34 represent contests of citations or orders (for which the aggregate amount assessed to date is less than \$100,000) under Section 104(a) of the Mine Safety Act and one represents a citation under Section 104(g)(1) of the Mine Safety Act. The one pending legal action at the Decker mine represents a citation under Section 104(d)(1).

### Glossary of Terms

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.
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.
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.
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.

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.
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.
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.
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.
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.
TDM	Time Division Multiplexing. A technology that transmits multiple signals simultaneously over a single transmission path.
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 25, 2011, 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.	79	Chairman of the Board
James Q. Crowe	61	Chief Executive Officer and Director
Jeff K. Storey	50	President and Chief Operating Officer
Charles C. Miller, III	58	Vice Chairman, Executive Vice President and Director
Sunit S. Patel	49	Executive Vice President and Chief Financial Officer
John M. Ryan	47	Executive Vice President, Chief Legal Officer and Secretary
Andrew Crouch	40	President Sales, Level 3 Communications, LLC
Eric J. Mortensen	52	Senior Vice President and Controller
R. Douglas Bradbury	60	Director(1)
Douglas C. Eby	51	Director(1)
Admiral James O. Ellis, Jr.	63	Director(3)
Richard R. Jaros	59	Director(2)
Robert E. Julian	71	Director(1)
Michael J. Mahoney	60	Director(2)
Rahul N. Merchant	54	Director(1)
Arun Netravali	64	Director(2)
John T. Reed	67	Director(1)(3)
Michael B. Yanney	77	Director(3)
Dr. Albert C. Yates	69	Director(2)

- (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 25, 2011, about the following members of senior management of Level 3 Communications, LLC.

<u>Name</u>	<u>Age</u>	<u>Position</u>
James Heard	48	President European Markets Group
John F. Waters, Jr.	45	President Operations, Chief Technology Officer
Anthony S. Fogel	46	Chief Human Resources Officer
Mark Martinet	44	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 ("MidAmerican"), and Valmont Industries, Inc. Mr. Scott was also previously a director of Burlington Resources Inc., Commonwealth Telephone Enterprises, Inc. ("Commonwealth") and RCN Corporation ("RCN").

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. Mr. Crowe was also previously a director of Commonwealth and RCN.

Jeff 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 2001. Mr. Miller has also been a director of the Company since February 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 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.

John M. Ryan has been Executive Vice President, Chief Legal Officer and Secretary of the Company since February 2011. Mr. Ryan is responsible for Level 3's legal and regulatory functions worldwide. Prior to his current position, Mr. Ryan was Senior Vice President and Assistant Chief Legal Officer of Level 3 Communications, LLC from March 2007, responsible for the customer and vendor contracting groups and the public policy group. Mr. Ryan was a Senior Vice President within the Legal Department from June 2004, and was a Vice President in the Legal Department from December 1999 through June 2004. Prior to December 1999, Mr. Ryan was a partner and associate at Fraser Stryker Law Firm in Omaha, where his practice focused on the communications industry.

Andrew Crouch has been the President Sales for Level 3 Communications, LLC since August 2010. Prior to that, Mr. Crouch was President of the Wholesale Markets Group for Level 3 Communications, LLC from January 2008 until August 2010, 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, all for Level 3 Communications, LLC. Mr. Crouch began his career at Level 3 Communications, LLC 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.

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 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 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. Mr. Bradbury is a member of the Audit Committee.

Douglas C. Eby has been a director of the Company since August 2007. Mr. Eby has been acting Chief Executive Officer of Realty Finance Corporation, a commercial real estate specialty finance company since May 2010 and a general partner of OmniCapital Group LLC, a venture capital firm since January 2011. Prior to that, Mr. Eby was a private investor from December 2009 to May 2010. Mr. Eby was previously chairman and CEO of TimePartners LLC, an investment advisory firm from 2004 until December 2009. 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 and chairman of the board of directors of Realty Finance Corporation. Mr. Eby is also a past member of the Board of Trustees and past Chairman of the Boys and Girls Clubs of Greater Washington, DC and a past trustee of Suburban Hospital Healthcare System, a member of The Johns Hopkins Health System Corporation. 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 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 was previously a director of Commonwealth, MidAmerican and RCN. 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 has been a private investor since March 2007. From 2000 until March 2007, Mr. Mahoney was the president and chief executive officer of Commonwealth. Prior to that, from 1997 until 2000, Mr. Mahoney was president and chief operating officer of RCN. 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 Directors of FairPoint Communications, Inc. and the Board of Trustees of Wilkes University. Mr. Mahoney is a member of the Compensation Committee.

Rahul N. Merchant has been a director of the Company since September 2009. Mr. Merchant has been a partner at Exigen Capital, a private equity firm based in New York City since 2008. From 2006 until 2008, Mr. Merchant was Executive Vice President, Chief Information Officer and Member of the Executive Committee at Fannie Mae. In this role, he led and transformed Technology and Operations groups. Prior to joining Fannie Mae, Mr. Merchant was Senior Vice President and Chief Technology Officer at Merrill Lynch & Co. In this role, Mr. Merchant managed the global technology organization from 2000 until 2006. Mr. Merchant has also held senior leadership positions at Cooper Neff and Associates, Lehman Brothers, Sanwa Financial Products and Dresdner Bank. Mr. Merchant serves as a member of the Board of Directors at Fair Isaac Corporation (FICO) and Netuitive, Inc. He also serves on the board of advisors to the American India Foundation. Mr. Merchant was previously a director of Sun Microsystems, Inc. Mr. Merchant is a member of the Audit Committee.

Arun Netravali has been a director of the Company since April 2003. Since November 2004, Mr. Netravali has been the managing partner of OmniCapital Group LLC, a venture capital firm. 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 Investors Real Estate Trust, a real estate investment trust. Mr. Reed is also Chairman 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 was also previously a director of Bridges Investment Fund, Inc., a mutual fund and First National Nebraska, Inc. 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 was previously a director of Burlington Northern Santa Fe Corporation and RCN. 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.

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.

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.

Anthony S. Fogel has been Chief Human Resources Officer since August 2010. Prior to that, Mr. Fogel was an independent consultant on human resources management issues from April 2010 until August 2010. Mr. Fogel was Executive Vice President of Human Resources and Administration at CareOne Management, LLC, a family owned senior health care facility operator from July 2009 until April 2010. Prior to joining CareOne, Mr. Fogel was Chief Human Resources Officer at Marathon Asset Management LLP from 2007 until July 2009. Mr. Fogel was Managing Director—Global Head of Human Resources for Investment Management at Lehman Brothers Holdings Inc. from 2005 until 2007. Prior to that, Mr. Fogel was Managing Director—European Head of Human Resources at Lehman Brothers from 2000 until 2005.

Mark Martinet has been Chief Information Officer since December 2009. Prior to that, Mr. Martinet was Chief Information Officer and Chief Technology Officer for BT Business, a part of BT Group plc. from September 2007 until December 2009. In this role, Mr. Martinet was responsible for improving cycle time, productivity and quality of information technology deliveries. Prior to that, Mr. Martinet was a director of Strategy and Transformation for BT Group from 2004 until September 2007. Prior to joining BT Group, Mr. Martinet held various information technology positions with Qwest Communications Corporation from 2000 until 2004.

At our 2011 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](http://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](http://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](http://www.level3.com) or by filing a Form 8-K with the Securities and Exchange Commission or SEC.

## SEC Filings

We file annual, quarterly and current reports, proxy statements and other information with the SEC. These filings are available to the public on the Internet at the SEC's website at [www.sec.gov](http://www.sec.gov). You may also read and copy any document we file with the SEC at the SEC's public reference room, located at 100 F Street, N.E. Room 1580, Washington, D.C. 20549.

Our Form 10-K and 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

To our knowledge, except as described below, 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 one open market sale transaction to generate cash proceeds to pay withholding taxes due as a result of the lapsing of restrictions on transfer for previously issued restricted stock units, as a result of a clerical error, our Executive Vice President and Chief Financial Officer, Sunit Patel, did not timely file a Form 4 to report that transaction.

## Employees

As of December 31, 2010, we had approximately 5,500 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.

For more information about our results of operations and financial condition, you should see the discussion included under *Management's Discussion and Analysis of Financial Condition and Results of Operations*, appearing later in this Form 10-K.

### ***Risks Related to our Business***

#### ***Communications Business***

##### ***Continued uncertainty in the global financial markets and the global economy may negatively affect our financial results.***

Continued 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 or forego 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 forego 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 unwilling or unable to provide us with the materials we need for our network on a timely basis or on terms that we find acceptable; or
- our financial counterparties, insurance providers or other contractual counterparties are unable to, or do not meet, their contractual commitments to us.

***We need to not only increase but also maintain the network traffic and resulting revenue from the services that we offer to realize our targets for anticipated revenue growth, cash flow and operating performance.***

We must increase and maintain the network traffic and resulting revenue from our data, voice, content and infrastructure services at acceptable margins in order to realize our targets for anticipated revenue growth, cash flow and operating performance. If:

- we do not maintain or improve our current relationships with existing key customers;

- we are not able to expand the available capacity on our network to meet our customers' demands in a timely manner;
- we do not develop new large volume and enterprise customers; or
- our customers determine to obtain these services from either their own network or from one of our competitors;

we may not be able to increase or maintain our revenue at acceptable margins, which would adversely affect our ability to become and/or remain profitable.

***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 anticipated benefits from any 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:

- quoting, accepting and inputting customer orders for services;
- provisioning, installing and delivering services;
- providing customers with direct access to our information systems so that they can manage the services that they purchase from us, generally through web-based customer portals; and
- billing for services.

Because our business provides for continued rapid growth in the number of customers that we serve, the volume of services offered as well as the integration of any 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 or complete the data migration regarding network and circuit inventory into these 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.

***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 limit and mitigate 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 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 (including natural disasters that may increase in frequency as a result of the effects of climate change), 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.

***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, address the changing communications needs of our existing customers 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.

***Our future growth depends upon the continued development and expansion of the Internet as a communications medium and marketplace for the distribution and consumption of data and video by businesses, consumers and governments.***

Achieving the anticipated benefits of our business operations will depend in part upon the continued development and expansion of the Internet as a communications medium and marketplace for the distribution and consumption of data and video by businesses, consumers and governments. If the use of the Internet for these purposes does not grow and expand at the rate that we anticipated or is restricted by such things as:

- future regulation;
- actions by ISPs or the owners of access networks that restrict us from delivering our customer's traffic to the users of those networks;

- a lack of anticipated technology innovation and adoption; or
- a lack of continued broadband penetration both in the United States and elsewhere;

we could experience material adverse effects on our financial condition, results of operations and future prospects.

***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 offer a variety of content distribution network, or CDN, and related services. There are many difficulties that we may encounter in selling these services, including customer support system development issues, intellectual property matters, technological issues, increasing capacity on our network to meet our customers' demands in a timely manner, 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.

***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 consolidated revenue is concentrated in a limited number of communications customers.***

A significant portion of our consolidated revenue is concentrated among a limited number of communications customers. For the year ended December 31, 2010, our top ten communications customers represented approximately 27% of our total consolidated revenue. If we lost one or more of our top five communications customers, or, if one or more of these major customers significantly decreased orders for our services, our business would be materially and adversely affected.

***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, 2010 and December 31, 2009, we incurred net losses of approximately \$622 million and \$618 million, 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 able 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.

***The need to obtain additional capacity for our network from other providers increases our costs. In addition, the need to interconnect our network to networks that are controlled by others could increase our costs.***

We use network resources owned by other companies for portions of our network. 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 as well as the owners of networks that our customers desire to access in order to deliver their services. We are not always able to secure these interconnection agreements on favorable terms. Costs of obtaining service from other communications 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 and local access network owners, 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 as well as providers of network colocation facilities 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.

***ILECs may not provide us local access services at prices that 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. The ILECs 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 timeframes, we may be at a competitive disadvantage to the ILECs.

***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. While we disclaim any liability for third party content in our services agreements, 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.

***Our financial condition and growth depends upon the successful integration of 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 any acquisitions depends in part upon whether we can integrate our businesses in an efficient and effective manner. We may acquire businesses in accordance with our business strategy. The integration of any acquired businesses involves a number of risks, including, but not limited to:

- demands on management related to any 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 management of integration activities;
- 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 may be geographically dispersed.

Successful integration of acquired businesses or operations depends 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 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 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.

***Changes in regulations affecting commercial power providers may increase our costs.***

In the normal course of business, we need to enter into agreements with many providers of commercial power for our office, network and Gateway facilities. Costs of obtaining commercial power can comprise a significant component of our operating expenses. Changes in regulations that affect commercial power providers, particularly regulations related to the control of greenhouse gas emissions or other climate change related matters, could affect the costs of commercial power, which may increase the costs of providing our services and may adversely affect our operating results.

***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 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.

***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.

***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, 2011. We are engaged in addressing or have liquidated environmental liabilities at 74 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 14 sites with unknown future costs and (d) there are 35 sites with no likely future costs. The remaining 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.

#### ***Increased regulation of greenhouse gas ("GHG") emissions may adversely affect demand for coal.***

Present and proposed regulation of GHG emissions on the state, regional, national, and international level has typically included requirements applicable to the utility sector and coal-fired power plants. Therefore, such regulation could adversely affect the demand for coal in coming years, particularly from our utility customers. This could have an adverse effect on our operating results.

### ***General***

#### ***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.***

Disruptions in the commercial credit markets could result in a tightening of credit markets. The effects of recent credit market disruptions were widespread, and it is impossible to predict whether the

improvement in the global credit markets will continue. As a result of 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 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.

***If we experience a change in control or certain other events, we may be unable to satisfy our obligations to repurchase our outstanding notes as required under our outstanding debt agreements.***

Upon the occurrence of certain events defined in the various debt agreements relating to our outstanding debt, we are required to make an offer to purchase all of our outstanding notes at a purchase price generally equal to 101% of the principal amount of the notes, plus accrued and unpaid interest thereon (if any). In addition, to the extent that we are required to make an offer to purchase one of the outstanding issues of our notes, the debt agreements relating to our other issues of notes may require us to repurchase that other debt upon a change in control or termination of trading. We may not have sufficient funds to pay the purchase price for all the notes tendered by holders seeking to accept the offer to purchase.

***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 substantial deficiencies of earnings to cover fixed charges of approximately \$713 million for the fiscal year ended December 31, 2010, approximately \$617 million for the fiscal year ended December 31, 2009, approximately \$264 million for the fiscal year ended December 31, 2008, approximately \$1.1 billion for the fiscal year ended December 31, 2007, and approximately \$742 million for the fiscal year ended December 31, 2006.

***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, 2010, aggregate future maturities of our long-term debt, capital leases and our commercial mortgage approximated \$6.641 billion (after taking into account the issuance of the Company's 11.875% Senior Notes due 2019 issued in January 2011, the retirement of the Company's 5 <sup>1</sup> / 4 % Convertible Senior Notes due 2011 and 9% Convertible Senior Discount Notes due 2013 as well as excluding debt discounts, premiums and fair value adjustments). Of this amount, \$4 million is due to mature in 2011, approximately \$299 million is due to mature in 2012 and approximately \$405 million is due to mature in 2013, in each case excluding debt 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 integration activities with respect to any 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, 2010, we had net operating loss carry forwards of approximately \$5.9 billion for U.S. 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. 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.***

There can be no assurance that there will not be future 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 in 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 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. 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 5,000 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 2010 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

Level 3 Communications, Inc. and certain of its subsidiaries (the "companies") are parties to a number of purported class action lawsuits involving the companies' right to install fiber optic cable network in railroad right-of-ways adjacent to plaintiffs' land. The only lawsuit in which a class has been certified against the companies occurred in *Koyle, et. al. v. Level 3 Communications, Inc., et. al.*, a purported two state class action filed in the United States District Court for the District of Idaho. In November of 2005, the court granted class certification only for the state of Idaho. The companies have defeated motions for class certification in a number of these actions but expect that plaintiffs in the pending lawsuits will continue to seek certification of statewide or multi-state classes. 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 companies negotiated a series of class settlements affecting all persons who own or owned land next to or near railroad rights of way in which the companies have installed their fiber optic cable network. The United States District Court for the District of Massachusetts in *Kingsborough v. Sprint Communications Co. L.P.* granted preliminary approval of the proposed settlement; however, on September 10, 2009, the court denied a motion for final approval of the settlement on the basis that the court lacked subject matter jurisdiction and dismissed the case.

In November, 2010, the companies negotiated revised settlement terms for a series of state class settlements affecting all persons who own or owned land next to or near railroad rights of way in which the companies have installed their fiber optic cable network. The companies are currently negotiating certain procedural issues with legal counsel representing the interests of the current and former landowners with respect to presentment of the settlement in applicable jurisdictions. The settlement affecting current and former landowners in the state of Idaho was presented to the United States

District Court for the District of Idaho and preliminary approval of the settlement was granted on January 28, 2011.

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 companies 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 settlement is not ultimately approved for all affected landowners. 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 specified in the complaint that the defendants failed to disclose material adverse facts about the Company's integration activities, business and operations. 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. On May 4, 2009, the Court appointed a lead plaintiff in the case, and on September 29, 2009, the lead plaintiff filed a Consolidated Class Action Complaint (the "Complaint"). A motion to dismiss the Complaint was filed by the Company and the other named defendants. While the motion to dismiss the Complaint was pending, the court granted the lead plaintiff's motion to further amend the Complaint (the "Amended Complaint"). Thereafter, the Company and the other defendants named in the Amended Complaint filed a motion to dismiss the Amended Complaint with prejudice. The court granted this motion to dismiss, with prejudice, and the plaintiff has filed a notice of appeal of that decision to the Tenth Circuit Court of Appeals.

It remains 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.

During March 2009, Level 3 Communications, Inc., as a nominal defendant, certain of its directors and its current officers, and a former officer, were named as defendants in purported stockholder derivative actions in the District Court, Broomfield County, Colorado, which have been consolidated as *In re Level 3 Communications, Inc. Derivative Litigation (Lead Case No. 2009CV59)*. On December 11, 2009, Level 3 Communications, Inc., as a nominal defendant, certain of its directors and current officers, and a former officer, were named as defendants in purported stockholder derivative action in the United States District Court for the District of Colorado in *Iron Workers District Council Of Tennessee Valley & Vicinity Pension Plan v. Level 3 Communications, Inc., et. al.* ( Civil Case No. 09cv02914 ). The plaintiffs allege that during the period specified in the complaints the named defendants failed to disclose material adverse facts about the Company's integration activities, business and operations. The complaints seek damages on behalf of the Company based on purported breaches of fiduciary duties for disseminating false and misleading statements and failing to maintain internal controls; unjust enrichment; abuse of control; gross mismanagement; waste of corporate assets; and, with respect to certain defendants, breach of fiduciary duties in connection with the resignation of Kevin O'Hara. The parties have agreed to a temporary stay of all activities in these actions pending the outcome of the motion to dismiss or other relevant time periods in the securities litigation described above.

It remains too early for the Company to reach a conclusion as to the ultimate outcome of these derivative actions. However, management believes that the complaints have numerous deficiencies including that each plaintiff failed to make a demand on the Company's Board of Directors before filing the suit.

In March 2009, late April 2009 and early May 2009, Level 3 Communications, Inc., the Level 3 Communications, Inc. 401(k) Plan Committee and certain current and former officers and directors of Level 3 Communications, Inc. were named as defendants in purported class action lawsuits filed in the U.S. District Court for the District of Colorado. These cases have been consolidated as *Walter v. Level 3 Communications, Inc., et. al.*, ( *Civil Case No. 09cv00658* ). The complaint alleges breaches of fiduciary and other duties under the Employee Retirement Income Security Act ("ERISA") with respect to investments in the Company's common stock held in individual participant accounts in the Level 3 Communications, Inc. 401(k) Plan. The complaint claims that those investments were imprudent for reasons that are similar to those alleged in the securities and derivative actions described above.

It remains too early for the Company to reach a conclusion as to the ultimate outcome of these ERISA 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. [Removed and Reserved]

### 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 22, 2011, 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 sales prices of our common stock as reported by the NASDAQ Global Select Market of The NASDAQ Stock Market LLC.

<u>Year Ended December 31, 2010</u>	<u>High</u>	<u>Low</u>
First Quarter	\$ 1.77	\$ 1.24
Second Quarter	1.77	1.07
Third Quarter	1.20	0.93
Fourth Quarter	1.21	0.83

<u>Year Ended December 31, 2009</u>	<u>High</u>	<u>Low</u>
First Quarter	\$ 1.65	\$ 0.60
Second Quarter	1.77	0.87
Third Quarter	1.72	1.11
Fourth Quarter	1.54	1.16

*Equity Compensation Plan Information.*

We have only one equity compensation plan—The Level 3 Communications, Inc. Stock Plan—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 Level 3 Communications, Inc. Stock Plan as of December 31, 2010.

<u>Plan Category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights</u>	<u>Weighted-average exercise price of outstanding options, warrants and rights</u>	<u>Number of securities remaining available for future issuance under equity compensation plans</u>
Equity compensation plans approved by stockholders	45,572,806†	\$ 1.47†‡	93,510,608
Equity compensation plans not approved by stockholders	0	\$ 0.00	0

† Includes awards of 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 Level 3 Communications, Inc. Stock Plan.

‡ At December 31, 2010, the only type of award outstanding under The Level 3 Communications, Inc. Stock Plan that included an "exercise price" was the OSOs. The weighted-average exercise price indicated is for the 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 settled. 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 OSOs are not 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."

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, 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 date. The Initial Price, however, cannot 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 as follows. The Initial Price is adjusted over time (the "Adjusted Strike Price") until the settlement 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.

<b>If Level 3 Stock Outperforms the S&amp;P 500® Index by:</b>	<b>Then the Pre-multiplier Gain Is Multiplied by a Success Multiplier of:</b>
0% or Less	0.00
More than 0% but Less than 11%	Outperformance percentage multiplied by <sup>4</sup> / <sub>11</sub>
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.*

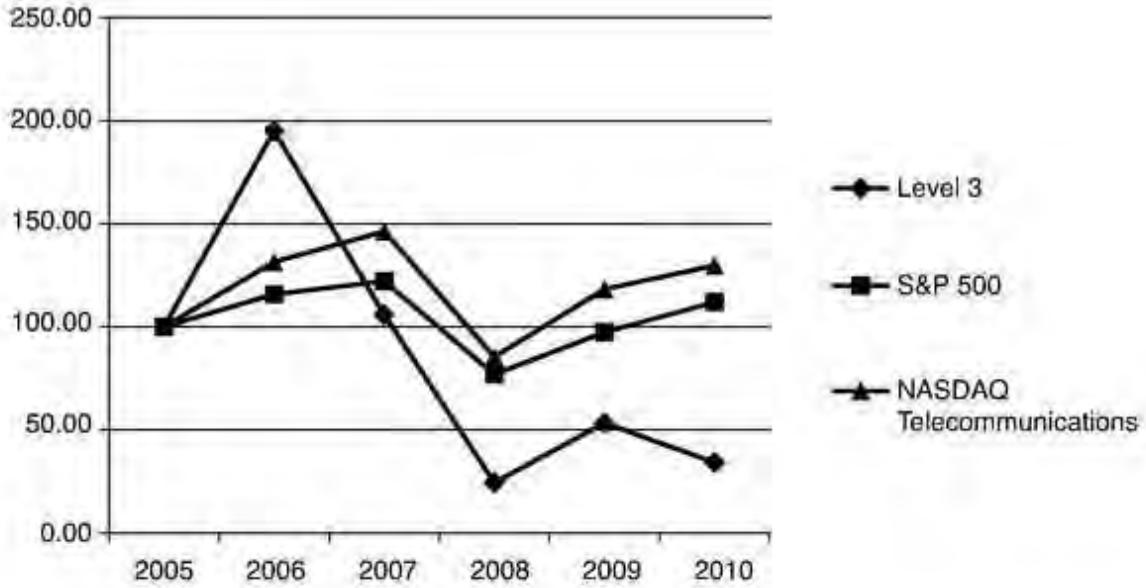
The following performance graph shall not be deemed to be incorporated by reference by means of any general statement incorporating by reference this Form 10-K into any filing under the Securities Act of 1933, as amended or the Securities Exchange Act of 1934, except to the extent that the company specifically 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 2006 through 2010 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, 2005, 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**



	12/05	12/06	12/07	12/08	12/09	12/10
Level 3 Common Stock	\$ 100.00	\$ 195.12	\$ 105.92	\$ 24.39	\$ 53.31	\$ 34.15
S&P 500® Index	100.00	115.80	122.16	76.96	97.33	111.99
NASDAQ Telecommunications	100.00	131.50	146.22	85.43	118.25	129.78

**ITEM 6. SELECTED FINANCIAL DATA**

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

	Fiscal Year Ended(1),(2)				
	2010	2009	2008	2007	2006
(dollars in millions, except per share amounts)					
<b>Results of Operations:</b>					
Revenue	\$ 3,651	\$ 3,762	\$ 4,301	\$ 4,269	\$ 3,378
Loss from continuing operations(3)	(622)	(618)	(318)	(1,146)	(812)
Income from discontinued operations(4)	—	—	—	—	46
Net loss	(622)	(618)	(318)	(1,146)	(766)
<b>Per Common Share:</b>					
Loss from continuing operations(3)	(0.37)	(0.38)	(0.20)	(0.76)	(0.81)
Income from discontinued operations(4)	—	—	—	—	0.05
Net loss	(0.37)	(0.38)	(0.20)	(0.76)	(0.76)
Dividends(5)	—	—	—	—	—
<b>Financial Position:</b>					
Total assets	8,355	9,062	9,634	10,249	9,987
Current portion of long-term debt(6)	180	705	186	32	5
Long-term debt, less current portion(6)	6,268	5,755	6,245	6,631	7,122
Stockholders' equity (deficit)(7)	(157)	491	1,021	1,266	602

- (1) The financial information for the periods of 2008 and prior have been adjusted for the retrospective application of Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) which has been codified into the guidance relating to Debt with Conversion and Other Options.
- (2) The operating results of Software Spectrum, Inc. ("Software Spectrum"), which was sold in 2006, are included in discontinued operations for the period for which Level 3 owned Software Spectrum.

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 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 Ltd. ("Servecast") 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 acquisition of WilTel Communications Group, LLC ("WilTel").

- (3) 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, \$36 million of induced debt conversion expenses, net, 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 customer relationships. 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.

In 2009, the Company recognized a gain of approximately \$14 million as a result of debt repurchases and exchanges of certain of the Company's debt securities and \$9 million of restructuring charges.

In 2010, the Company recognized a loss of approximately \$59 million associated with the tender offer to repurchase the Company's 12.25% Senior Notes due 2013 and as a result of the redemption of its 10% Convertible Senior Notes due 2011. The Company also recognized a \$91 million benefit primarily related to the release of foreign deferred tax valuation allowances.

- (4) 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 for 2006.
- (5) 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 debt-related covenants from paying cash dividends on shares of its common stock.
- (6) 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.

In 2009, the Company received net proceeds of \$274 million as a result of amending and restating its existing senior secured credit facility to increase the borrowings through the creation of a \$280 million Tranche B Term Loan. The Company exchanged \$142 million of its 6% Convertible Subordinated Notes due 2010 and \$140 million of its 2.875% Convertible Senior Notes due 2010 for \$200 million of 7% Convertible Senior Notes due 2015 and \$78 million of cash. In 2009, the Company received net proceeds of \$274 million from the issuance of its 7% Convertible Senior Notes due 2015, Series B. Also in 2009, the Company repurchased \$126 million aggregate principal amount of its 6% Convertible Subordinated Notes due 2009, \$55 million aggregate principal amount of its 6% Convertible Subordinated Notes due 2010, \$13 million aggregate principal amount of its 2.875% Convertible Senior Notes due 2010, \$131 million aggregate principal amount of its 5.25% Convertible Senior Notes due 2011, \$56 million aggregate principal amount of its 10% Convertible Senior Notes due 2011, and \$31 million aggregate principal amount of its 3.5% Convertible Senior Notes due 2012. The Company also redeemed the remaining \$13 million of its 11.5% Senior Notes due 2010, repurchased the remaining \$6 million aggregate principal amount of its Floating Rate Notes due 2011 and repaid at maturity the remaining \$55 million of its outstanding 6% Convertible Subordinated Notes due 2009.

In 2010, the Company received net proceeds of \$613 million from the issuance of its 10% Senior Notes due 2018 and net proceeds of \$195 million from the issuance of its 6.5% Convertible Senior Notes due 2016. In connection with the issuance of its 10% Senior Notes due 2018, the Company repurchased \$550 million of the total outstanding 12.25% Senior Notes due 2013 primarily through a tender offer. In addition, during 2010, the Company redeemed all of the outstanding

\$172 million aggregate principal amount of its 10% Convertible Senior Notes due 2011, \$3 million of its 5.25% Convertible Senior Notes due 2011, the remaining \$3 million of its 10.75% Senior Notes due 2011, and \$2 million of its 2.875% Convertible Senior Notes due 2010. Upon maturity, the Company repaid the remaining \$111 million of its 6% Convertible Subordinated Notes due 2010 and the remaining \$38 million of its 2.875% Convertible Senior Notes due 2010.

- (7) 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, 2010, 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:

- 1) Core Network Services includes revenue from transport, infrastructure, data and local and enterprise voice services.
- 2) Wholesale Voice Services includes revenue from long distance voice services, including domestic voice termination, international voice termination and toll free services.
- 3) 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.

These 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 Network Services is critical to the long-term success of its communications business.

#### *Core Network Services*

The Company's transport services include metropolitan and intercity wavelengths, private line, Ethernet private line, professional services and transoceanic services. The Company's infrastructure services include dark fiber and colocation 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. Customer expenditures for these services 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 metropolitan transport services have been relatively stable. 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.

Data services primarily include the Company's high speed Internet protocol service, dedicated Internet access ("DIA") service, ATM and frame relay services, IP and Ethernet virtual private network ("VPN") services, content delivery network ("CDN") services, and Vyvx broadcast services. Level 3's Internet access service is a high quality and high-speed 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.

Revenue growth from customers that are seeking to distribute their feature rich content or video over the Internet is dependent on the continued increase in demand from consumers, the pricing environment and the availability of capacity on the Company's network. 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. The market for data and IP is generally characterized by price compression and high unit growth rates depending upon the type of service. The Company experienced price compression in the high-speed IP market in 2010 and expects that pricing for its high-speed IP services will continue to decline in 2011.



The Company, through its Level 3 Vyvx Service business, provides video transport services over the Company's fiber-optic network and via satellite. It carries live broadcast content from the original source such as sporting events, special events or other live studio produced programming, to production studios, broadcast master control centers and other destinations within the broadcasters' delivery chain.

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. For these services, most of Level 3 Vyvx's customers 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.

In June 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.

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 in January 2007, and the acquisition of Dublin, Ireland based Servecast Ltd. in July 2007. The Company believes that the addition of the CDN Business with its strong, broad portfolio of patents has helped 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's Core Network Services include local and enterprise voice services. Local voice services are primarily components that enable other service providers to deliver business or consumer-ready voice services to their end customers. Enterprise voice services are business-grade voice services that the Company sells directly to its business customers.

Beginning in the first quarter of 2010, Level 3 modified its revenue disclosure based on the manner in which certain customers are classified within customer-facing groups. Level 3 has discussed its Core Network Services revenue in terms of wholesale, large enterprise and federal, mid-market, and European customers. The 2009 and 2008 amounts have also been presented for comparability purposes.

- Wholesale includes revenue from international and domestic carriers, cable companies, wireless companies, voice service providers and the vast majority of former content market group customers.
- Large enterprise and federal includes Fortune® 300 and other large enterprises that purchase communications services in a manner similar to carriers, including financial services, healthcare and systems integrators, Federal Government agencies and academic consortia, plus certain large former Content Markets Group customers.
- Mid-market includes medium enterprises generally outside the Fortune® 300, regional service providers, certain academic institutions and some state and local governments.
- European remains unchanged from the 2009 presentation. The European revenue includes the largest European consumers of bandwidth, including the largest European and international



carriers, large system integrators, voice service providers, cable operators, Internet service providers, content providers, enterprises, and government and education sectors.

Core Network Services revenue by customer group was as follows:

(dollars in millions)	Year Ended December 31,		
	2010	2009	2008
Wholesale	\$ 1,375	\$ 1,409	\$ 1,589
Large Enterprise and Federal	566	507	517
Mid-Market	595	632	741
European	291	292	289
Total Core Network Services	\$ 2,827	\$ 2,840	\$ 3,136

The Company believes that the alignment of Core Network Services around customer groups allowed 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. 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. The classification of customers within each customer group can change based upon sales team assignments, merger and acquisition activity by customers and other factors.

#### *Wholesale Voice Services*

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.

#### *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, its related reciprocal compensation services, and SBC Contract Services, which includes revenue derived under the SBC Master Services Agreement that was obtained in the WiTel 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. The Company expects ongoing declines in Other Communications services revenue similar to what has been experienced over the past several years.

The Company receives compensation from other carriers when it terminates traffic originating on those carriers' networks. This 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. The majority of the Company's existing reciprocal compensation revenue is associated with agreements that are in evergreen status, meaning that the agreements remain in place and in effect until either terminated by mutual agreement or replaced by a successor agreement. 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, which are declining. The Company also receives reciprocal compensation from its voice services. In this case, reciprocal compensation is reported within Core Network Services revenue.

*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 delivering communications services and meeting its financial objectives. To the extent that certain lines of business, customer 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:

- growing Core Network Services revenue by increasing sales, reducing customer churn, and continuous improvement in operational efficiency;
- focusing on the the delivery of a customer experience that is the best in the industry;
- continuing to localize certain decision making and interaction with its mid-market enterprise customers, including leveraging its existing network assets;
- enabling its sales channels through effective marketing and sales support;
- effectively managing network costs and operating expenses;
- continuing to show improvements in Adjusted EBITDA;
- reducing its leverage ratio and refinancing its future debt maturities; and
- managing Wholesale Voice Services revenue for margin contribution.

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 already provided. 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.

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

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

The Company has ongoing process and system development work that is being implemented as part of the continued efforts that have improved and are expected to further improve the full spectrum of the customer experience, including service activation, service management and customer billing as well as various operational efficiency improvements.

The Company's ongoing operating results and financial condition could be affected by certain trends or uncertainties. For example, the continued worldwide economic downturn and prolonged uncertainty in the global financial markets have required the Company to continue to manage its cost structure and operating expenses carefully and to concentrate its capital expenditures on those technologies and assets that enable the Company to further develop its Core Network Services and replace the decline in revenue and earnings from Other Communications Services. The Company has

also experienced shortages of certain types of equipment from its suppliers that may affect its ability to provision capacity on its network. As a result, the Company increased its inventory of certain equipment components to compensate for certain vendor delivery issues, which supported increased customer installations during the second half of the year. In addition, the Company has experienced increased intervals for the installation of capacity from providers of connections or capacity from the Company's network to a customer location or other carrier, which are referred to as "off-net" connections. The Company's ongoing operating results and financial condition could also be negatively affected, if as a result of economic conditions the Company's customers defer or forego purchases of the Company's services or fail to make timely payments to the Company as a result of the customer's inability to obtain adequate access to credit.

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 January 2011, the Company issued \$605 million aggregate principal amount of its 11.875% Senior Notes due 2019 in two private transactions. Approximately \$300 million was issued in exchange for the \$295 million aggregate principal of the Company's outstanding 9% Convertible Senior Discount Notes due 2013, and a portion of the net proceeds from the first transaction was used to redeem the \$196 million aggregate principal of the Company's outstanding 5.25% Convertible Senior Notes due 2011. The Company expects to recognize a loss of \$20 million in the first quarter of 2011 as a result of the above mentioned exchange and redemption.

In the third quarter of 2010, the Company issued \$175 million aggregate principal amount of its 6.5% Convertible Senior Notes due 2016 (the "6.5% Convertible Senior Notes") and an additional \$26 million aggregate principal amount in the fourth quarter, for a total of \$201 million aggregate principal amount, for net proceeds of approximately \$195 million. In addition, the Company repaid \$38 million aggregate principal amount of its 2.875% Convertible Senior Notes due 2010 that had matured during the third quarter.

In the second quarter of 2010, the Company redeemed all of the outstanding \$172 million aggregate principal amount of its 10% Convertible Senior Notes due 2011 with available cash. The Company recognized a loss on extinguishment of approximately \$4 million.

In the first quarter of 2010, Level 3 Financing, Inc. issued \$640 million aggregate principal amount of 10% Senior Notes due 2018, for net proceeds of \$613 million, and repurchased \$550 million of the total outstanding 12.25% Senior Notes due 2013 primarily through a tender offer. The Company recognized a \$55 million loss on the extinguishment of these notes.

Also in the first quarter of 2010, the Company repaid \$111 million aggregate principal amount of its 6% Convertible Subordinated Notes due 2010 that had matured. In addition, in various transactions during the first quarter of 2010, the Company, or its subsidiaries, repurchased \$3 million in aggregate principal amount of 5.25% Convertible Senior Notes due 2011, the remaining \$3 million of its 10.75% Senior Notes due 2011, and \$2 million aggregate principal amount of 2.875% Convertible Senior Notes due 2010. The Company recognized a loss on these repurchases of less than \$1 million.

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 consolidated 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.

***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, equity, 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, accruals for estimated tax and legal liabilities, 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, 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 2010, 2009 and 2008.

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.

#### *Revenue Reserves*

The Company 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. The Company's significant estimates are based on assumptions and other considerations, including payment history, credit ratings, customer financial performance, history of billing disputes, industry financial performance and aging analysis.

#### *Cost of Revenue for Communications Services*

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 the 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. The Company establishes appropriate cost of revenue reserves for disputed supplier billings based on an analysis of its historical experience in resolving disputes with its suppliers.

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, 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.

#### *Non-Cash Compensation*

The Company recognizes stock-based compensation expense for all share-based payment awards in accordance with fair value recognition provisions. Under the fair value recognition provisions, 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 assumption for stock price volatility. The Company estimates the stock price volatility using a combination of historical and implied volatility, as Level 3 believes it is consistent with the approach most marketplace participants would consider by using all available information to estimate expected volatility. The Company has determined that expected volatility is more reflective of market conditions and provides a more accurate indication of volatility than using solely historical volatility. In reaching this conclusion, the Company has considered many factors including the extent to which its future expectations of volatility over the respective term is likely to differ from historical measures, the absence of actively traded options for the Company's

Common Stock and the Company's ability to review volatility of its publicly traded convertible debt with similar terms and prices to the options the Company is valuing. 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 Company's stock price at the end of 2010, the aggregate intrinsic value of outstanding outperform stock options was zero as of December 31, 2010.

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 conduits. 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 2010 and concluded that its long-lived assets, including its 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 to their estimated fair value.

#### *Useful Lives of Long-Lived Assets*

The Company performs periodic internal reviews to evaluate the depreciable lives of its property, plant and equipment. Due to rapid changes in technology and the competitive environment, selecting the estimated economic life of telecommunications property, plant, and equipment requires a significant amount of judgment. The Company's internal reviews take into account input from the Company's global network services personnel regarding actual usage, physical wear and tear, replacement history, and assumptions regarding the benefits and costs of implementing new technology that factor in the need to meet the Company's financial objectives.

*Valuation of Goodwill and Acquired Indefinite-Lived Intangible Assets*

The Company performs an annual impairment assessment of its goodwill 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—Segment Information—to the Consolidated Financial Statements. Goodwill assigned to the Communications reportable segment totaled \$1.4 billion at both December 31, 2009 and 2010. There was no goodwill assigned to the Coal Mining reportable segment at December 31, 2009 or 2010. 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 considers the use of multiple valuation techniques in accordance with the Fair Value Measurements and Disclosures guidance to estimate the fair value of its reporting units and has consistently applied a market approach as part of its impairment assessment process.

Under the market approach, the Company estimates the fair value using an in-exchange valuation premise 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. The most significant estimates and assumptions utilized in its valuations with the market approach involved estimating an appropriate control premium and allocating the estimated enterprise fair value to each of its reporting units.

The Company concluded that using 20% as a control premium would be reasonable in its market approach valuation for purposes of performing its goodwill impairment test based on historical control premiums offered for comparable transactions in the communications industry, the availability of financing, and number of potential buyers. The calculated market value using the Company's quoted market price valuation is allocated to each of its two reporting units based on their relative percentage of Adjusted EBITDA, as this is a key external and internal valuation metric.

The Company conducted its goodwill impairment analysis at the end of 2010 and 2009 and concluded that its goodwill was not impaired in either period.

The Company also performs an assessment of its acquisition-related indefinite-lived 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 2010 and 2009 and concluded that there was no impairment in either period.

The Company performs periodic internal reviews to evaluate whether events and circumstances continue to support indefinite useful lives on its intangible assets. The Company considers input from



its legal, business development and product personnel in its evaluation of all relevant factors supporting the useful lives of its intangible assets.

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.

#### *Derivative Financial Instruments*

The Company uses derivative financial instruments, primarily interest rate swaps, to manage its exposure to fluctuations in interest rate movements. The Company's primary objective in managing interest rate risk is to decrease the volatility of its earnings and cash flows affected by changes in the underlying rates. To achieve this objective, the Company enters into financial derivatives, primarily interest rate swap agreements, the values of which change in the opposite direction of the anticipated future cash flows. The Company has floating rate long-term debt (see Note 11—Long-Term Debt—of the Consolidated Financial Statements). 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 decreases. The Company has designated its interest rate swap agreements as a cash flow hedge. Swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments to a counterparty over the lives of the agreements without exchange of the underlying notional amount. The change in the fair value of the interest rate swap agreements is reflected in Accumulated Other Comprehensive Income (Loss) ("AOCI") and is subsequently reclassified into earnings in the period that the hedged transaction affects earnings, due to the fact that the interest rate swap agreements qualify as effective cash flow hedges.

The Company also has certain equity conversion rights associated with debt instruments, which are considered derivative instruments as of December 31, 2010 and 2009. Certain of these derivative instruments were classified as a liability at December 31, 2010 and 2009. The Company had liabilities associated with its embedded derivatives of less than \$1 million at December 31, 2010 and \$20 million at December 31, 2009. The Company has recognized the gains or losses from changes in fair value of any derivatives that are not designated as hedges in other income (expense) in the statements of operations. As a result of the changes in fair value related to these derivative instruments, the Company recognized a gain of \$10 million in 2010, a gain of \$14 million in 2009 and no gains or losses in 2008. The Company does not use any derivative financial instruments for speculative purposes.

The Company is exposed to credit related losses in the event of non-performance by counterparties. The Company considers credit valuation adjustments to appropriately reflect both the Company's non-performance risk and the respective counterparty's non-performance risk in its fair value measurements. The counterparties to any of the financial derivatives the Company enters into are major institutions with investment grade credit ratings. The Company evaluates counterparty credit risk before entering into any hedge transaction, and continues to closely monitor the financial market and the risk that its counterparties will default on their obligations. This credit risk is generally limited to the unrealized gains, if any, in such contracts, should any of these counterparties fail to perform as contracted.

#### *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 the present value of such costs using the Company's estimate of its credit-adjusted risk-free interest rate upon initial recognition.

The Company periodically 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.

The asset retirement obligations for certain leased facilities and coal mining locations were increased by an insignificant amount in 2010 and 2009 due to revised estimates of future obligations.

### ***Recently Issued Accounting Pronouncements***

In October 2009, the FASB issued a new accounting standard that provides revenue recognition guidance for arrangements with multiple deliverables. Specifically, the new standard requires an entity to allocate consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices. In the absence of the vendor-specific objective evidence or third-party evidence of the selling prices, consideration must be allocated to the deliverables based on management's best estimate of the selling prices. In addition, the new standard eliminates the use of the residual method of allocation. This guidance is generally expected to result in revenue recognition for more delivered elements than under the current rules. Level 3 is required to adopt this guidance prospectively for new or materially modified agreements as of January 1, 2011. The Company elected to adopt this guidance prospectively for new or materially modified agreements as of January 1, 2010. The adoption of this guidance did not have a material effect on the Company's consolidated results of operations or financial condition.

In June 2009, the FASB issued a new accounting standard that changes the consolidation rules as they relate to variable interest entities. The new standard makes significant changes to the model for determining who should consolidate a variable interest entity, and also addresses how often this assessment should be performed. The standard was effective for Level 3 effective January 1, 2010. The Company's adoption of this guidance did not have a material effect on the Company's consolidated results of operations or financial condition.

In December 2010, the FASB issued new accounting guidance to address concerns about performing the goodwill impairment test when a reporting unit has zero or negative carrying values. The guidance requires the Company to automatically perform Step 2 of the impairment test for reporting units with a zero or negative carrying amount if there are qualitative factors that indicate that it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, these adverse qualitative factors should also be considered between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The adverse qualitative factors are part of existing accounting standards. The guidance is effective for Level 3 on January 1, 2011. The Company evaluated the adverse qualitative factors in anticipation of its January 1, 2011 adoption of the new accounting guidance and concluded that it was not required to perform Step 2 of the impairment test.

*Results of Operations 2010 vs. 2009*

(dollars in millions)	Year Ended		
	December 31, 2010	December 31, 2009	Change %
<b>Revenue:</b>			
Communications	\$ 3,591	\$ 3,695	(3)%
Coal Mining	60	67	(10)%
Total Revenue	3,651	3,762	(3)%
<b>Costs and Expenses (exclusive of depreciation and amortization shown separately below):</b>			
<b>Cost of Revenue:</b>			
Communications	1,434	1,499	(4)%
Coal Mining	56	66	(15)%
Total Cost of Revenue	1,490	1,565	(5)%
Depreciation and Amortization	876	915	(4)%
Selling, General and Administrative	1,373	1,338	3%
Restructuring Charges	2	9	(78)%
Total Costs and Expenses	3,741	3,827	(2)%
Operating Loss	(90)	(65)	38%
<b>Other Income (Expense):</b>			
Interest income	1	2	(50)%
Interest expense	(586)	(595)	(2)%
Gain (loss) on extinguishment of debt, net	(59)	14	NM
Other, net	21	27	(22)%
Total Other Expense	(623)	(552)	13%
Loss Before Income Taxes	(713)	(617)	16%
Income Tax Benefit (Expense)	91	(1)	NM
Net Loss	\$ (622)	\$ (618)	1%

NM—Not meaningful

*Communications* revenue consists of:

- 1) Core Network Services includes revenue from transport, infrastructure, data and local and enterprise voice communications services.
- 2) Wholesale Voice Services includes revenue from long distance voice services, including domestic voice termination, international voice termination and toll free services.
- 3) 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 revenue attributable to each of these services is as follows (in millions):

	Year Ended December 31,	
	2010	2009
Core Network Services	\$ 2,827	\$ 2,840
Wholesale Voice Services	650	663
Other Communications Services	114	192
Total Communications Services Revenue	<u>\$ 3,591</u>	<u>\$ 3,695</u>

**Communications Revenue** decreased 3% in 2010 compared to 2009. The decrease in 2010 compared to 2009 is primarily the result of Wholesale Voice Services and expected declines in Other Communications Revenue.

The Company's Core Network Services revenue in 2010 compared to 2009 was essentially flat. Full year declines in the Company's data, local and enterprise voice services were driven by lower usage of Internet access and voice services which was primarily driven by macroeconomic conditions. Similar macroeconomic conditions driving declines in data service revenue and Vyx broadcast services during the first half of 2010, strengthened to reflect growth during the second half of the year. In addition, full year increases in transport and infrastructure services driven by strong demand led sequential quarterly improvement that offset the annual declines in data, local and enterprise voice services.

The decrease in Wholesale Voice Services revenue in 2010 compared to 2009 is primarily attributable to a decline in international voice termination services that experienced pricing pressure during the year. This decrease was offset by slight increases in domestic voice termination and toll free services. 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 \$114 million in 2010 from \$192 million in 2009. The decrease is 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.

Reciprocal compensation revenue from managed modem services also declined in 2010 compared to 2009 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 or amended agreements containing lower rates, reciprocal compensation revenue may experience further declines over time. In addition, if 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 internet service provider bound traffic, reciprocal compensation revenue may continue to decline.

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 the first half of 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 December 2005 WilTel acquisition.

**Coal mining** revenue decreased to \$60 million in 2010 from \$67 million in 2009 primarily due to a decrease in volume of tons mined attributable to the expiration of certain long term purchase contracts earlier in 2010, partially offset by the commencement of new contracts during the year.

**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.

Cost of revenue for the communications business, as a percentage of communications revenue, decreased to 39.9% in the 2010 compared to 40.6% in 2009. The Company has benefited from higher margin on-net Core Network Services and an improving gross margin mix. The Company continues to decrease its lower margin voice and certain private line services, and to implement initiatives to reduce both fixed and variable network expenses.

**Coal mining** cost of revenue decreased to \$56 million in 2010 from \$66 million in 2009. Coal mining cost of revenue approximated 93% of coal mining revenue in 2010 and 99% in 2009. The decrease in coal mining cost of revenue as a percentage of coal mining revenue in 2010 compared to 2009 is the result of the mix of lower tons mined resulting in higher costs per ton more than offset by higher revenues per ton under new contracts commencing in 2010.

**Depreciation and Amortization** expense decreased 4% to \$876 million in 2010 from \$915 million in 2009. This decrease is primarily attributable to the reduction in depreciation expense associated with shorter-lived fixed assets becoming fully depreciated and the effect of foreign currency fluctuations.

**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 increased 3% to \$1.4 billion in 2010 compared to \$1.3 billion in 2009. The increase is primarily a result of higher employee compensation and related costs as the Company continued to increase investments in its sales and support and customer install activity headcount during 2010. Included in selling, general and administrative expenses was \$67 million of non-cash, stock-based compensation expenses related to grants of outperform stock options, restricted stock units, restricted stock shares, shares issued for the Company's discretionary bonus, and shares issued for the Company's matching contribution for the 401(k) plan. This compares to \$59 million of non-cash, stock-based compensation expenses recognized in 2009. The increase in non-cash, stock-based compensation expense is primarily due to higher headcount and shares issued for the Company's discretionary bonus in 2010 and lower non-cash compensation awards in 2009.

**Restructuring Charges** decreased to \$2 million in 2010 from \$9 million in 2009 primarily as a result of the timing of the Company's workforce reduction activities. During 2009, the Company initiated a workforce reduction of approximately 260 employees, or 5% of the Company's total employee base. The Company did not initiate any significant new workforce reduction plans in 2010.

The Company may experience further restructuring charges in 2011 as it continues to optimize its cost structure if revenue performance does not improve.

**Adjusted EBITDA**, as defined by the Company, is net income (loss) from the consolidated statements of operations before (1) income tax benefit (expense), (2) total other income (expense), (3) non-cash impairment charges included within restructuring charges, (4) depreciation and

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

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

Note 14—Segment Information—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 \$849 million in 2010 compared to \$910 million in 2009. The decrease in Adjusted EBITDA for the communications business is primarily attributable to the decline in the Company's revenue, partially offset by a decrease in cost of revenue, in addition to higher selling, general and administrative expenses in 2010.

**Interest Income** decreased to \$1 million in 2010 from \$2 million in 2009. The decrease is primarily due to a decrease in the average returns on the Company's investment portfolio, as well as a decrease in the average invested balance during 2010.

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 2% to \$586 million in 2010 from \$595 million in 2009. Interest expense decreased as a result of lower average interest rates in 2010 as compared to 2009 on the Company's variable rate debt.

The Company expects annual interest expense in 2011 to approximate \$615 million based on the Company's outstanding debt as of December 31, 2010 taking into consideration the current interest rates on the Company's variable rate debt, the January 2011 issuances of \$605 million aggregate principal amount of its 11.875% Senior Notes due 2019, of which approximately \$300 million was in

exchange for its 9% Convertible Senior Discount Notes, and the redemption of the 5.25% Convertible Senior Notes due 2011. See Note 11—Long-Term Debt—of the Notes to Consolidated Financial Statements for additional information on Level 3's financing activities.

**Gain (Loss) on Extinguishment of Debt, Net** reflected a loss totaling \$59 million in 2010 compared to a gain of \$14 million in 2009. The loss during 2010 consisted of a \$4 million charge recognized as a result of the redemption of the Company's 10% Convertible Senior Notes due 2011 and a \$55 million charge recognized in connection with the tender offer and consent solicitation of the Company's 12.25% Senior Notes due 2013. The 2009 net gain on extinguishment of debt of \$14 million was the result of certain debt repurchases prior to maturity. See Notes 11—Long-Term Debt—and 17—Subsequent Events—of the Notes to Consolidated Financial Statements for additional information regarding the Company's financing activities.

The Company may enter into additional transactions in the future to repurchase or exchange existing debt that may result in gains or losses on the extinguishment of debt. The Company expects to recognize a loss of \$20 million in the first quarter of 2011 as a result of the redemption of the 5.25% Convertible Senior Notes due 2011 and the exchange of the 9% Convertible Senior Discount Notes due 2013.

**Other, net** decreased to \$21 million in 2010 compared to \$27 million in 2009. Other, net is primarily comprised of gains and losses from the change in the fair value of certain derivative investments, as well as gains and losses on the sale of non-operating assets, realized foreign currency gains and losses and other income.

**Income Tax Benefit (Expense)** reflected a benefit of \$91 million in 2010 compared to expense of \$1 million in 2009. The income tax benefit of \$91 million in 2010 primarily relates to a release of certain foreign deferred tax valuation allowances (see Note 13—Income Taxes—of the Notes to Consolidated Financial Statements). The income tax expense in 2009 primarily relates to state and foreign 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 positions.

The difference between the Company's effective tax rate and the U.S. statutory rate was primarily due to the fact that the Company continues to maintain a full valuation allowance against the majority of its net federal, state and certain foreign deferred tax assets.



*Results of Operations 2009 vs. 2008*

<u>(dollars in millions)</u>	<u>Year Ended</u>		
	<u>December 31,</u> <u>2009</u>	<u>December 31,</u> <u>2008</u>	<u>Change</u> <u>%</u>
<b>Revenue:</b>			
Communications	\$ 3,695	\$ 4,226	(13)%
Coal Mining	67	75	(11)%
Total Revenue	3,762	4,301	(13)%
<b>Costs and Expenses (exclusive of depreciation and amortization shown separately below):</b>			
<b>Cost of Revenue:</b>			
Communications	1,499	1,740	(14)%
Coal Mining	66	69	(4)%
Total Cost of Revenue	1,565	1,809	(13)%
Depreciation and Amortization	915	931	(2)%
Selling, General and Administrative	1,338	1,505	(11)%
Restructuring and Impairment Charges	9	25	(64)%
Total Costs and Expenses	3,827	4,270	(10)%
Operating Income (Loss)	(65)	31	NM
<b>Other Income (Expense):</b>			
Interest income	2	15	(87)%
Interest expense	(595)	(570)	4%
Gain (loss) on extinguishment of debt, net	14	89	(84)%
Gain on sale of business groups, net	—	99	NM
Other, net	27	24	13%
Total Other Expense	(552)	(343)	61%
Loss Before Income Taxes	(617)	(312)	98%
Income Tax Expense	(1)	(6)	(83)%
Net Loss	\$ (618)	\$ (318)	94%

NM—~~No~~meaningful

*Communications* revenue consists of:

<u>(dollars in millions)</u>	<u>Year Ended</u> <u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
Core Network Services	\$ 2,840	\$ 3,136
Wholesale Voice Services	663	724
Other Communications Services	192	366
Total Communications Services Revenue	\$ 3,695	\$ 4,226

**Communications Revenue** decreased 13% in 2009 compared to 2008. Contributing to this decline in Communications revenue was a decrease in Core Network Services and Wholesale Voice Services revenue, and is generally the result of macroeconomic conditions driving increased customer monthly recurring revenue churn, usage revenue declines, customers delaying the purchase of communications services, customers self-serving and optimizing their own networks for communications services and the lag effect of prior customer experience issues, particularly for mid-market enterprise customers.

The Company experienced declines within Core Network Services in 2009 compared to 2008, including transport, Vyvx broadcast data services, local voice and enterprise voice services. The decrease in transport revenue is primarily the result of macroeconomic conditions causing customers to optimize their own networks as opposed to utilizing the Company's network and delays in customer sales cycles. The decrease in Vyvx broadcast data services is primarily the result of macroeconomic conditions causing lower usage as customers generally cut back on the number of broadcasting events they covered. The decrease in local voice and enterprise voice services is primarily the result of macroeconomic conditions causing lower voice usage. In addition, revenue associated with the Vyvx advertising distribution business declined in 2009 compared to 2008 as, on June 5, 2008, the Company completed the sale of the Vyvx advertising distribution business and therefore did not record any Vyvx advertising distribution revenue subsequent to the date of sale. Revenue attributable to the Vyvx advertising distribution business was \$15 million in 2008. Partially offsetting the decreases in transport, Vyvx broadcast data services, Vyvx advertising distribution services and local voice and enterprise voice revenue were increases in infrastructure revenue in 2009 compared to 2008.

The decrease in Wholesale Voice Services revenue is primarily attributable to a decrease in domestic and international voice termination services, which was caused by price declines and lower usage. Partially offsetting the decrease in domestic and international voice termination revenue was an increase in toll free revenue due to higher traffic attributable to conferencing provider customers.

Other Communications Services revenue declined to \$192 million in 2009 from \$366 million in 2008. The decrease is primarily the result of an expected decline related to SBC contract services and 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. In addition, the Company renewed contracts with certain of its managed modem customers during the year at reduced prices.

Reciprocal compensation revenue from managed modem services also declined in 2009 compared to 2008 as a result of the continuing decline in demand for managed modem services.

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 the first half of 2008.

**Coal mining** revenue decreased to \$67 million in 2009 from \$75 million in 2008 primarily as a result of a long-term supply contract that enabled a customer to buyout future coal purchase commitments with the Company in the first quarter of 2008. The Company did not have any further obligations with respect to future coal commitments under the contract, and therefore recognized the transaction as revenue in the first quarter of 2008. Also contributing to the decrease are the lower contractual selling prices with customers based on their purchasing volumes. Partially offsetting this decrease is a customer buyout of future coal purchase commitments under its contract which was completed and recognized in 2009.

**Cost of Revenue** for the communications business, as a percentage of communications revenue, was 40.6% in 2009 compared to 41.2% in 2008. The decrease in communications cost of revenue as a percentage of communications revenue is the result of the Company deriving synergies from acquisitions which eliminate duplicate network costs. In addition, the continued reduction in SBC Contract Services revenue has improved communications cost of revenue as a percentage of communications revenue, as the gross margins for SBC Contract Services revenue are lower than the gross margins for Core Network Services revenue. Partially offsetting this downward trend in communications cost of revenue as a percentage of communications revenue have been increases in Wholesale Voice Services revenue as a percentage of total communications revenue and lower managed modem revenue.

**Coal mining** cost of revenue decreased to \$66 million in 2009 from \$69 million in 2008. Coal mining cost of revenue approximated 99% of coal mining revenue in 2009 compared to 92% in 2008. This increase in coal mining cost of revenue as a percentage of coal mining revenue is the result of 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 2% to \$915 million in 2009 from \$931 million in 2008. This decrease was primarily attributable to reduced depreciation expense associated with shorter-lived fixed assets becoming fully depreciated. Also contributing to the decrease was a reduction in 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 2008.

**Selling, General and Administrative** expenses decreased 11% to \$1.3 billion in 2009 from \$1.5 billion in 2008. The decreases are primarily attributable to a reduction in employee compensation and related costs due to a lower average headcount, which decreased approximately 6% in 2009 compared to 2008. Also contributing to the reduction in employee compensation and related costs were lower bonus expenses, as a result of the reduction in the Company's revenue and Adjusted EBITDA performance. Offsetting the decrease in the change in selling, general and administrative expenses is an \$86 million benefit that was the result of a revision in the Company's estimate of its asset retirement obligations liability in the fourth quarter of 2008.

The decrease in selling, general and administrative expenses in 2009 compared to 2008 was also the result of synergies that have been achieved due to acquisition integration efforts and the Company's focus on reducing operating expenses, which resulted in decreases in professional fees and vendor services, and network related administrative expenses. Also contributing to the decrease is a reduction in the accretion on asset retirement obligations in 2009 compared to 2008 as a result of the reduction in the estimate of the asset retirement obligation recorded on December 31, 2008.

Included in selling, general and administrative expenses in 2009 was \$59 million of non-cash, stock-based compensation expenses related to grants of outperform stock options and restricted stock units and restricted stock shares. This compares to \$78 million of non-cash, stock-based compensation expenses recognized in 2008. This decrease in non-cash, stock-based compensation expense is primarily due to lower headcount, higher estimated forfeiture rates given the Company's continued organizational structure optimization efforts and a reduction in the Company's 401(k) stock-based matching contribution, as effective March 6, 2009, the Company matches 100% of employee contributions up to 3% of eligible earnings or applicable regulatory limits. Prior to March 6, 2009, the Company matched 100% of employee contributions up to 7% of eligible earnings or applicable regulatory limits.

**Restructuring Charges** decreased to \$9 million in 2009 from \$25 million in 2008 primarily as a result of the timing of the Company's workforce reduction activities.

**Adjusted EBITDA**, for the communications business was \$910 million in 2009 compared to \$1.039 billion in 2008. The decrease in Adjusted EBITDA for the communications business is primarily attributable to a reduction in communications revenue partially offset by the benefits of continued operating expense reductions.

**Interest Income** decreased to \$2 million in 2009 from \$15 million in 2008. The decrease is primarily due to a decrease in the average return on the Company's cash and cash equivalents and restricted cash and securities balances, partially offset by an increase in the average invested balance during 2009 as compared to the average invested balance during 2008.

**Interest Expense** increased 4% to \$595 million in 2009 from \$570 million in 2008. Interest expense increased primarily as a result of increases in the average debt balance and average interest rate in 2009 as compared to 2008.

**Gain on Sale of Business Groups, Net** totaled \$99 million in 2008 compared to zero in 2009. On June 5, 2008, Level 3 completed the sale of its Vyvx advertising distribution business to DG FastChannel, Inc. and recognized a net 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—Vyvx Advertising Distribution Business Disposition—of the Notes to Consolidated Financial Statements for additional information regarding the Company's disposition activities.

**Gain on Extinguishment of Debt, Net** totaled \$14 million in 2009 and \$89 million in 2008. The 2009 net gain on extinguishment of debt of \$14 million was the result of certain debt repurchases prior to maturity. The 2008 net 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 \$36 million loss attributable to induced debt conversion expenses related to the exchange of certain of the Company's convertible debt securities. See Notes 11—Long-Term Debt—and 17—Subsequent Events—of the Notes to Consolidated Financial Statements for additional information regarding the Company's financing activities.

**Other, net** was \$27 million in 2009 compared to \$24 million in 2008. Other, net is primarily comprised of gains and losses from the changes in the fair value of certain derivative investments, realized foreign currency gains and losses, gains and losses on the sale of non-operating assets and other income.

**Income Tax Expense** was \$1 million in 2009 compared to \$6 million in 2008. The income tax expense in all periods presented primarily relates to state and foreign income taxes.

### Financial Condition—December 31, 2010

Cash flows provided by operating activities, investing activities and financing activities for the years ended December 31, 2010 and 2009, respectively are summarized as follows:

(dollars in millions)	Year Ended		
	December 31, 2010	December 31, 2009	Change
Net Cash Provided by Operating Activities	\$ 339	\$ 357	\$ (18)
Net Cash Used in Investing Activities	(429)	(307)	(122)
Net Cash Provided by (Used In) Financing Activities	(122)	16	(138)
Effect of Exchange Rates on Cash and Cash Equivalents	(8)	2	(10)
Net Change in Cash and Cash Equivalents	\$ (220)	\$ 68	\$ (288)

### Operating Activities

Cash provided by operating activities decreased by \$18 million in 2010 compared to 2009. The decrease in cash provided by operating activities was primarily due to reduced operating income in 2010.

### Investing Activities

Cash used in investing activities increased by \$122 million in 2010 compared to the same period of 2009 primarily as a result of additional capital expenditures, which totaled \$436 million in 2010 and \$313 million in 2009. The increase in expenditures in 2010 was directed at supporting customer installations, extending the Company's reach with success-based builds, network upgrades across several layers, and increased network equipment to compensate for delivery issues during the middle of 2010.

**Financing Activities**

Cash used in financing activities increased \$138 million in 2010 compared to 2009 as a result of increased debt payments and repurchases, net of new issuances.

**Liquidity and Capital Resources**

The Company incurred a net loss of \$622 million in 2010 and \$618 million in 2009. The Company used \$436 million for capital expenditures and used \$122 million for financing activities in 2010. This compares to \$313 million of cash used for capital expenditures and \$16 million of cash flows provided from financing activities in 2009.

Cash interest payments are expected to increase slightly to approximately \$555 million in 2011 from the \$523 million made in 2010 based on forecasted interest rates on the Company's variable rate debt outstanding, and the January 2011 issuance of \$605 million aggregate principal amount of its 11.875% Senior Notes due 2019, of which approximately \$300 million was exchanged for its 9% Convertible Senior Discount Notes, and the redemption of its 5.25% Convertible Senior Notes in February 2011. Capital expenditures for 2011 are expected to be slightly higher than the \$436 million in 2010 as the Company invests in base capital expenditures (estimated capital required to keep the network operating efficiently and support new service development) with the remaining capital expenditures expected to be project based where capital is required to expand the network prior to a specific customer revenue opportunity or success-based, which is tied to incremental revenue. As of December 31, 2010 and including the effect of transactions completed in January and February 2011, 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 \$4 million that mature in 2011, \$299 million that mature in 2012 and \$405 million that mature in 2013.

In January 2011, the Company issued \$605 million aggregate principal amount of its 11.875% Senior Notes due 2019 in two private transactions. Approximately \$300 million was issued in exchange for all of the Company's outstanding 9% Convertible Senior Discount Notes due 2013, and a portion of the net proceeds from the first transaction were used to redeem the Company's outstanding 5.25% Convertible Senior Notes due 2011.

In the second half of 2010, the Company issued \$201 million total aggregate principal amount of its 6.5% Convertible Senior Notes due 2016 for net proceeds of approximately \$195 million. In addition, the Company repaid \$38 million aggregate principal amount of its 2.875% Convertible Senior Notes due 2010 that had matured during the third quarter.

In early 2010, Level 3 Financing, Inc. issued \$640 million aggregate principal amount of 10% Senior Notes due 2018 in a private offering. In conjunction with a concurrent tender offer and consent solicitation, the proceeds from this issuance were used to repurchase \$547 million aggregate principal amount of its 12.25% Senior Notes due 2013. The Company also repaid \$111 million aggregate principal amount of its 6% Convertible Subordinated Notes due 2010 that matured on March 15, 2010, repurchased the remaining \$3 million aggregate principal amount of the 12.25% Senior Notes due 2013 and repurchased an additional \$8 million in debt in various transactions throughout the first quarter of 2010.

Level 3 had \$616 million of cash and cash equivalents on hand at December 31, 2010. In addition, \$122 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 the existing market conditions and the possible dilutive effect to stockholders. The amounts involved in any such transaction, individually or in the aggregate, may be material.

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

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

### Off-Balance Sheet Arrangements

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

### Contractual Obligations

The following table summarizes the contractual obligations and other commercial commitments of the Company at December 31, 2010, as further described in the Notes to Consolidated Financial Statements.

#### *Payments Due by Period*

	Total	Less than 1 Year	2 - 3 Years	4 - 5 Years	After 5 Years
<b>Contractual Obligations</b>					
Long-Term Debt, including current portion(1)	6,527	200	999	3,770	1,558
Interest Obligations(2)	2,322	531	995	522	274
Asset Retirement Obligations	179	8	21	34	116
Operating Leases	966	161	266	207	332
Right of Way Agreements	992	119	150	135	588
Purchase Obligations	293	293	—	—	—
<b>Other Commercial Commitments</b>					
Letters of Credit	22	1	1	1	19

- (1) Pro forma for the issuance of \$605 million aggregate principal amount of the Company's 11.875% Senior Notes due 2019, the exchange of \$295 million aggregate principal amount of the Company's 9% Convertible Senior Discount Notes due 2013 and the redemption of \$196 million aggregate principal amount of the Company's 5.25% Convertible Senior Notes due 2011 in January and February 2011 (together the "January and February 2011 Transactions"). The Company's contractual obligations for long-term debt, including current portion would total \$6.641 billion comprised of \$4 million due in less than one year, \$704 million due in two to three years, \$3.770 billion due in four to five years and \$2.163 billion due after 5 years.
- (2) Pro forma for the January and February 2011 Transactions, the Company's Interest Obligations would total \$2.843 billion comprised of \$566 million due in less than one year, \$1.085 billion due in two to three years, \$666 million due in four to five years and \$526 million due after 5 years.

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. The Company's debt instruments do not have covenants that require the Company or its subsidiaries to maintain certain levels of financial performance or other financial measures such as total leverage or minimum revenues. These types of covenants are commonly referred to as "maintenance covenants."

The Company is unable to reliably estimate the future cash flows of the derivatives included in Other Non-Current Liabilities presented in Note 9—Fair Value of Financial Instruments—of the Notes to Consolidated Financial Statements. Therefore, such amounts are excluded from this table.

Due to uncertainty regarding the completion of tax audits and possible outcomes, the remaining estimate of the timing of payments related to uncertain tax positions and interest cannot be made. See Note 13—Income Taxes—of the Notes to Consolidated Financial Statements for additional information regarding the Company's uncertain tax positions.

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, 2010. In addition, interest is calculated based on debt outstanding as of December 31, 2010, 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 15 years from January 1, 2011, which approximates the estimated 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, 2011, 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, 2010.

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, 2010, the Company had borrowed a total of \$2.0 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 these debt instruments. The weighted average interest rate on the variable rate instruments at December 31, 2010, was approximately 4.1%.

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 of approximately \$1 billion has a weighted average interest rate of 5.7% at December 31, 2010. A hypothetical increase in the weighted average rate by 1% point (i.e. a weighted average rate of 6.7%) would increase the Company's annual interest expense by approximately \$10 million. At December 31, 2010, the Company had \$4.5 billion (excluding fair value adjustments, discounts and premiums) of fixed rate debt bearing a weighted average interest rate of 8.8%. 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, 2010. 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 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### **Management's Annual 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 its management, including the Company's principal executive officer and principal financial officer, management assessed the effectiveness of internal controls over financial reporting as of December 31, 2010 based on the guidelines established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on the Company's assessment, management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2010.

The Company's independent registered public accounting firm, KPMG LLP, has issued an attestation report on the effectiveness of the assessment of the Company's internal control over financial reporting as of December 31, 2010. 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 2011 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 2011 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, 2010, 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 2011 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 2011 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 2011 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.
- 3.1.1 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).
  - 3.1.2 Certificate of Amendment of Restated Certificate of Incorporation of Level 3 Communications, Inc. (incorporated by reference to Exhibit 3.2 of Level 3 Financing, Inc.'s, Level 3 Communications, Inc.'s and Level 3 Communications, LLC's Registration Statement on Form S-4 (SEC File No. 333-167110) filed with the Securities and Exchange Commission on May 26, 2010).
  - 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 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).
  - 4.2 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).
  - 4.3 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).
  - 4.4 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).

- 4.5 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).
- 4.6 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).
- 4.7 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).
- 4.8 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).
- 4.9 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).
- 4.10 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).
- 4.11 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).

- 4.12 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).
- 4.13 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).
- 4.14 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).
- 4.15 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).
- 4.16 Indenture, dated as of June 26, 2009, among Level 3 Communications, Inc. and The Bank of New York Mellon, relating to 7% Convertible Senior Notes Due 2015 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated July 2, 2009).
- 4.17 Second Supplemental Indenture, dated as of October 15, 2009, among Level 3 Communications, Inc. and The Bank of New York Mellon, relating to 7% Convertible Senior Notes Due 2015, Series B (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated October 15, 2009).
- 4.18 Indenture, dated as of January 20, 2010, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer, and The Bank of New York Mellon, as Trustee, relating to the 10% Senior Notes due 2018 of Level 3 Financing, Inc. (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated January 21, 2010)
- 4.19 Supplemental Indenture, dated as of March 19, 2010, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer, Level 3 Communications, LLC, as Guarantor and The Bank of New York Mellon, as Trustee, relating to the 10% Senior Notes Due 2018 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated March 19, 2010)
- 4.20 Supplemental Indenture, dated as of March 19, 2010, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer, Level 3 Communications, LLC, as Guarantor and The Bank of New York Mellon, as Trustee, relating to the 10% Senior Notes Due 2018 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated March 19, 2010)
- 4.21 Third Supplemental Indenture, dated as of September 20, 2010, among Level 3 Communications, Inc. and The Bank of New York Mellon, relating to the 6.5% Convertible Senior Notes Due 2016 (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated September 20, 2010).
- 4.22 Indenture, dated as of January 19, 2011, among Level 3 Communications, Inc., as Issuer, and The Bank of New York Mellon Trust Company, N.A., as Trustee, relating to the 11.875% Senior Notes due 2019 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated January 21, 2011).

- 4.23 Registration Agreement, dated January 19, 2010, among Level 3 Communications, Inc. and Citigroup Global Markets Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. Incorporated and Deutsche Bank Securities Inc. (as representatives of the initial purchasers of the 11.875% Senior Notes due 2019) (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated January 21, 2011).
- 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 Level 3 Communications, Inc. Stock Plan (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated May 25, 2010).
- 10.6 Form of OSO Master Award Agreement of Level 3 Communications, Inc. (Exhibit 10.2 to the Registrant's Current Report on Form 8-K dated May 25, 2010).
- 10.7 Form of Amended Master Deferred Issuance Stock Agreement of Level 3 Communications, Inc. (Exhibit 10.3 to the Registrant's Current Report on Form 8-K dated May 25, 2010).
- 10.8 Form of Master Deferred Issuance Stock Agreement for Non-Employee Directors (Exhibit 10.4 to the Registrant's Current Report on Form 8-K dated May 25, 2010).
- 10.9 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).
- 10.10 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).
- 10.11 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).
- 10.12 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).
- 10.13 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).



- 10.14 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).
- 10.15 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).
- 10.16 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).
- 10.17 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).
- 10.18 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).
- 10.19 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).
- 10.20 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).
- 10.21 Amendment Agreement to the March 13, 2007 Credit Agreement, dated April 16, 2009, among Level 3 Communications, Inc., Level 3 Financing, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. Incorporated, Citigroup Global Markets, Inc., Credit Suisse Securities (USA) LLC, Wachovia Bank, N.A., Merrill Lynch Capital Corporation (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated April 17, 2009).
- 10.22 Amended and Restated Loan Proceeds Note Collateral Agreement, dated as of March 13, 2007, as amended and restated as of April 16, 2009, among Level 3 Financing, Inc., Level 3 Communications, LLC and Merrill Lynch Capital Corporation (Exhibit 10.3 to the Registrant's Current Report on Form 8-K dated April 17, 2009).
- 10.23 First Amendment, dated as of May 15, 2009, to the Amended and Restated Credit Agreement dated as of April 16, 2009, among Level 3 Communications, Inc., Level 3 Financing, Inc. and Merrill Lynch Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. Incorporated, Banc of America Securities LLC, Citigroup Global Markets, Inc., Credit Suisse Securities (USA) LLC, Wachovia Bank, N.A., and Merrill Lynch Capital Corporation (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated May 15, 2009).
- 10.24 Amended and Restated Loan Proceeds Note, dated as of May 15, 2009, issued by Level 3 Communications, LLC to Level 3 Financing, Inc. (Exhibit 10.2 to the Registrant's Current Report on Form 8-K dated May 15, 2009).



- 10.25 Securities Purchase Agreement, dated as of October 1, 2009, among Level 3 Communications, Inc., and Steelhead Navigator Master, L.P. Fairfax Financial Holdings Limited, Zazove Associates, LLC, Loomis, Sayles & Company, L.P., Fidelity Financial Trust: Fidelity Convertible Securities and Fidelity Magellan Fund: Fidelity Magellan Fund (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated October 2, 2009).
- 10.26 Standstill Agreement, dated as of October 26, 2009, between Level 3 Communications, Inc. and Southeastern Asset Management, Inc., on behalf certain institutional clients (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated October 26, 2009).
- 10.27 Retirement Agreement and General Release, dated February 16, 2011, between Level 3 Communications, LLC and Thomas C. Stortz (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated February 23, 2011).
- 10.28 Consulting Agreement, dated as of February 16, 2011, between Level 3 Communications, LLC and Thomas C. Stortz (Exhibit 10.2 to the Registrant's Current Report on Form 8-K dated February 23, 2011).
- 10.29 Form of Master OSO Master Award Agreement for consultants (Exhibit 10.3 to the Registrant's Current Report on Form 8-K dated February 23, 2011).
- 10.30 Form of Master Deferred Issuance Stock Agreement for consultants (Exhibit 10.4 to the Registrant's Current Report on Form 8-K dated February 23, 2011).
- 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.
- 101 The following materials from the Annual Report on Form 10-K of Level 3 Communications, Inc. for the year ended December 31, 2010, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Statements of Operations, (ii) Consolidated Balance Sheets, (iii) Consolidated Statement of Cash Flows, (iv) Consolidated Statements of Changes in Stockholders' Equity (Deficit) (v) Consolidated Statements of Comprehensive Loss (vi) Supplementary Stockholders' Equity Information and (vii) Notes to Consolidated Financial Statements†.

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† Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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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, 2010 and 2009, 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, 2010. 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, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010, 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, 2010, 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 25, 2011 expressed an unqualified opinion on the effectiveness of Level 3 Communications, Inc.'s internal control over financial reporting.

/s/ KPMG LLP

Denver, Colorado  
February 25, 2011

**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, 2010, 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, 2010, 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, 2010 and 2009, 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, 2010, and our report dated February 25, 2011 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Denver, Colorado  
February 25, 2011

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

For each of the three years ended December 31, 2010

	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(dollars in millions, except per share data)		
Revenue:			
Communications	\$ 3,591	\$ 3,695	\$ 4,226
Coal Mining	60	67	75
Total Revenue	<u>3,651</u>	<u>3,762</u>	<u>4,301</u>
Costs and Expenses (exclusive of depreciation and amortization shown separately below):			
Cost of Revenue:			
Communications	1,434	1,499	1,740
Coal Mining	56	66	69
Total Cost of Revenue	<u>1,490</u>	<u>1,565</u>	<u>1,809</u>
Depreciation and Amortization	876	915	931
Selling, General and Administrative	1,373	1,338	1,505
Restructuring Charges	2	9	25
Total Costs and Expenses	<u>3,741</u>	<u>3,827</u>	<u>4,270</u>
Operating Income (Loss)	(90)	(65)	31
Other Income (Expense):			
Interest income	1	2	15
Interest expense	(586)	(595)	(570)
Gain on sale of business groups, net	—	—	99
Gain (loss) on extinguishments of debt, net	(59)	14	89
Other, net	21	27	24
Total Other Expense	<u>(623)</u>	<u>(552)</u>	<u>(343)</u>
Loss Before Income Taxes	(713)	(617)	(312)
Income Tax (Expense) Benefit	91	(1)	(6)
Net Loss	<u>\$ (622)</u>	<u>\$ (618)</u>	<u>\$ (318)</u>
Shares Used to Compute Basic and Diluted Loss Per Share (in thousands)			
	1,660,196	1,633,049	1,564,996
Loss Per Share (Basic and Diluted)	<u>\$ (0.37)</u>	<u>\$ (0.38)</u>	<u>\$ (0.20)</u>

See accompanying notes to consolidated financial statements.

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2010 AND 2009

	<u>2010</u>	<u>2009</u>
	(dollars in millions, except per share data)	
<i>Assets</i>		
<i>Current Assets:</i>		
Cash and cash equivalents	\$ 616	\$ 836
Restricted cash and securities	2	3
Receivables, less allowances for doubtful accounts of \$17 and \$18, respectively	264	323
Other	90	97
<b>Total Current Assets</b>	<b>972</b>	<b>1,259</b>
Property, Plant and Equipment, net	5,302	5,687
Restricted Cash and Securities	120	122
Goodwill	1,427	1,429
Other Intangibles, net	371	467
Other Assets, net	163	98
<b>Total Assets</b>	<b>\$ 8,355</b>	<b>\$ 9,062</b>
<i>Liabilities and Stockholders' Equity (Deficit)</i>		
<i>Current Liabilities:</i>		
Accounts payable	\$ 329	\$ 364
Current portion of long-term debt	180	705
Accrued payroll and employee benefits	84	51
Accrued interest	146	140
Current portion of deferred revenue	151	162
Other	66	97
<b>Total Current Liabilities</b>	<b>956</b>	<b>1,519</b>
Long-Term Debt, less current portion	6,268	5,755
Deferred Revenue, less current portion	736	740
Other Liabilities	552	557
<b>Total Liabilities</b>	<b>8,512</b>	<b>8,571</b>
<i>Commitments and Contingencies</i>		
<i>Stockholders' Equity (Deficit):</i>		
Preferred stock, \$.01 par value, authorized 10,000,000 shares: no shares issued or outstanding	—	—
Common stock, \$.01 par value, authorized 2,900,000,000 shares: 1,670,478,384 issued and outstanding in 2010 and 1,644,116,265 issued and outstanding in 2009	17	16
Additional paid-in capital	11,603	11,537
Accumulated other comprehensive loss	(98)	(5)
Accumulated deficit	(11,679)	(11,057)
<b>Total Stockholders' Equity (Deficit)</b>	<b>(157)</b>	<b>491</b>
<b>Total Liabilities and Stockholders' Equity (Deficit)</b>	<b>\$ 8,355</b>	<b>\$ 9,062</b>

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, 2010

	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(dollars in millions)		
<b>Cash Flows from Operating Activities:</b>			
Net Loss	\$ (622)	\$ (618)	\$ (318)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	876	915	931
Deferred income taxes	(93)	2	(3)
Loss (gain) on debt extinguishments, net	59	(14)	(89)
Accretion of debt discount and amortization of debt issuance costs	57	56	52
Change in fair value of embedded derivative	(10)	(14)	—
Non-cash compensation expense attributable to stock awards	67	59	78
Accrued interest on long-term debt	6	22	(13)
Asset retirement obligation adjustment	—	—	(86)
Loss on impairments	—	—	8
Loss (gain) on sale of property, plant and equipment and other assets	4	—	(3)
Gain on sale of business groups, net	—	—	(99)
Other, net	(7)	(18)	2
Change in working capital items:			
Receivables	57	70	5
Other current assets	1	(1)	2
Payables	(33)	(19)	(26)
Deferred revenue	7	10	(34)
Other current liabilities	(30)	(93)	6
Net Cash Provided by Operating Activities	<u>339</u>	<u>357</u>	<u>413</u>
<b>Cash Flows from Investing Activities:</b>			
Capital expenditures	(436)	(313)	(449)
Decrease (increase) in restricted cash and securities, net	3	5	(5)
Proceeds from sale of property, plant and equipment and other assets	4	1	3
Proceeds from sale of business groups, net	—	—	124
Proceeds from sales and maturities of marketable securities	—	—	4
Other	—	—	2
Net Cash Used in Investing Activities	<u>(429)</u>	<u>(307)</u>	<u>(321)</u>
<b>Cash Flows from Financing Activities:</b>			
Long-term debt borrowings, net of issuance costs	808	543	400
Payments on and repurchases of long-term debt, including current portion and refinancing costs	(930)	(527)	(436)
Other	—	—	2
Net Cash Provided by (Used in) Financing Activities	<u>(122)</u>	<u>16</u>	<u>(34)</u>
Effect of Exchange Rates on Cash and Cash Equivalents	(8)	2	(4)
Net Change in Cash and Cash Equivalents	<u>(220)</u>	<u>68</u>	<u>54</u>
Cash and Cash Equivalents at Beginning of Year	836	768	714
Cash and Cash Equivalents at End of Year	<u>\$ 616</u>	<u>\$ 836</u>	<u>\$ 768</u>
<b>Supplemental Disclosure of Cash Flow Information:</b>			
Cash interest paid	\$ 523	\$ 517	\$ 531
Income taxes paid, net of refunds	(1)	5	4
<b>Noncash Investing and Financing Activities:</b>			
Long-term debt issued in exchange transaction	\$ —	\$ 196	\$ —
Long-term debt retired in exchange transaction	—	204	—
Long-term debt converted to equity	—	—	128

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, 2010

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
	Shares	\$				
(dollars in millions)						
Balances at						
January 1, 2008	1,537,862,685	\$ 15	\$ 11,268	\$ 104	\$ (10,121)	\$ 1,266
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	127	—	—	128
Stock-based Compensation Expense	—	—	79	—	—	79
Net Loss	—	—	—	—	(318)	(318)
Other Comprehensive Loss	—	—	—	(155)	—	(155)
Balances at						
December 31, 2008	1,617,615,258	16	11,495	(51)	(10,439)	1,021
Common Stock:						
Common stock issued under employee stock and benefit plans and other	27,108,607	—	15	—	—	15
Stock-based Compensation Expense	—	—	30	—	—	30
Other	(607,600)	—	(3)	—	—	(3)
Net Loss	—	—	—	—	(618)	(618)
Other Comprehensive Income	—	—	—	46	—	46
Balances at						
December 31, 2009	1,644,116,265	16	11,537	(5)	(11,057)	491
Common Stock:						
Common stock issued under employee stock and benefit plans and other	26,362,119	1	21	—	—	22
Stock-based Compensation Expense	—	—	29	—	—	29
Reclassification of Derivative Liability	—	—	16	—	—	16
Net Loss	—	—	—	—	(622)	(622)
Other Comprehensive Loss	—	—	—	(93)	—	(93)
Balances at						

December 31, 2010    1,670,478,384    \$ 17    \$ 11,603    \$ (98)    \$ (11,679)    \$ (157)

See accompanying notes to consolidated financial statements.

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

**For each of the three years ended December 31, 2010**

	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(dollars in millions)		
Net Loss	\$ (622)	\$ (618)	\$ (318)
Other Comprehensive Income (Loss) Before Income Taxes:			
Foreign currency translation	(78)	36	(63)
Unrealized holding gain (loss) on interest rate swaps	(16)	5	(60)
Unrealized holding gain (loss) on available-for-sale investment	—	—	(7)
Other, net	1	5	(25)
Other Comprehensive Income (Loss), Before Income Taxes	(93)	46	(155)
Income Tax Related to Items of Other Comprehensive Income (Loss)	—	—	—
Other Comprehensive Income (Loss), Net of Income Taxes	(93)	46	(155)
Comprehensive Loss	<u>\$ (715)</u>	<u>\$ (572)</u>	<u>\$ (473)</u>

See accompanying notes to consolidated financial statements.

**SUPPLEMENTARY STOCKHOLDERS' EQUITY INFORMATION****ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)****For each of the three years ended December 31, 2010**

	<u>Net Foreign Currency Translation Adjustment</u>	<u>Unrealized Holding Gain (Loss) on Investment and Interest Rate Swaps</u>	<u>Other</u>	<u>Total</u>
	(dollars in millions)			
Balance at January 1, 2008	\$ 160	\$ (30)	\$ (26)	\$ 104
Change	(63)	(67)	(25)	(155)
Balance at December 31, 2008	97	(97)	(51)	(51)
Change	36	5	5	46
Balance at December 31, 2009	133	(92)	(46)	(5)
Change	(78)	(16)	1	(93)
Balance at December 31, 2010	<u>\$ 55</u>	<u>\$ (108)</u>	<u>\$ (45)</u>	<u>\$ (98)</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*

Level 3 Communications, Inc. and subsidiaries (the "Company" or "Level 3") is a facilities based provider (that is, a provider that owns or leases a substantial portion of the plant, property and equipment necessary to provide its services) of a broad range of integrated communications services. The Company 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 in which it has a controlling interest, 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 consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP").

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

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—Vyvx Advertising Distribution Business Disposition—for more details regarding the disposition of the Vyvx advertising distribution business. The disposal of the Vyvx advertising distribution business did not qualify for presentation as discontinued operations since the business was not considered a separately identifiable asset group.

*Foreign Currency Translation*

Generally, local currencies of foreign subsidiaries are the functional currencies for financial reporting purposes. For operations outside the U.S. that prepare financial statements in currencies other than the U.S. dollar, assets and liabilities are translated at year-end exchange rates, and 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 loss in stockholders' equity (deficit) and in the consolidated statements of

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(1) Organization and Summary of Significant Accounting Policies (Continued)**

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 2010, 2009 and 2008. As a result, the Company has experienced significant foreign currency translation adjustments that are recognized as a component of accumulated other comprehensive loss in stockholders' equity (deficit) and in the consolidated statement of comprehensive loss in accordance with accounting guidance for 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 consolidated financial statements in conformity with GAAP 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 judgments include revenue recognition, revenue reserves, cost of revenue for communications services, the determination of the useful lives of long-lived assets, the valuation and recognition of stock-based compensation expense, the valuation of long-lived assets, goodwill and acquired indefinite-lived intangible assets, derivative financial instruments, the valuation of asset retirement obligations, the allowance for doubtful accounts, 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 valuation of other assets and liabilities measured at fair value. Actual results may differ from these estimates under different assumptions or conditions and such differences could be material.

*Revenue and Cost of Revenue for Communications Services*

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. Actual results may differ from these estimates under different assumptions or conditions and such differences could be material.

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 2010, 2009 and 2008.



**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(1) Organization and Summary of Significant Accounting Policies (Continued)**

For certain sale and long-term indefeasible 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 credits are a reduction to 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 package delivery costs and blank tape media costs associated with this business in communications cost of revenue.

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 the 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.

*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.

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(1) Organization and Summary of Significant Accounting Policies (Continued)***USF and Gross Receipts Taxes*

The revenue recognition standards include guidance relating to 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, and some excise taxes. The Company records Universal Service Fund ("USF") contributions where the Company is the primary obligor for the taxes assessed in each jurisdiction where it does business 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 \$77 million, \$62 million and \$65 million for the years ended December 31, 2010, 2009 and 2008, 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, \$7 million and \$8 million for the years ended December 31, 2010, 2009 and 2008, respectively.

*Stock-Based Compensation*

The Company recognizes the estimated fair value of stock based compensation costs, net of an estimated forfeiture rate, over the requisite service period of the award, which is generally the vesting term or term for restrictions on transfer that lapse, as the case may be. The Company funded a portion of its 2010 and 2009 discretionary bonus in stock awards that were vested upon issuance. The Company estimates forfeiture rates based on its historical experience for the type of award.

*Income Taxes*

The Company recognizes deferred tax assets and liabilities for its domestic and foreign operations, for the expected tax consequences of temporary differences between the tax basis 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.

*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, 2010 and 2009, the carrying value of cash and cash equivalents approximates fair value due to the short period of time to maturity.

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(1) Organization and Summary of Significant Accounting Policies (Continued)***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 \$122 million at December 31, 2010 and \$125 million at December 31, 2009.

*Derivative Financial Instruments*

All derivative instruments, including derivatives embedded in other financial instruments, are measured at fair value and recognized as either assets or liabilities on the Company's consolidated balance sheets. The Company's derivative instruments are valued primarily using models based on readily observable market parameters for all substantial terms of the Company's derivative contracts and thus are classified as Level 2. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

For derivative instruments designated as cash flow hedges, the effective portion of the derivative's gain (loss) is initially reported as a component of Accumulated Other Comprehensive Income (Loss) ("AOCI") and is subsequently recognized in earnings in the period the hedged transaction affects earnings. Gains (losses) resulting from hedge ineffectiveness and those resulting from changes in fair values on derivatives not designated as hedging instruments are recognized in other income (expense) in the consolidated statements of operations. See Note 10—Derivative Financial Instruments—for additional information.

*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 collectibility. 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 \$16 million in 2010, \$14 million in 2009 and \$9 million in 2008.

**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 or 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

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

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 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 \$68 million, \$57 million and \$83 million for the years ended December 31, 2010, 2009 and 2008, respectively.

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 the estimated fair value of 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. 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 then to 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)***Goodwill and Acquired Indefinite-Lived Intangible Assets*

Accounting guidance prohibits the amortization of goodwill and purchased intangible assets with indefinite useful lives. The Company reviews goodwill and purchased intangible assets with indefinite lives for impairment annually 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. 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—Segment Information. The Company considers the use of multiple valuation techniques in accordance with GAAP Fair Value Measurements and Disclosures guidance to estimate the fair value of its reporting units and has consistently applied a market approach as part of its impairment assessment process. Under the market approach, the Company estimates the fair value using an in-exchange valuation premise 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. 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.

GAAP 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 acquired indefinite-lived 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 2010 and 2009 and concluded that its goodwill and acquired indefinite-lived intangible assets were not impaired in any of those periods. As a result of the sale of the Vyvx advertising distribution business in the second quarter of 2008, the Company also performed an interim 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. 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 is the excess of the asset's carrying value over its estimated fair value.

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(1) Organization and Summary of Significant Accounting Policies (Continued)**

The Company conducted a long-lived asset impairment analysis in 2010, 2009 and 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 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 collectibility 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. 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 27%, 28% and 32% of Level 3's communications revenue for the years ended December 31, 2010, 2009 and 2008, respectively.

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(1) Organization and Summary of Significant Accounting Policies (Continued)***Correction of an Immaterial Error in Prior Period Consolidated Financial Statements*

During the fourth quarter of 2010 in connection with the preparation of the 2009 financial statements for the Company's European subsidiaries, Level 3 identified an error in the Company's previously issued consolidated financial statements related to the recognition of foreign deferred taxes. To correct this error, the Company recorded an adjustment in the fourth quarter of 2010 to recognize approximately \$41 million of additional foreign jurisdiction deferred tax assets that had been subject to a full valuation allowance (consisting principally of those related to net operating loss carryforwards and fixed assets), approximately \$27 million of related currency translation adjustments, and a corresponding net deferred tax benefit of approximately \$68 million principally resulting from the release of valuation allowances for certain of its foreign subsidiaries that had become profitable in prior periods. This error did not materially affect the Company's previously reported results of operations or financial condition, or the current period results of operations or financial condition. The adjustments had no effect on income taxes paid, and did not materially affect the Company's consolidated net deferred tax assets before valuation allowance. See Note 13—Income Taxes.

*Recently Issued Accounting Pronouncements*

In October 2009, the FASB issued a new accounting standard that provides revenue recognition guidance for arrangements with multiple deliverables. Specifically, the new standard requires an entity to allocate consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices. In the absence of the vendor-specific objective evidence or third-party evidence of the selling prices, consideration must be allocated to the deliverables based on management's best estimate of the selling prices. In addition, the new standard eliminates the use of the residual method of allocation. This guidance is generally expected to result in revenue recognition for more delivered elements than under the current rules. Level 3 is required to adopt this guidance prospectively for new or materially modified agreements as of January 1, 2011.

In June 2009, the FASB issued a new accounting standard that changes the consolidation rules as they relate to variable interest entities. The new standard makes significant changes to the model for determining who should consolidate a variable interest entity, and also addresses how often this assessment should be performed. The standard is effective for Level 3 effective January 1, 2010. The Company's adoption of this guidance did not have a material effect on the Company's consolidated results of operations or financial condition.

In December 2010, the FASB issued new accounting guidance to address concerns about performing the goodwill impairment test when a reporting unit has zero or negative carrying values. The guidance requires the Company to automatically perform Step 2 of the impairment test for reporting units with a zero or negative carrying amount if there are qualitative factors that indicate that it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, these adverse qualitative factors should also be considered between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The adverse qualitative factors are part of existing accounting standards. The guidance is effective for Level 3 on January 1, 2011. The Company evaluated the adverse qualitative factors in anticipation of its January 1, 2011 adoption of the new accounting guidance and concluded that it was not required to perform Step 2 of the impairment test.



**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(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 through the date of sale. The disposal of the Vyvx advertising distribution business did not meet the criteria for presentation as discontinued operations since the business was not considered a separately identifiable 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."

Revenue attributable to the Vyvx advertising distribution business totaled \$15 million in 2008. 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 2010, 2009 or 2008 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 782 million, 673 million and 489 million shares issuable pursuant to the various series of convertible notes outstanding at December 31, 2010, 2009 and 2008, 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 47 million, 43 million and 57 million stock options, outperform stock options, restricted stock units, restricted stock shares and warrants outstanding at December 31, 2010, 2009 and 2008, 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, 2010 and 2009 are as follows (in millions):

	Cost	Accumulated Depreciation	Net
<b>December 31, 2010</b>			
Land	\$ 160	\$ —	\$ 160
Land Improvements	82	(48)	34
Facility and Leasehold Improvements:			
Communications	1,898	(887)	1,011
Coal Mining	166	(159)	7
Network Infrastructure	5,630	(2,544)	3,086
Operating Equipment:			
Communications	4,322	(3,381)	941
Coal Mining	73	(67)	6
Furniture, Fixtures and Office Equipment	145	(133)	12
Other	22	(22)	—
Construction-in-Progress	45	—	45
	<u>\$ 12,543</u>	<u>\$ (7,241)</u>	<u>\$ 5,302</u>
<b>December 31, 2009</b>			
Land	\$ 162	\$ —	\$ 162
Land Improvements	80	(44)	36
Facility and Leasehold Improvements:			
Communications	1,906	(802)	1,104
Coal Mining	159	(156)	3
Network Infrastructure	5,632	(2,269)	3,363
Operating Equipment:			
Communications	4,009	(3,041)	968
Coal Mining	74	(66)	8
Furniture, Fixtures and Office Equipment	146	(129)	17
Other	23	(22)	1
Construction-in-Progress	25	—	25
	<u>\$ 12,216</u>	<u>\$ (6,529)</u>	<u>\$ 5,687</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 \$781 million in 2010, \$823 million in 2009 and \$832 million in 2008.

## (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

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (5) Asset Retirement Obligations (Continued)

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.

The asset retirement obligations for certain leased facilities and coal mining locations were increased by an insignificant amount in 2010 and 2009 due to revised estimates of future obligations.

Approximately \$71 million of restricted cash and securities were contractually restricted to settle the Company's coal mining reclamation liabilities at December 31, 2010 and 2009, 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, 2010 and 2009 (in millions):

	December 31,	
	2010	2009
Asset retirement obligation at January 1	\$ 167	\$ 151
Accretion expense	12	16
Liabilities settled	(13)	(6)
Revision in estimated cash flows	13	6
Asset retirement obligation at December 31	<u>\$ 179</u>	<u>\$ 167</u>

## (6) Goodwill

The changes in the carrying amount of goodwill during the years ended December 31, 2010 and 2009 are as follows (in millions):

	Communications Segment	Coal Mining Segment	Total
Balance as of January 1, 2009	\$ 1,432	\$ —	\$ 1,432
Goodwill adjustments	(3)	—	(3)
Accumulated impairment losses	—	—	—
Balance as of December 31, 2009	1,429	—	1,429
Accumulated impairment losses	—	—	—
Effect of foreign currency rate change	(2)	—	(2)
Balance as of December 31, 2010	<u>\$ 1,427</u>	<u>\$ —</u>	<u>\$ 1,427</u>

The Company conducted its annual goodwill impairment analysis at December 31, 2010 and 2009. As a result of the Company's annual assessment, Level 3 concluded that its goodwill was not impaired in 2010 and 2009.

## 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, 2010 and December 31, 2009 were as follows (in millions):

	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net</u>
<b>December 31, 2010</b>			
Finite-Lived Intangible Assets:			
Customer Contracts and Relationships	\$ 743	\$ (488)	\$ 255
Patents and Developed Technology	140	(76)	64
	<u>883</u>	<u>(564)</u>	<u>319</u>
Indefinite-Lived Intangible Assets:			
Vyvx Trade Name	32	—	32
Wireless Licenses	20	—	20
	<u>\$ 935</u>	<u>\$ (564)</u>	<u>\$ 371</u>
<b>December 31, 2009</b>			
Finite-Lived Intangible Assets:			
Customer Contracts and Relationships	\$ 743	\$ (407)	\$ 336
Patents and Developed Technology	141	(62)	79
	<u>884</u>	<u>(469)</u>	<u>415</u>
Indefinite-Lived Intangible Assets:			
Vyvx Trade Name	32	—	32
Wireless Licenses	20	—	20
	<u>\$ 936</u>	<u>\$ (469)</u>	<u>\$ 467</u>

During the third quarter of 2010, the Company determined that the useful life of certain customer relationships and developed technology should be reduced based on adverse economic conditions affecting customer attrition associated with these assets, which prospectively increased amortization expense by approximately \$2 million during the year ended December 31, 2010.

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

Acquired finite-lived intangible asset amortization expense was \$95 million in 2010, \$92 million in 2009 and \$99 million in 2008.

The weighted average remaining useful lives of the Company's acquired finite-lived intangible assets was 3.2 years for customer contracts and relationships and 4.1 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, 2010, 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):

2011	\$ 93
2012	69
2013	51
2014	40
2015	27
Thereafter	39
	<u>\$ 319</u>

**(8) Restructuring 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 previously acquired companies. Restructuring charges totaled \$2 million in 2010, \$9 million in 2009 and \$25 million in 2008. During 2010, the Company did not initiate any significant new workforce reduction plans.

During 2009, the Company initiated a workforce reduction of approximately 260 employees, or 5% of the Company's total employee base. As a result of the 2009 workforce reduction, the Company incurred a restructuring charge of \$9 million, all of which related to the communications business. The workforce reductions related 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 2009. During 2009, the Company paid approximately \$21 million of involuntary termination benefits for affected employees in 2009, of which \$9 million related to the Company's 2009 restructuring activities and \$12 million related to restructuring activities initiated in the fourth quarter of 2008. The Company does not have any remaining termination benefit liabilities related to restructuring activities.

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 related 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 concluded this workforce reduction in the first quarter of 2009.

The Company also has accrued contract termination costs of \$30 million and \$42 million as of December 31, 2010 and December 31, 2009, respectively, 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 recognized a benefit of approximately \$5 million in 2010 as a result of lease modifications and incurred charges of \$1 million in 2009 as the Company ceased using additional facilities. The Company records charges for

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(8) Restructuring Charges (Continued)**

contract termination costs within selling, general and administrative expenses in the consolidated statements of operations.

**(9) Fair Value of Financial Instruments**

The Company's financial instruments consist of cash and cash equivalents, restricted cash and securities, accounts receivable, accounts payable, interest rate swaps and long-term debt (including the current portion) as of December 31, 2010 and 2009. The Company also had embedded derivative contracts included in its financial position as of December 31, 2009. The embedded derivative contracts were insignificant as of December 31, 2010. The carrying values of cash and cash equivalents, restricted cash and securities, accounts receivable and accounts payable approximated their fair values at December 31, 2010 and 2009. The Company's interest rate swaps and embedded derivative contracts are recorded in the consolidated balance sheets at fair value. The carrying value of the Company's long-term debt, including the current portion, reflects the original amounts borrowed net of unamortized discounts, premiums and debt discounts and was \$6.4 billion and \$6.5 billion as of December 31, 2010 and 2009, respectively.

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

*Fair Value Hierarchy*

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

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

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

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

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (9) Fair Value of Financial Instruments (Continued)

The table below presents the fair values for certain of Level 3's liabilities measured on a recurring basis as well as the input levels used to determine these fair values as of December 31, 2010 and 2009 (in millions):

	Fair Value Measurement Using					
	Total Carrying Value in Consolidated Balance Sheet		Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)	
	December 31, 2010	December 31, 2009	December 31, 2010	December 31, 2009	December 31, 2010	December 31, 2009
<i>Liabilities Recorded at Fair Value in the Financial Statements:</i>						
Derivatives:						
Interest Rate Swap Liabilities (included in other non-current liabilities)	\$ 108	\$ 92	\$ —	\$ —	\$ 108	\$ 92
Embedded Derivatives in Convertible Debt (included in other non-current liabilities)	—	20	—	—	—	20
<b>Total Derivative Liabilities Recorded at Fair Value in the Financial Statements</b>	<b>\$ 108</b>	<b>\$ 112</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 108</b>	<b>\$ 112</b>
<i>Liabilities Not Recorded at Fair Value in the Financial Statements:</i>						
Long-term Debt, including the current						



portion:							
Senior							
Notes	\$ 2,885	\$ 2,809	\$ 2,789	\$ 2,609	\$ —	\$ —	
Convertible							
Notes	1,788	1,873	697	778	1,189	1,267	
Term Loans	1,679	1,678	1,632	1,577	—	—	
Commercial							
Mortgage	67	68	—	—	79	75	
Capital							
Leases							
and							
Other	29	32	—	—	29	32	
Total							
Long-term							
Debt,							
including							
the							
current							
portion:	\$ 6,448	\$ 6,460	\$ 5,118	\$ 4,964	\$ 1,297	\$ 1,374	

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

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(9) Fair Value of Financial Instruments (Continued)***Derivatives*

The interest rate swaps are measured in accordance with the GAAP Fair Value Measurements and Disclosures guidance using discounted cash flow techniques that use observable market inputs, such as LIBOR-based forward yield curves, forward rates, and the specific swap rate stated in each of the swap agreements. The embedded derivative contracts are priced using inputs that are observable in the market, such as the Company's stock price, risk-free interest rate and other contractual terms of certain of the Company's convertible senior notes.

*Senior Notes*

The estimated fair value of the Company's Senior Notes approximated \$2.8 billion and \$2.6 billion at December 31, 2010 and 2009, respectively, based on market prices. The fair value of each instrument was based on the December 31, 2010 and 2009 trading quotes as provided by large financial institutions that trade in the Company's securities. The pricing quotes provided by these market participants incorporate spreads to the Treasury curve, security coupon (which ranges from LIBOR plus 3.75% to 10%), corporate and security credit ratings, maturity date (ranging from 2014 to 2018) and liquidity, among other security characteristics and relative value at both the borrower entity level and across other securities of similar terms.

The Senior Notes are unsecured obligations of Level 3 Financing, Inc.; however, the Senior Notes are fully and unconditionally guaranteed by Level 3 Communications, Inc. and Level 3 Communications, LLC, which is a first tier, wholly owned subsidiary of Level 3 Financing, Inc.

*Convertible Notes*

The estimated fair value of the Company's actively traded Convertible Notes, including the 5.25% Convertible Senior Notes due 2011, the 3.5% Convertible Senior Notes due 2012, and the 6.5% Convertible Senior Notes due 2016, approximated \$697 million and \$778 million at December 31, 2010 and 2009, respectively. The fair value of the Company's actively traded Convertible Notes is based on the trading quotes as of December 31, 2010 and 2009 provided by large financial institutions that trade in the Company's securities. The estimated fair value of the Company's Convertible Notes which are not actively traded, such as the 9% Convertible Senior Discount Notes due 2013, the 15% Convertible Senior Notes due 2013, the 7% Convertible Senior Notes due 2015, and the 7% Convertible Senior Notes due 2015, Series B approximated \$1.2 billion and \$1.3 billion at December 31, 2010 and 2009, respectively. To estimate the fair value of the Convertible Notes which are not actively traded, Level 3 used a Black-Scholes valuation model and an income approach using discounted cash flows. The most significant inputs affecting the valuation are the pricing quotes provided by market participants which incorporate spreads to the Treasury curve, security coupon (ranging from 7% to 15%), convertible optionality, corporate and security credit ratings, maturity date (ranging from 2013 to 2015), liquidity, and other equity option inputs, such as the risk-free rate, underlying stock price, strike price of the embedded derivative, estimated volatility and maturity inputs for the option component and for the bond component, among other security characteristics and relative value at both the borrower entity level and across other securities with similar terms. The fair value of each instrument is obtained by adding together the value derived by discounting the security's coupon or interest payment using a risk-adjusted discount rate and the value calculated from the embedded equity option based on the

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(9) Fair Value of Financial Instruments (Continued)**

estimated volatility of the Company's stock price, conversion rate of the particular Convertible Note, remaining time to maturity, and risk-free rate.

The Convertible Notes are unsecured obligations of Level 3 Communications, Inc. No subsidiary of Level 3 Communications, Inc. has provided a guarantee of the Convertible Notes.

*Term Loans*

The fair value of the Term Loans was approximately \$1.6 billion at December 31, 2010 and 2009, respectively. The fair value of each loan is based on the December 31, 2010 and 2009 trading quotes as provided by large financial institutions that trade in the Company's loans. The pricing quotes provided by these market participants incorporate LIBOR curve expectations, interest spread, which is LIBOR plus 2.25% for the \$1.4 billion in aggregate principal value in Tranche A Term Loan and LIBOR plus 8.5% for the \$280 million Tranche B Term Loan (aggregate principal value), LIBOR floor (only applicable to the Tranche B Term Loan at 3.0% minimum), corporate and loan credit ratings, maturity date (March 2014) and liquidity, among other loan characteristics and relative value across other instruments of similar terms.

The Term Loans are secured by a pledge of the equity interests in certain domestic subsidiaries of Level 3 Financing, Inc. and 65% of the equity interest in Level 3 Financing, Inc.'s Canadian subsidiary and liens on the assets of Level 3 Communications, Inc. and certain domestic subsidiaries of Level 3 Financing, Inc. In addition, Level 3 Communications, Inc. and certain domestic subsidiaries of Level 3 Financing, Inc. have provided full and unconditional guarantees of the obligations under the Term Loans.

*Commercial Mortgage*

The fair value of the Commercial Mortgage was approximately \$79 million and \$75 million at December 31, 2010 and 2009, respectively, as compared to the carrying amounts of \$67 million and \$68 million, respectively. The Commercial Mortgage is not actively traded and its fair value is estimated by management using a valuation model based on an income approach. The significant inputs used to estimate fair value of this debt instrument using discounted cash flows include the anticipated scheduled mortgage payments and observable market yields on other actively traded debt of similar characteristics and collateral type.

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

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.

**(10) Derivative Financial Instruments**

The Company uses derivative financial instruments, primarily interest rate swaps, to manage its exposure to fluctuations in interest rate movements. The Company's primary objective in managing interest rate risk is to decrease the volatility of its earnings and cash flows affected by changes in the

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(10) Derivative Financial Instruments (Continued)**

underlying rates. To achieve this objective, the Company enters into financial derivatives, primarily interest rate swap agreements, the values of which change in the opposite direction of the anticipated future cash flows. The Company has floating rate long-term debt (see Note 11—Long-Term Debt). 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. The Company has designated its interest rate swap agreements as cash flow hedges. Swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the lives of the agreements without exchange of the underlying notional amount. The change in the fair value of the interest rate swap agreements are reflected in AOCI and subsequently reclassified into earnings in the period that the hedged transaction affects earnings, due to the fact that the interest rate swap agreements qualify as effective cash flow hedges. The Company does not use derivative financial instruments for speculative purposes.

Specifically, 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. The Company uses interest rate swaps to convert specific variable rate debt issuances into fixed rate debt. 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 evaluates the effectiveness of the hedges 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. During all of the periods presented, these derivatives were used to hedge the variable cash flows associated with existing obligations. The Company recognizes any ineffective portion of the change in fair value of the hedged items in the consolidated statements of operations. All components of the interest rate swaps were included in the assessment of hedge effectiveness. Hedge ineffectiveness for the Company's cash flow hedges was not material in any period presented.

The Company also has issued certain equity conversion rights associated with debt instruments, which are not designated as hedging instruments, but are considered derivative instruments. The Company's primary objective associated with including such conversion rights in certain of its debt instruments is to reduce the contractual interest rate and related current cash borrowing costs of the debt instruments. Certain of these derivative instruments were classified as liabilities at December 31, 2009 due to a potential requirement to settle the conversion rights in cash, as a result of the Company not having a sufficient number of authorized and unissued shares of common stock to cover all potentially convertible shares, for which the conversion rights were carried at fair value. As a result of the approval by the Company's stockholders at the May 20, 2010 annual meeting to increase the number of authorized shares of Level 3 common stock to 2.9 billion, the \$16 million fair value of these derivative instruments was reclassified into additional paid in capital as of May 20, 2010, as the Company had sufficient authorized and unissued common stock available to settle all of the potential conversion rights. As a result of the September 20, 2010 issuance of \$175 million aggregate principal amount of 6.5% Convertible Senior Notes due in 2016, the Company did not have a sufficient number of authorized and unissued common shares available to settle all of the equity conversion rights and

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (10) Derivative Financial Instruments (Continued)

make-whole premiums associated with its convertible debt. The fair value of the embedded derivative liability at December 31, 2010 and changes in its fair value from September 20, 2010 through December 31, 2010 were not significant. The Company has recognized the gains or losses from changes in fair values of these derivative instruments in other income (expense) in the consolidated statements of operations. Changes in these derivative resulted in the Company recognizing a gain of approximately \$10 million and \$14 million for the years ended December 31, 2010 and 2009, respectively.

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

Amounts reported in AOCI related to derivatives are indirectly recognized in earnings as periodic settlements occur throughout the term of the swaps, when the related interest payments are made on the Company's variable-rate debt. As of December 31, 2010 and 2009, the Company had the following outstanding interest rate derivatives that were designated as cash flow hedges of interest rate risk:

<u>Interest Rate Derivative</u>	<u>Number of Instruments</u>	<u>Notional (in Millions)</u>
Interest rate swaps	Two	\$ 1,000

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

<u>Derivatives designated as hedging instruments</u>	<u>Liability Derivatives</u>			
	<u>December 31, 2010</u>		<u>December 31, 2009</u>	
	<u>Balance Sheet Location</u>	<u>Fair Value</u>	<u>Balance Sheet Location</u>	<u>Fair Value</u>
Cash flow hedging contracts	Other noncurrent liabilities	\$ 108	Other noncurrent liabilities	\$ 92

<u>Derivatives not designated as hedging instruments</u>	<u>Liability Derivatives</u>			
	<u>December 31, 2010</u>		<u>December 31, 2009</u>	
	<u>Balance Sheet Location</u>	<u>Fair Value</u>	<u>Balance Sheet Location</u>	<u>Fair Value</u>
Embedded equity conversion rights	Other noncurrent liabilities	\$ —	Other noncurrent liabilities	\$ 20

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

<u>Derivatives designated as hedging instruments</u>	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
Cash flow hedging contracts	\$ (16)	\$ 5

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (10) Derivative Financial Instruments (Continued)

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

<u>Derivatives designated as hedging instruments</u>	<u>Income Statement Location</u>	<u>Year Ended December 31,</u>	
		<u>2010</u>	<u>2009</u>
Cash flow hedging contracts	Interest Expense	\$ 46	\$ 40

Changes in the fair value of interest rate swaps designated as hedging instruments of the variability of cash flows associated with floating-rate, long-term debt obligations are reported in AOCI. These amounts subsequently are reclassified into interest expense as a yield adjustment of the hedged debt obligation in the same period in which the related interest on the floating-rate debt obligations affects earnings. Amounts currently included in AOCI will be reclassified to earnings prior to the settlement of these cash flow hedging contracts in 2014. The Company estimates that \$46 million of net losses on the interest rate swaps (based on the estimated LIBOR curve as of December 31, 2010) will be reclassified into earnings within the next twelve months. The Company's interest rate swap agreements designated as cash flow hedging contracts qualify as effective hedge relationships, and as a result, hedge ineffectiveness was not material in any of the periods presented.

The effect of the Company's derivative instruments not designated as hedging instruments on net loss is as follows (in millions):

<u>Derivatives not designated as hedging instruments</u>	<u>Location of Gain Recognized in Income/Loss on Derivative</u>	<u>Year Ended December 31,</u>		
		<u>2010</u>	<u>2009</u>	<u>2008</u>
Embedded equity conversion rights	Other Income (Expense)—Other, net	\$ 10	\$ 14	\$ —

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (11) Long-Term Debt

As of December 31, 2010 and 2009, long-term debt was as follows:

<u>(dollars in millions)</u>	<u>2010</u>	<u>2009</u>
Senior Secured Term Loan due 2014	\$ 1,680	\$ 1,680
Senior Notes due 2011 (10.75%)	—	3
Senior Notes due 2013 (12.25%)	—	550
Senior Notes due 2014 (9.25%)	1,250	1,250
Floating Rate Senior Notes due 2015 (4.344% as of December 31, 2010 and 4.601% as of December 31, 2009)	300	300
Senior Notes due 2017 (8.75%)	700	700
Senior Notes due 2018 (10.0%)	640	—
Convertible Senior Notes due 2010 (2.875%)	—	40
Convertible Senior Notes due 2011 (5.25%)	196	199
Convertible Senior Notes due 2011 (10.0%)	—	172
Convertible Senior Notes due 2012 (3.5%)	294	294
Convertible Senior Notes due 2013 (15.0%)	400	400
Convertible Senior Discount Notes due 2013 (9.0%)	295	295
Convertible Senior Notes due 2015 (7.0%)	200	200
Convertible Senior Notes due 2015 Series B (7.0%)	275	275
Convertible Senior Notes due 2016 (6.5%)	201	—
Convertible Subordinated Notes due 2010 (6.0%)	—	111
Commercial Mortgage due 2015 (9.86% as of December 31, 2010 and 6.86% of December 31, 2009)	67	68
Capital Leases	29	32
Total Debt Obligations	<u>6,527</u>	<u>6,569</u>
Unamortized (Discount) Premium:		
Discount on Senior Secured Term Loan due 2014	(1)	(2)
Discount on Senior Notes due 2013 (12.25%)	—	(2)
Discount on Senior Notes due 2018 (10%)	(12)	—
Premium on Senior Notes due 2014 (9.25%)	7	8
Discount on Convertible Senior Notes due 2011 (5.25%)	(20)	(38)
Discount on Convertible Senior Notes due 2012 (3.5%)	(29)	(46)
Discount on Convertible Senior Notes due 2015 (7.0%)	(3)	(4)
Discount due to embedded derivative contracts	(21)	(25)
Total Unamortized (Discount) Premium	<u>(79)</u>	<u>(109)</u>
Carrying Value of Debt	6,448	6,460
Less current portion	(180)	(705)
Long-term Debt, less current portion	<u>\$ 6,268</u>	<u>\$ 5,755</u>

## 2010 Debt Issuances

During the third quarter of 2010, the Company issued \$175 million aggregate principal amount of its 6.5% Convertible Senior Notes due 2016 (the "6.5% Convertible Senior Notes"). The net proceeds from the issuance of the 6.5% Convertible Senior Notes were approximately \$170 million after





**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(11) Long-Term Debt (Continued)**

deducting debt issuance costs. In connection with the issuance of the Company's 6.5% Convertible Senior Notes, the Company granted an overallotment option to the underwriters to purchase up to an additional \$26 million aggregate principal amount of these notes less the underwriting discount. The underwriters exercised the overallotment option in full during the fourth quarter of 2010, and the Company received net proceeds of approximately \$25.5 million, after deducting underwriting discounts and commissions. The 6.5% Convertible Senior Notes will mature on October 1, 2016 and have an interest rate of 6.5% per annum with interest payable semiannually on April 1 and October 1, beginning April 1, 2011. Debt issue costs of approximately \$6 million were capitalized and are being amortized over the term of the 6.5% Convertible Senior Notes.

During the first quarter of 2010, Level 3 Financing, Inc. issued \$640 million in aggregate principal amount of its 10% Senior Notes due 2018 (the "10% Senior Notes") in a private offering. The net proceeds from the issuance of the 10% Senior Notes were \$613 million after deducting a \$13 million discount and approximately \$14 million of debt issuance costs. The net proceeds were used to fund Level 3 Financing, Inc.'s purchase of its 12.25% Senior Notes due 2013 (the "12.25% Senior Notes") in a concurrent tender offer and consent solicitation. The 10% Senior Notes will mature on February 1, 2018 and are guaranteed by Level 3 Communications, Inc. and Level 3 Communications, LLC (see Note 16—Condensed Consolidating Financial Information). Interest on the notes accrues at 10% per year and is payable on February 1 and August 1 of each year, beginning August 1, 2010.

The offering of the 10% Senior Notes was not originally registered under the Securities Act of 1933, as amended, and included a registration rights agreement. In June 2010, all of the originally placed notes were exchanged for a new issue of 10% Senior Notes due 2018 with identical terms and conditions, other than those related to registration rights, in a registered exchange offer and are now freely tradable.

*2010 Tender Offer*

In the first quarter of 2010, Level 3 Financing, Inc. commenced a tender offer to purchase for cash any and all of the outstanding \$550 million aggregate principal amount of its 12.25% Senior Notes for a price equal to \$1,080.00 per \$1,000 principal amount of the notes, which included \$1,050.00 as the tender offer consideration and \$30.00 as a consent payment (the "12.25% Tender Offer"). In connection with the 12.25% Tender Offer, Level 3 and Level 3 Financing, Inc. solicited consents to certain proposed amendments to the indenture governing the 12.25% Senior Notes to eliminate substantially all of the covenants, certain repurchase rights and certain events of default and related provisions contained in the indenture.

Holders of the 12.25% Senior Notes, representing approximately 99.4% of the aggregate principal amount of the outstanding 12.25% Senior Notes, participated in the tender offer. At the expiration of the tender offer, an aggregate principal amount of \$546,912,000 notes had been tendered. The Company redeemed in full the remaining \$3 million aggregate principal of the 12.25% Senior Notes, at a redemption price equal to 106.125% of the principal amount thereof, plus accrued and unpaid interest.

The Company recognized a loss associated with the 12.25% Tender Offer of approximately \$55 million.

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(11) Long-Term Debt (Continued)***2010 Debt Redemptions and Repurchases*

In the third quarter of 2010, the Company repaid the \$38 million aggregate principal amount of its 2.875% Convertible Senior Notes due 2010 that matured on July 15, 2010.

In the second quarter of 2010, the Company redeemed all of the outstanding \$172 million aggregate principal amount of its 10% Convertible Senior Notes due 2011 for a price equal to \$1,016.70 per \$1,000 principal amount of the notes plus accrued and unpaid interest up to, but not including the redemption date. The Company used cash on hand to fund the redemption of these notes, and recognized a loss on extinguishment of approximately \$4 million.

In the first quarter of 2010, the Company repaid \$111 million aggregate principal amount of its 6% Convertible Subordinated Notes due 2010 that matured on March 15, 2010. In addition, in various transactions during the first quarter of 2010, the Company repurchased \$3 million in aggregate principal amount of 5.25% Convertible Senior Notes due 2011, the remaining \$3 million of its 10.75% Senior Notes due 2011, and \$2 million aggregate principal amount of 2.875% Convertible Senior Notes due 2010. Repurchases were made at prices to par ranging from 95% to 100%, and the Company recognized a net loss on these repurchases of less than \$1 million.

*2009 Debt Issuances*

During the second quarter of 2009, Level 3 Financing amended and restated its existing senior secured credit facility to increase the borrowings through the creation of a \$280 million Tranche B Term Loan that matures on March 13, 2014 with a current interest rate of LIBOR plus 8.50% per annum, with LIBOR set at a minimum of 3.00%. The net proceeds of the Tranche B Term Loan were approximately \$274 million after deducting a \$2 million original issue discount and \$4 million of debt issuance costs.

Level 3 Financing's obligations under the Tranche B Term Loan are, subject to certain exceptions, secured by certain of the assets of (i) the Company and (ii) certain of the Company's material domestic subsidiaries which are engaged in the communications business. The Company and certain of its subsidiaries have also guaranteed the obligations of Level 3 Financing under the Tranche B Term Loan.

No changes were made to any of the restrictive covenants or events of default contained in the existing senior secured credit facility.

During the fourth quarter of 2009, Level 3 Communications, Inc. issued (at par) \$275 million aggregate principal of 7% Convertible Senior Notes due 2015, Series B, (the "7% Convertible Senior Notes, Series B"). The net proceeds approximated \$274 million after deducting debt issuance costs of approximately \$1 million. These new notes are substantially similar in all respects to the \$200 million of 7% Convertible Notes due 2015 issued on June 26, 2009, except that these notes were a separate series (Series B). The 7% Convertible Senior Notes due 2015, Series B, will mature on March 15, 2015 and have an interest rate of 7% per annum with interest payable semi-annually on March 15 and September 15, beginning on March 15, 2010.

*2009 Debt Exchange*

During the second quarter of 2009, the Company exchanged approximately \$142 million aggregate principal amount of the Company's 6% Convertible Subordinated Notes due 2010 and approximately

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**(11) Long-Term Debt (Continued)**

\$140 million aggregate principal amount of its 2.875% Convertible Senior Notes due 2010 for \$200 million aggregate principal amount of the Company's 7% Convertible Senior Notes due 2015 ("7% Convertible Notes due 2015") and \$78 million in cash, plus accrued and unpaid interest.

The Company recognized a net gain on the exchange transaction, after deducting \$1 million in unamortized debt issuance costs, of approximately \$7 million.

The Company paid approximately \$3 million of debt issuance costs in the third quarter related to this transaction.

*2009 Debt Repurchases and Maturities*

In the first quarter of 2009, the Company repurchased \$5 million aggregate principal amount of its 6% Convertible Senior Notes due 2009 and \$1 million aggregate principal amount of its 11.5% Senior Notes due 2010 at discounts to the principal amounts and recognized a net gain on extinguishment of less than \$1 million.

In the second quarter of 2009, the Company repurchased approximately \$301 million aggregate principal amount of various issues of its convertible debt at discounts to the principal amount and recognized a net gain on extinguishment of debt of approximately \$7 million. The gain consisted of a \$33 million cash gain, which was partially offset by \$20 million of unamortized debt discount, \$1 million in unamortized debt issuance costs and a \$5 million increase to equity for the component of the convertible debt subject to guidance for convertible debt that may be settled in cash upon conversion.

The second quarter 2009 debt repurchases consisted of \$121 million in 2009 maturities, \$50 million in 2010 maturities, \$106 million in 2011 maturities and \$24 million in 2012 maturities. The second quarter 2009 debt repurchases consisted of the following:

- \$121 million aggregate principal amount of 6% Convertible Subordinated Notes due 2009;
- \$47 million aggregate principal amount of 6% Convertible Subordinated Notes due 2010;
- \$3 million aggregate principal amount of 2.875% Convertible Senior Notes due 2010;
- \$75 million aggregate principal amount of 5.25% Convertible Senior Notes due 2011;
- \$31 million aggregate principal amount of 10% Convertible Senior Notes due 2011; and
- \$24 million aggregate principal amount of 3.5% Convertible Senior Notes due 2012.

In the third quarter of 2009, \$55 million of outstanding aggregate principal of the Company's 6% Convertible Subordinated Notes due 2009 matured. In addition, during the third quarter of 2009, the Company repurchased approximately \$39 million aggregate principal amount of various issues of its convertible and floating rate debt at discounts to the principal amount and recognized a net gain on extinguishment of debt of approximately \$2 million. The third quarter 2009 debt repurchases consisted of \$11 million in 2010 maturities and \$28 million in 2011 maturities. The third quarter 2009 debt repurchases consisted of the following:

- \$25 million aggregate principal amount of 10% Convertible Senior Notes due 2011
- \$8 million aggregate principal amount of 6% Convertible Subordinated Notes due 2010;
- \$3 million aggregate principal amount of 2.875% Convertible Senior Notes due 2010; and

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(11) Long-Term Debt (Continued)**

- \$3 million aggregate principal amount of Floating Rate Notes due 2011.

During the fourth quarter of 2009, the Company repurchased approximately \$73 million aggregate principal amount of various issues of its convertible and floating rate debt at discounts to the principal amount and recognized a net loss on extinguishment of debt of approximately \$2 million. The loss consisted of \$11 million of unamortized debt discount and unamortized debt issuance costs partially offset by a cash gain of \$6 million and a \$3 million decrease to equity for the component of the convertible debt subject to the guidance for convertible debt that may be settled in cash upon conversion. The fourth quarter 2009 debt repurchases consisted of the following:

- \$56 million aggregate principal amount of 5.25% Convertible Senior Notes due 2011
- \$7 million aggregate principal amount of 3.5% Convertible Senior Notes due 2012;
- \$7 million aggregate principal amount of 2.875% Convertible Senior Notes due 2010; and
- \$3 million aggregate principal amount of Floating Rate Notes due 2011.

*2009 Debt Redemption*

The Company redeemed the remaining \$13 million aggregate principal amount of its 11.5% Senior Notes due 2010 at 100% of the outstanding principal amount in the second quarter of 2009.

*Convertible Debt That May be Settled in Cash Upon Conversion*

During 2008, the FASB issued accounting guidance that requires issuers of convertible debt that may be settled in cash upon conversion 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. This guidance applies to certain of the Company's convertible debt that may be settled in cash upon conversion and was applied retrospectively to all periods presented in the Company's consolidated financial statements upon adoption in 2009. Although the adoption of this accounting guidance did not affect the Company's actual past or future cash flows, the Company incurred additional non-cash interest expense as a result of this accounting guidance of approximately \$35 million and \$39 million for the years ended December 31, 2010 and 2009, respectively. The Company expects to incur additional non-cash interest expense of \$22 million for the year ended December 31, 2011 and \$10 million for the year ended December 31, 2012, assuming no further debt repurchases, modifications, extinguishments or conversion of its convertible debt subject to accounting under this guidance prior to maturity.

This guidance is only applicable to the Company's 5.25% Convertible Senior Notes due 2011 and 3.5% Convertible Senior Notes due 2012, as the Company has the right to deliver cash in lieu of shares of its common stock, or a combination of cash and shares of common stock, upon conversion for each of these issuances. The 5.25% Convertible Senior Notes are convertible, at the option of the holders, into approximately 49 million shares of the Company's common stock as of December 31, 2010, at a conversion price of \$3.98 per share, subject to certain adjustments. The 3.5% Convertible Senior Notes are convertible, at the option of the holders, into approximately 54 million shares of the Company's common stock as of December 31, 2010, at a conversion price of \$5.46 per share, subject to certain adjustments.

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (11) Long-Term Debt (Continued)

The Company recognized total interest expense of approximately \$56 million, \$64 million and \$66 million during the years ended December 31, 2010, 2009 and 2008, respectively, related to both the contractual interest coupon and amortization of the discount for the liability component of the Company's 5.25% Convertible Senior Notes and 3.5% Convertible Senior Notes. The effective interest rate on the liability component of the Company's 5.25% Convertible Senior Notes is approximately 17%. The effective interest rate on the liability component of the Company's 3.5% Convertible Senior Notes is approximately 11%. The Company is amortizing the discount on the liability component of its 5.25% Convertible Senior Notes and 3.5% Convertible Senior Notes over the remaining term of each issuance.

The carrying amount of the equity component, principal amount of the liability component, unamortized debt discount related to the liability component and net carrying amount of the liability component of the Company's convertible debt that may be settled in cash upon conversion as of December 31, 2010 and December 31, 2009 were as follows (in millions):

	December 31, 2010	December 31, 2009
Carrying amount of equity component	\$ 243	\$ 243
Principal amount of liability component	\$ 490	\$ 493
Unamortized discount related to liability component	(49)	(84)
Net carrying amount of liability component	<u>\$ 441</u>	<u>\$ 409</u>

*Senior Secured Term Loan due 2014*

On March 13, 2007, Level 3 Communications, Inc., 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 to Level 3 Financing. The \$1.4 billion senior secured term loan has an interest rate of LIBOR plus an applicable margin of 2.25% per annum. In addition, during the second quarter of 2009, Level 3 Financing amended and restated its existing senior secured Credit Agreement to increase the borrowings through the creation of a \$280 million Tranche B Term Loan with a current interest rate of LIBOR plus 8.50% per annum, with LIBOR set at a minimum of 3.00%. The entire \$1.68 billion senior secured term loan ("Senior Secured Term Loan due 2014") matures on March 13, 2014.

The borrower has the option of electing one, two, three or six month LIBOR at the end of each interest period and may elect different options with respect to different portions of the Senior Secured Term Loan due 2014. Interest 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 interest rate on \$1.0 billion of the Senior Secured Term Loan due 2014 resets quarterly and was 2.54% and 2.53% as of December 31, 2010 and 2009, respectively. The interest rate on \$400 million resets quarterly and was 2.54% and 2.53% as of December 31, 2010 and 2009, respectively. The interest rate on the remaining \$280 million of the Senior Secured Term Loan due 2014 issued in the second quarter of 2009 currently resets semiannually and was 11.5% as of December 31, 2010 and 2009.

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(11) Long-Term Debt (Continued)**

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 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.

Debt issuance costs of \$22 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 \$12 million at December 31, 2010.

*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 are treated as a single series of notes. The Company received total net proceeds of \$1.239 billion (excluding prepaid interest). The Notes were subsequently registered through a public exchange offer.

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—Condensed Consolidating Financial Information). 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, 2010, the premium remaining was approximately \$7 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



## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (11) Long-Term Debt (Continued)

prices (expressed as a percentage of principal amount) set forth below, plus accrued and unpaid interest thereon to the redemption date, if redeemed during the twelve months beginning November 1, of the years indicated below:

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

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 \$13 million at December 31, 2010.

*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 Notes were subsequently registered through a public exchange offer. 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—Condensed Consolidating Financial Information). 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 15<sup>th</sup> 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 4.34% at December 31, 2010. 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.

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.

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (11) Long-Term Debt (Continued)

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%

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, 2010 at the redemption prices (expressed as a percentage of principal amount) set forth below, plus accrued and unpaid interest thereon to the redemption date, if redeemed during the twelve months beginning February 15, of the years indicated below:

<u>Year</u>	<u>Redemption Price</u>
2010	101.0%
2011	100.0%

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.

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 \$11 million at December 31, 2010.

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 \$3 million at December 31, 2010.

*10% Senior Notes due 2018*

On January 20, 2010, Level 3 Financing, Inc. received \$613 million proceeds, after deducting a \$13 million discount and approximately \$14 million of debt issuance costs, from a private offering of \$640 million in aggregate principal amount of its 10% Senior Notes due 2018 (the "10% Senior Notes"). The net proceeds were used to fund Level 3 Financing, Inc.'s purchase of its 12.25% Senior Notes due 2013 (the "12.25% Senior Notes") in a concurrent tender offer and consent solicitation. The 10% Senior Notes will mature on February 1, 2018 and are guaranteed by Level 3 Communications, Inc. and Level 3 Communications, LLC (see Note 16—Condensed Consolidating Financial Information). Interest on the notes accrues at 10% per year and is payable on February 1 and August 1 of each year, beginning August 1, 2010. As of December 31, 2010, the discount remaining was approximately \$12 million.

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(11) Long-Term Debt (Continued)**

As a result of amortization, the capitalized debt issuance costs have been reduced to approximately \$13 million at December 31, 2010.

The offering of the 10% Senior Notes was not originally registered under the Securities Act of 1933, as amended, and included a registration rights agreement. In June 2010, all of the originally placed notes were exchanged for a new issue of 10% Senior Notes due 2018 with identical terms and conditions, other than those related to registration rights, in a registered exchange offer and are now freely tradable.

*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 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.

During 2009, the Company repurchased approximately \$131 million aggregate principal amount of its 5.25% Convertible Senior Notes at discounts to the principal amount and recognized a net loss on extinguishment of debt of approximately \$3 million.

In 2010, the Company repurchased \$3 million in aggregate principal amount of its 5.25% Convertible Senior Notes and recognized a net loss on extinguishment of debt of less than \$1 million.

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 price 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 had 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.

The Company may redeem for cash, at its option, all or a portion of the notes at any time. The 5.25% Convertible Senior Notes are subject to redemption, in whole or in part, at any time or from time to time, on not more than 60 nor less than 30 days' notice at a purchase price of 100.75% of the

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(11) Long-Term Debt (Continued)**

principal amount plus accrued and unpaid interest thereon to the redemption date. In February 2011, the Company redeemed the 5.25% Convertible Senior Notes at a redemption price of 100.75% (See Note 17—Subsequent Events).

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, repurchases and exchanges, the remaining unamortized debt issuance costs were less than \$1 million at December 31, 2010.

*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 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 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 approximately \$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.

During 2009, in various transactions, the Company repurchased approximately \$31 million aggregate principal amount of its 3.5% Convertible Senior Notes at discounts to the principal amount and recognized a net gain on extinguishment of debt of approximately \$3 million.

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.

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**(11) Long-Term Debt (Continued)**

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 plus accrued and unpaid interest thereon (if any) to the redemption date. If redeemed before maturity, the Company will pay a premium on the principal amount redeemed. The premium for the twelve months beginning June 15, 2010 is equal to 1.17% and for the twelve month period beginning June 15, 2011 is 0.58%.

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 \$1 million at December 31, 2010.

*15% Convertible Senior Notes Due 2013*

On December 24, 2008, the Company received gross proceeds of \$374 million and on December 31, 2008, the Company received gross proceeds of \$26 million from the issuance of its \$400 million 15% Convertible Senior Notes due 2013 ("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

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(11) Long-Term Debt (Continued)**

the effect of increasing the number of shares due to holders of the 15% Convertible Senior Notes upon conversion.

Debt issuance costs of \$3 million were originally capitalized and are being amortized to interest expense over the term of the 15% Convertible Senior Notes. The unamortized debt issuance costs were approximately \$2 million at December 31, 2010.

*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 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.

The 9% Convertible Senior Discount Notes are convertible into shares of the Company's common stock at a conversion price 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. If the initial holders sell greater than 33.33% of the notes, this amount decreases to 130% and 120% effective October 15, 2009 and 2010, respectively. 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. See Note 17—Subsequent Events—for additional information regarding these notes.

*7% Convertible Senior Notes due 2015*

On June 26, 2009, Level 3 Communications, Inc. issued \$200 million aggregate principal amount of 7% Convertible Notes due 2015 under an indenture between Level 3 and The Bank of New York, as trustee. The 7% Convertible Notes due 2015 were issued in conjunction with the exchange of approximately \$142 million aggregate principal amount of the Company's 6% Convertible Subordinated Notes due 2010 and approximately \$140 million aggregate principal amount of its 2.875% Convertible Senior Notes due 2010. As part of this exchange, Level 3 also paid \$78 million in cash, including accrued and unpaid interest for the notes exchanged.

On October 15, 2009, Level 3 issued \$275 million aggregate principal amount of 7% Convertible Senior due 2015, Series B under a second supplemental indenture between Level 3 and The Bank of New York, as trustee. The 7% Convertible Senior Notes due 2015, Series B are substantially similar in all respects to the 7% Convertible Senior Notes due 2015. The 7% Convertible Senior Notes due 2015,

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(11) Long-Term Debt (Continued)**

together with the 7% Convertible Senior Notes due 2015, Series B are referred to as the "7% Convertible Senior Notes due 2015".

The 7% Convertible Senior Notes due 2015 mature on March 15, 2015 and bear interest at a rate of 7% per annum, payable semiannually in arrears on March 15 and September 15. Interest payments commence for the 7% Convertible Senior Notes due 2015, Series A on September 15, 2009 and on March 15, 2010 for the 7% Convertible Senior Notes due 2015, Series B. The 7% Convertible Senior Notes due 2015 rank equally in right of payment with all other existing and future senior unsecured indebtedness of Level 3 Communications, Inc.

The 7% Convertible Senior Notes due 2015 are convertible into shares of Level 3 common stock, at the option of the holder, at any time prior to maturity, unless previously repurchased or redeemed, or unless Level 3 has caused the conversion rights to expire. The 7% Convertible Senior Notes due 2015 may be converted at the initial rate of 555.5556 shares of common stock per each \$1,000 principal amount of notes, subject to adjustment in certain circumstances. This is equivalent to a conversion price of approximately \$1.80 per share.

Upon the occurrence of a designated event (a change of control or a termination of trading), holders of the 7% Convertible Senior Notes due 2015 will have the right, subject to certain exceptions and conditions, to require Level 3 to repurchase all or any part of the 7% Convertible Senior Notes due 2015 at a repurchase price equal to 100% of the principal amount plus accrued and unpaid interest thereon (if any) to, but excluding, the designated event purchase date. In addition, if an event treated as a change in control of Level 3 occurs, Level 3 will be obligated, subject to certain conditions, to offer to purchase all of the outstanding 7% Convertible Senior Notes due 2015 at a purchase price of 100% of the principal amount, plus a "make whole" premium, by increasing the conversion rate applicable to such 7% Convertible Senior Notes due 2015.

Debt issuance costs of \$4 million were originally capitalized and are being amortized to interest over the term of the 7% Convertible Senior Notes due 2015 using the effective interest method. The unamortized debt issuance costs were approximately \$4 million at December 31, 2010.

*6.5% Convertible Subordinated Notes due 2016*

On September 20, 2010, the Company received \$170 million of net proceeds after transaction costs, from a public offering of \$175 million aggregate principal amount of its 6.5% Convertible Senior Notes due 2016 (the "6.5% Convertible Senior Notes"). On October 5, 2010, in connection with the underwriters' exercise of the \$26 million over-allotment option associated with the 6.5% Convertible Senior Notes, the Company received an additional \$25.5 million net proceeds after transaction costs of less than \$1 million. The 6.5% Convertible Senior Notes are senior unsecured obligations of the Company and rank equally in right of payment with all other existing and future unsubordinated indebtedness of Level 3 Communications, Inc. The 6.5% Convertible Senior Notes will mature on October 1, 2016. Interest on the notes accrues at 6.5% per year and is payable semiannually on April 1 and October 1, beginning April 1, 2011.

The 6.5% Convertible Senior Notes are convertible by holders into shares of the Company's common stock at any time prior maturity, unless previously redeemed, repurchased or unless the Company has caused the conversion rights to expire. The initial conversion rate is 809.7166 shares per each \$1,000 principal amount of 6.5% Convertible Senior Notes, subject to adjustment in certain



**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(11) Long-Term Debt (Continued)**

circumstances. This is equivalent to a conversion price of approximately \$1.235 per share. In addition, if a designated event (a change in control or a termination of trading) occurs, Level 3 will be obligated, subject to certain conditions, to offer to purchase all of the outstanding 6.5% Convertible Senior Notes due 2016 at a purchase price of 100% of the principal amount, plus accrued and unpaid interest thereon. If an event treated as a change in control occurs, the Company will be obligated, subject to certain conditions, to offer to purchase all of the outstanding 6.5% Convertible Senior Notes at a purchase price of 100% of the principal amount plus a "make whole" premium, by increasing the conversion rate applicable to such 6.5% Convertible Senior Notes due 2016.

Debt issuance costs of \$6 million were originally capitalized and are being amortized to interest expense over the term of the 6.5% Convertible Senior Notes. The capitalized unamortized debt issuance costs remain approximately \$6 million at December 31, 2010.

*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 October 1, 2010, the initial repayment date as defined in the loan agreement ("Commercial Mortgage"). HQ Realty, Inc. received \$66 million of net proceeds after transaction costs. During 2010, at the election of HQ Realty, Inc. the maturity term of the Commercial Mortgage was extended to October 1, 2015 and the interest rate adjusted to 9.86%. 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. HQ Realty, Inc. has deposited \$8 million into restricted cash accounts as of December 31, 2010, for future facility improvements and property taxes.

Debt issuance costs of \$1 million were capitalized and are being amortized as interest expense over the term of the Commercial Mortgage. The capitalized debt issuance costs have been fully amortized as of December 31, 2010.

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, 2010. Depreciation expense related to assets under capital leases is included in depreciation and amortization expense.

*Covenant Compliance*

At December 31, 2010 and 2009, 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 contractual maturities of long-term debt and capital leases (excluding issue discounts, premiums and fair value adjustments) were as follows as of December 31, 2010 (in millions):

2011	\$ 200
2012	299
2013	700
2014	2,937
2015	833
Thereafter	1,558
	<u>\$ 6,527</u>

See Note 17—Subsequent Events—for information regarding our financing activities subsequent to December 31, 2010.

## (12) Stock-Based Compensation

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 other stock-based compensation associated with the Company's discretionary bonus grants. Total non-cash compensation expense related to these equity awards was \$67 million in 2010, \$59 million in 2009 and \$78 million in 2008.

The following table summarizes non-cash compensation expense and capitalized non-cash compensation for each of the three years ended December 31, 2010 (in millions):

	<u>2010</u>	<u>2009</u>	<u>2008</u>
OSO	10	\$ 7	\$ 13
Restricted Stock Units and Shares	19	23	36
401(k) Match Expense	11	16	30
Restricted Stock Unit Bonus Grant	28	14	—
	<u>68</u>	<u>60</u>	<u>79</u>
Capitalized Noncash Compensation	(1)	(1)	(1)
	<u>\$ 67</u>	<u>\$ 59</u>	<u>\$ 78</u>

OSOs and restricted stock units and shares are granted under the Level 3 Communications, Inc. Stock Plan, as amended (the "Stock Plan"), which term extends through May 20, 2020. The Stock Plan 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 the Stock Compensation guidance, 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 \$8 million in 2010, \$5 million in 2009 and \$7 million in 2008.

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (12) Stock-Based Compensation (Continued)

*Outperform Stock Options*

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, 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&amp;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 <sup>4</sup> / 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 as 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.

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 were 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

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (12) Stock-Based Compensation (Continued)

units granted on or after April 1, 2007, thus the expected life of all such OSO units is three years. During the first quarter of 2010, the Company revised the eligibility criteria and grant schedule for its non-cash compensation. Effective April 1, 2010, the Company's OSOs are granted quarterly to certain levels of management and its RSUs are granted annually on July 1 to certain other eligible employees. There were no changes to the vesting schedule, or any other aspects of the non-cash compensation plans.

As of December 31, 2010, there was \$9 million of unamortized compensation expense related to granted OSO units. The weighted average period over which this cost will be recognized is 1.90 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 market conditions and 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.

	Year Ended December 31,		
	2010	2009	2008
S&P 500 Expected Dividend Yield Rate	2.00%	3.00%	2.00%
Expected Life	3 years	3 years	3 years
S&P 500 Expected Volatility Rate	30%	26%	13%
Level 3 Common Stock Expected Volatility Rate	51%	45%	56%
Expected S&P 500 Correlation Factor	.40	.46	.32
Calculated Theoretical Value	132%	119%	147%
Estimated Forfeiture Rate	20%	20%	12%

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

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. The Company estimates the stock price volatility using a combination of historical and implied volatility as Level 3 believes it is consistent with the approach most marketplace participants would consider using all available information to estimate expected volatility. The Company has determined that expected volatility is more reflective of market conditions and provides a more accurate indication of volatility than using solely historical volatility. In reaching this conclusion, the Company has considered many factors including the extent to which its future expectations of volatility over the respective term is likely to differ from historical measures, the absence of actively traded options and the Company's ability to review volatility of its publicly traded convertible debt with similar terms and prices to the securities the Company is valuing.

The fair value for OSO units awarded to participants during the years ended December 31, 2010, 2009 and 2008 was approximately \$10 million, \$8 million and \$18 million, respectively.

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (12) Stock-Based Compensation (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 January 1, 2008	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 forfeited	(1,552,070)	1.05 - 6.10	4.65		
Options expired	(2,228,545)	2.03 - 5.70	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 granted	7,167,525	.70 - 1.51	1.15		
Options forfeited	(2,320,959)	.70 - 6.10	3.25		
Options expired	(4,804,432)	2.03 - 5.39	3.23		
Options exercised	—	—	—		
Balance December 31, 2009	15,849,402	\$.70 - \$6.10	\$ 2.95	\$ 5.2	1.55 years
Options granted	7,666,238	.94 - 1.62	1.30		
Options forfeited	(1,760,421)	.70 - 6.10	1.72		
Options expired	(5,909,322)	3.03 - 6.10	5.13		
Options exercised	—	—	—		
Balance December 31, 2010	15,845,897	\$.70 - \$3.44	\$ 1.47	\$ —	1.73 years
Options exercisable ("vested"):					
December 31, 2008	7,962,066	\$2.03 - \$5.39	\$ 3.95		
December 31, 2009	3,298,799	\$4.44 - \$5.39	\$ 5.01		
December 31, 2010	—	—	—	\$ —	N/A

N/A—Not Applicable

Range of Exercise Prices	OSO units Outstanding at December 31, 2010		OSO units Exercisable at December 31, 2010	
	Number Outstanding	Weighted Average Remaining Life (years)	Number Exercisable	Weighted Average Initial Strike Price
\$ .70 - \$1.05	3,702,184	1.90	—	\$ 0.00
\$1.07 - \$1.59	8,083,965	1.92	—	\$ 0.00
\$1.62 - \$2.23	2,199,253	1.84	—	\$ 0.00
\$2.70 - \$3.44	1,860,495	.43	—	\$ 0.00
	15,845,897		—	

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (12) Stock-Based Compensation (Continued)

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, 2010. As noted above, all of the outstanding OSO units granted have an expected life of three years with no intrinsic value based on the Company's performance against the S&P 500 Index as of December 31, 2010.

The total realized value of OSO units exercised was zero, zero and \$2 million for the years ended December 31, 2010, 2009 and 2008, respectively. The Company issued approximately zero, zero and 466,000 shares of Level 3 common stock upon the exercise of OSO units for the years ended December 31, 2010, 2009 and 2008, 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, 2010, 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*

Effective April 1, 2010, restricted stock units and shares are annually granted to certain other eligible 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 \$21 million, \$16 million and \$43 million, for the years ended December 31, 2010, 2009 and 2008, 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, 2010, unamortized compensation cost related to nonvested restricted stock and restricted stock units was \$14 million and the weighted average period over which this cost will be recognized is 2.67 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 January 1, 2008	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	26,133,799	3.26
Stock and units granted	13,618,696	1.15
Lapse of restrictions	(11,854,329)	3.11
Stock and units forfeited	(3,969,484)	2.74
Nonvested at December 31, 2009	23,928,682	2.22
Stock and units granted	17,735,296	1.17
Lapse of restrictions	(8,918,701)	2.58
Stock and units forfeited	(2,419,674)	1.77
Nonvested at December 31, 2010	<u>30,325,603</u>	<u>\$ 1.53</u>

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(12) Stock-Based Compensation (Continued)**

The total fair value of restricted stock and restricted stock units whose restrictions lapsed in the years ended December 31, 2010, 2009 and 2008 was \$23 million, \$37 million and \$35 million, respectively.

*Warrants*

As of December 31, 2010, there were approximately 1 million warrants outstanding ranging in exercise price from \$4.00 to \$4.90, expiring in April 2011 and January 2013. All of the warrants are fully vested and compensation expense had been fully recognized in the consolidated statements of operations. The weighted average exercise price of these warrants was \$4.58 as of December 31, 2010.

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. The remaining 1 million of the Broadwing warrants expired in the fourth quarter of 2010.

*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 \$16,500 in 2010. Effective March 6, 2009, the Company matches 100% of employee contributions up to 3% of eligible earnings or applicable regulatory limits. Prior to March 6, 2009, the Company matched 100% of employee contributions up to 7% 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 \$11 million, \$16 million and \$30 million for the years ended December 31, 2010, 2009 and 2008, respectively. The Company's matching contributions are recorded as non-cash compensation and included in selling, general and administrative expenses.

*Restricted Stock Unit Bonus Grant*

In 2009 the Company paid a portion of its discretionary bonus in the form of restricted stock units. Restricted stock units of approximately 26 million shares will be awarded in the first quarter of 2011



## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (12) Stock-Based Compensation (Continued)

for 2010 bonus payouts and will vest upon award. Restricted stock units of approximately 10 million shares were awarded in the first quarter of 2010 and vested upon award.

## (13) Income Taxes

An analysis of the income tax benefit (provision) attributable to loss before income taxes for each of the years in the three year period ended December 31, 2010 follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(dollars in millions)		
Current:			
United States federal	\$ —	\$ —	\$ 1
State	(1)	—	(7)
Foreign	—	—	—
	<u>(1)</u>	<u>—</u>	<u>(6)</u>
Deferred, net of changes in valuation allowances:			
United States federal	—	—	—
State	—	(1)	—
Foreign	92	—	—
Income tax benefit (provision)	<u>\$ 91</u>	<u>\$ (1)</u>	<u>\$ (6)</u>

The United States and foreign components of loss before income taxes are as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(dollars in millions)		
United States	\$ (543)	\$ (513)	\$ (216)
Foreign	(170)	(104)	(96)
	<u>\$ (713)</u>	<u>\$ (617)</u>	<u>\$ (312)</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 before income taxes for each of the years in the three-year period ended December 31, 2010 follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(dollars in millions)		
Computed tax benefit at statutory rate	\$ 250	\$ 216	\$ 109
Effect of earnings in jurisdictions outside of US	(13)	—	—
Foreign branch tax benefit	21	—	—
State income tax benefit	24	20	9
Change in valuation allowance	(175)	(253)	(102)
Disallowance of losses on extinguishments of debt	—	—	(15)
Other, net	(16)	16	(7)
Income tax benefit (provision)	<u>\$ 91</u>	<u>\$ (1)</u>	<u>\$ (6)</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, 2010 and 2009 were as follows:

	<u>2010</u>	<u>2009</u>
	(dollars in millions)	
Deferred Tax Assets:		
Accrued payroll and related benefits	\$ 77	\$ 64
State tax credit carry forwards	22	22
Deferred revenue	285	268
Unutilized tax net operating loss carry forwards	2,691	2,017
Fixed assets and intangible assets	38	—
Cash flow hedge	41	35
Other	59	69
Total Deferred Tax Assets	<u>3,213</u>	<u>2,475</u>
Deferred Tax Liabilities:		
Fixed assets and intangible assets	(79)	(27)
Convertible debt	(27)	(32)
Other	(2)	—
Foreign branch income	(40)	—
Total Deferred Tax Liabilities	<u>(148)</u>	<u>(59)</u>
Net Deferred Tax Assets before valuation allowance	3,065	2,416
Valuation Allowance	<u>(2,978)</u>	<u>(2,394)</u>
Net Deferred Tax Asset after Valuation Allowance	<u>\$ 87</u>	<u>\$ 22</u>
Balance sheet classification of deferred taxes:		
Net current deferred income tax asset	\$ —	\$ —
Net non-current deferred income tax asset	<u>87</u>	<u>22</u>
Net Deferred Tax Asset after Valuation Allowance	<u>\$ 87</u>	<u>\$ 22</u>

The Company has changed its presentation of certain deferred tax assets presented in the table above as of December 31, 2009 to be comparable with the presentation as of December 31, 2010. These changes are primarily reclassifications of the 2009 amounts to conform with the current year presentation, but also include certain immaterial corrections to components of prior year's income tax provisions. These changes to the Company's net deferred tax assets as of December 31, 2009 had no effect on the Company's results of operations or financial condition since a full valuation allowance was recognized against all deferred tax items affected by these changes. For the year ended December 31, 2010, the Company also recorded certain immaterial corrections of errors in prior year presentation that resulted in adjustments to net deferred tax assets, deferred tax benefit, and currency translation adjustments.

Level 3 also recognized approximately \$65 million of additional foreign jurisdiction net deferred tax assets (consisting principally of those related to net operating loss carryforwards and fixed assets), approximately \$27 million of related currency translation adjustments, and a corresponding net deferred tax benefit of approximately \$92 million principally resulting from the release of valuation allowances for certain of its foreign subsidiaries that had become profitable current and in prior periods. See

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (13) Income Taxes (Continued)

Note 1—Organization and Summary of Significant Accounting Policies, Correction of an Immaterial Error. As of December 31, 2010, the Company had net operating loss carry forwards of approximately \$5.9 billion for U.S. 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 ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. A valuation allowance has been recorded against U.S. and foreign jurisdiction deferred tax assets that the Company has concluded under relevant accounting standards that it is not more likely than not that the deferred tax assets are realizable.

The valuation allowance for deferred tax assets was approximately \$3.0 billion as of December 31, 2010 and \$2.4 billion as of December 31, 2009. The net change in the valuation allowance for the year ended December 31, 2010 was approximately \$584 million. The increase in the valuation allowance from December 31, 2009 to December 31, 2010 is due to recognition of foreign jurisdiction net deferred tax assets and an increase to the U.S. federal and state tax NOL resulting from continued operational tax losses.

The U.S. federal tax loss carry forwards expire in future years through 2030 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	\$ 532
2025	1,186
2026	1,029
2027	1,501
2028	356
2029	617
2030	659
	<u>\$ 5,880</u>

The Company has approximately \$55 million of foreign jurisdiction tax loss carry forwards for controlled foreign corporations at December 31, 2010. In addition, the Company has \$2.8 billion of foreign jurisdiction tax loss carry forwards associated with foreign corporations that have elected to be disregarded for US tax purposes. The majority of these foreign jurisdiction tax loss carry forwards have no expiration period. Finally, the Company has approximately \$5.5 billion of gross state tax loss carry forwards with various expiration periods through 2030.

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

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (13) Income Taxes (Continued)

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, 2010, 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, 2010 and 2009.

The Company's liability for uncertain tax positions totaled \$18 million at December 31, 2010, and \$16 million at December 31, 2009. These amounts also include the related accrued interest and penalties associated with the uncertain tax positions if applicable. The Company does not expect that the liability for uncertain tax positions will change significantly during the twelve months ended December 31, 2011; 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 January 1, 2008	\$ 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	16
Gross increases—tax positions prior to 2009	2
Gross decreases—settlements with taxing authorities	(2)
Balance as of December 31, 2009	16
Gross increases—tax position prior to 2010	2
Balance as of December 31, 2010	<u>\$ 18</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 with no changes in tax expense. In 2010 the Company completed an audit by the taxing authority in Germany for tax years 2003 through 2007 with no material changes to the Company's results of operations or financial condition. Additionally, in 2010 the Internal Revenue Service initiated an audit of one of the Company's coal mining joint ventures, in which it has a 50% interest.

The Company recognized accrued interest and penalties related to uncertain tax positions in income tax expense in its consolidated statements of operations of approximately \$2 million, \$1 million and \$2 million for the years ended December 31, 2010, 2009 and 2008, respectively. The Company's

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(13) Income Taxes (Continued)**

liability for uncertain tax positions includes approximately \$12 million and \$11 million of accrued interest and penalties at December 31, 2010 and 2009, respectively.

**(14) Segment Information**

Accounting guidance for the disclosures about segments of an enterprise defines operating segments as components of an enterprise for which separate financial information is available and which is evaluated regularly by the Company's chief operating decision maker, or decision making group, in deciding how to allocate resources and assess performance. The Company's operating segments are managed separately and represent separate strategic business units that offer different products or services and serve different markets. The Company's reportable segments include communications and coal mining (see Note 1—Organization and Summary of Significant Accounting Policies). Other business interests, which are not reportable segments, include corporate assets and overhead costs that are not attributable to a specific segment.

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

The data presented in the following tables includes information for the years ended December 31, 2010, 2009 and 2008 for all statement of operations and cash flow information presented, and as of December 31, 2010 and 2009 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):

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
<i>Revenue from external customers:</i>			
Communications	\$ 3,591	\$ 3,695	\$ 4,226
Coal Mining	60	67	75
	<u>3,651</u>	<u>\$ 3,762</u>	<u>\$ 4,301</u>
<i>Adjusted EBITDA:</i>			
Communications	\$ 849	\$ 910	\$ 1,039
Coal Mining	\$ 4	\$ —	\$ 5
<i>Capital expenditures:</i>			
Communications	\$ 435	\$ 308	\$ 446
Coal Mining	1	5	3
	<u>\$ 436</u>	<u>\$ 313</u>	<u>\$ 449</u>
<i>Depreciation and amortization:</i>			
Communications	\$ 870	\$ 906	\$ 929
Coal Mining	6	9	2
	<u>\$ 876</u>	<u>\$ 915</u>	<u>\$ 931</u>
<i>Total assets:</i>			
Communications	\$ 8,226	\$ 8,932	
Coal Mining	125	120	
Other	4	10	
	<u>\$ 8,355</u>	<u>\$ 9,062</u>	

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (14) Segment Information (Continued)

The following is a summary of geographical information (in millions):

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
<b><i>Revenue from external customers:</i></b>			
North America	\$ 3,335	\$ 3,436	\$ 3,975
Europe:			
United Kingdom	131	134	143
Germany	62	73	67
Other European Countries	123	119	116
Total Europe	<u>316</u>	<u>326</u>	<u>326</u>
	<u>\$ 3,651</u>	<u>\$ 3,762</u>	<u>\$ 4,301</u>
<b><i>Long-lived assets:</i></b>			
North America	\$ 5,239	\$ 5,648	
Europe:			
United Kingdom	114	121	
Germany	318	369	
Other European Countries	285	236	
Total Europe	<u>717</u>	<u>726</u>	
	<u>\$ 5,956</u>	<u>\$ 6,374</u>	

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 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 Network Services includes revenue from transport, infrastructure, data and local and enterprise voice communication services.
- 2) Wholesale Voice Services includes revenue from long distance voice services, including domestic voice termination, international voice termination and toll free services.
- 3) 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.



## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (14) Segment Information (Continued)

	<u>Core Network Services</u>	<u>Wholesale Voice Services</u>	<u>Other Communications Services</u>	<u>Total</u>
	(in millions)			
<b>Communications Revenue</b>				
<b>2010</b>				
North America	\$ 2,536	\$ 625	\$ 114	\$ 3,275
Europe	291	25	—	316
	<u>\$ 2,827</u>	<u>\$ 650</u>	<u>\$ 114</u>	<u>\$ 3,591</u>
<b>2009</b>				
North America	\$ 2,548	\$ 629	\$ 192	\$ 3,369
Europe	292	34	—	326
	<u>\$ 2,840</u>	<u>\$ 663</u>	<u>\$ 192</u>	<u>\$ 3,695</u>
<b>2008</b>				
North America	\$ 2,847	\$ 687	\$ 366	\$ 3,900
Europe	289	37	—	326
	<u>\$ 3,136</u>	<u>\$ 724</u>	<u>\$ 366</u>	<u>\$ 4,226</u>

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, 2010, 2009 and 2008 (in millions):

**2010**

	<u>Communications</u>	<u>Coal Mining</u>
Net Loss	\$ (617)	\$ (1)
Income Tax Benefit	(91)	—
Total Other (Income) Expense	620	(1)
Depreciation and Amortization Expense	870	6
Non-Cash Compensation Expense	67	—
Adjusted EBITDA	<u>\$ 849</u>	<u>\$ 4</u>

Total Net Loss for Reportable Segments	\$ (618)
Unallocated Corporate Expense	(4)
Consolidated Net Loss	<u>\$ (622)</u>

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (14) Segment Information (Continued)

2009

	<u>Communications</u>	<u>Coal Mining</u>
Net Income (Loss)	\$ (605)	\$ 6
Income Tax Provision (Benefit)	—	—
Total Other (Income) Expense	550	(15)
Depreciation and Amortization Expense	906	9
Non-Cash Compensation Expense	59	—
Adjusted EBITDA	<u>\$ 910</u>	<u>\$ —</u>

Total Net Loss for Reportable Segments	\$ (599)
Unallocated Corporate Expense	(19)
Consolidated Net Loss	<u>\$ (618)</u>

2008

	<u>Communications</u>	<u>Coal Mining</u>
Net Income (Loss)	\$ (322)	\$ 3
Income Tax Provision	4	—
Total Other (Income) Expense	350	—
Depreciation and Amortization Expense	929	2
Non-Cash Compensation Expense	78	—
Adjusted EBITDA	<u>\$ 1,039</u>	<u>\$ 5</u>

Total Net Loss for Reportable Segments	\$ (319)
Unallocated Corporate Expense	1
Consolidated Net Loss	<u>\$ (318)</u>

## (15) Commitments, Contingencies and Other Items

Level 3 Communications, Inc. and certain of its subsidiaries (the "companies") are parties to a number of purported class action lawsuits involving the companies' right to install fiber optic cable network in railroad right-of-ways adjacent to plaintiffs' land. The only lawsuit in which a class has been certified against the companies occurred in *Koyle, et. al. v. Level 3 Communications, Inc., et. al.*, a purported two state class action filed in the United States District Court for the District of Idaho. In November of 2005, the court granted class certification only for the state of Idaho. The companies have defeated motions for class certification in a number of these actions but expect that plaintiffs in the pending lawsuits will continue to seek certification of statewide or multi-state classes. 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

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(15) Commitments, Contingencies and Other Items (Continued)**

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

In November 2010, the companies negotiated revised settlement terms for a series of state class settlements affecting all persons who own or owned land next to or near railroad rights of way in which the companies have installed their fiber optic cable network. The companies are currently negotiating certain procedural issues with legal counsel representing the interests of the current and former landowners with respect to presentment of the settlement in applicable jurisdictions. The settlement affecting current and former landowners in the state of Idaho was presented to the United States District Court for the District of Idaho and preliminary approval of the settlement was granted on January 28, 2011.

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 companies 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 settlement is not ultimately approved for all affected landowners. 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 specified in the complaint that the defendants failed to disclose material adverse facts about the Company's integration activities, business and operations. 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. On May 4, 2009, the Court appointed a lead plaintiff in the case, and on September 29, 2009, the lead plaintiff filed a Consolidated Class Action Complaint (the "Complaint"). A motion to dismiss the Complaint was filed by the Company and the other named defendants. While the motion to dismiss the Complaint was pending, the court granted the lead plaintiff's motion to further amend the Complaint (the "Amended Complaint"). Thereafter, the Company and the other defendants named in the Amended Complaint filed a motion to dismiss the Amended Complaint with prejudice. The court granted this motion to dismiss with prejudice, and the plaintiff has filed a notice of appeal of that decision to the Tenth Circuit Court of Appeals.

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(15) Commitments, Contingencies and Other Items (Continued)**

It remains 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.

During March 2009, Level 3 Communications, Inc., as a nominal defendant, certain of its directors and its current officers, and a former officer, were named as defendants in purported stockholder derivative actions in the District Court, Broomfield County, Colorado, which have been consolidated as *In re Level 3 Communications, Inc. Derivative Litigation (Lead Case No. 2009CV59)*. On December 11, 2009, Level 3 Communications, Inc., as a nominal defendant, certain of its directors and current officers, and a former officer, were named as defendants in purported stockholder derivative action in the United States District Court for the District of Colorado in *Iron Workers District Council Of Tennessee Valley & Vicinity Pension Plan v. Level 3 Communications, Inc., et. al.* ( *Civil Case No. 09cv02914*). The Plaintiffs allege that during the period specified in the complaints the named defendants failed to disclose material adverse facts about the Company's integration activities, business and operations. The complaints seek damages on behalf of the Company based on purported breaches of fiduciary duties for disseminating false and misleading statements and failing to maintain internal controls; unjust enrichment; abuse of control; gross mismanagement; waste of corporate assets; and, with respect to certain defendants, breach of fiduciary duties in connection with the resignation of Kevin O'Hara. The parties have agreed to a temporary stay of all activities in these actions pending the outcome of the motion to dismiss or other relevant time periods in the securities litigation described above.

It remains too early for the Company to reach a conclusion as to the ultimate outcome of these derivative actions. However, management believes that the complaints have numerous deficiencies including that each plaintiff failed to make a demand on the Company's Board of Directors before filing the suit.

In March 2009, late April 2009 and early May 2009, Level 3 Communications, Inc., the Level 3 Communications, Inc. 401(k) Plan Committee and certain current and former officers and directors of Level 3 Communications, Inc. were named as defendants in purported class action lawsuits filed in the U.S. District Court for the District of Colorado. These cases have been consolidated as *Walter v. Level 3 Communications, Inc., et. al.*, ( *Civil Case No. 09cv00658*). The complaint alleges breaches of fiduciary and other duties under the Employee Retirement Income Security Act ("ERISA") with respect to investments in the Company's common stock held in individual participant accounts in the Level 3 Communications, Inc. 401(k) Plan. The complaint claims that those investments were imprudent for reasons that are similar to those alleged in the securities and derivative actions described above.

It remains too early for the Company to reach a conclusion as to the ultimate outcome of these ERISA 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.

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (15) Commitments, Contingencies and Other Items (Continued)

*Letters of Credit*

It is customary in Level 3's industry 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, 2010 and 2009, Level 3 had outstanding letters of credit of approximately \$22 million and \$25 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.

The right-of-way agreements have various expiration dates through 2088. Payments under these right-of-way agreements were \$127 million in 2010, \$118 million in 2009 and \$112 million in 2008.

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 \$203 million in 2010, \$198 million in 2009 and \$193 million in 2008.

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, 2010 (in millions):

	<u>Right-of-Way Agreements</u>	<u>Facilities</u>	<u>Total</u>
2011	\$ 119	\$ 161	\$ 280
2012	76	139	215
2013	74	127	201
2014	70	113	183
2015	65	94	159
Thereafter	588	332	920
Total	<u>\$ 992</u>	<u>\$ 966</u>	<u>\$ 1,958</u>

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.

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(15) Commitments, Contingencies and Other Items (Continued)**

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 15 years from January 1, 2011, which approximates the estimated 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, 2011, 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**

Level 3 Financing, Inc. ("Level 3 Financing"), a wholly owned subsidiary of the Company, has issued the 10.75% Senior Notes (fully redeemed in January 2010), Floating Rate Senior Notes due 2011 (fully redeemed in November 2009), 12.25% Senior Notes due 2013 (fully redeemed in March 2010), 9.25% Senior Notes due 2014, 8.75% Senior Notes due 2017, 10% Senior Notes due 2018, and the Floating Rate Senior Notes due 2015, (collectively, the "Senior Notes") that are unsecured obligations of Level 3 Financing; however, they are also jointly and severally and fully and unconditionally guaranteed on an unsecured senior basis by Level 3 Communications, Inc. and Level 3 Communications, LLC.

In conjunction with the registration of the Senior Notes, the accompanying condensed consolidating financial information has been prepared and presented pursuant to SEC Regulation S-X Rule 3-10 "Financial statements of guarantors and affiliates whose securities collateralize an issue registered or being registered." Level 3 Financing's 12.25% Senior Notes due 2013, Floating Rate Senior Notes due 2011 and 9.25% Senior Notes due 2014 are also 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 from January 1, 2008 through December 31, 2009 when the Company merged Broadwing Financial Services, Inc. with and into Level 3 Communications LLC. In the Condensed Consolidating Balance Sheets for the year ended December 31, 2009 and 2010, Broadwing Financial Services, Inc. is included in Level 3 Communications, LLC. Further, the Condensed Consolidating Balance Sheet for the year ended December 31, 2009 includes the 10.75% Senior Notes and 12.25% Senior Notes due 2013 which were fully redeemed in 2010.

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

## 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, 2010

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Non-Guarantor Subsidiaries	Eliminations	Total
	(dollars in millions)					
Revenue	\$ —	\$ —	\$ 2,046	\$ 1,834	\$ (229)	\$ 3,651
Costs and Expenses:						
Cost of Revenue	—	—	800	907	(217)	1,490
Depreciation and Amortization	—	—	429	447	—	876
Selling, General and Administrative	2	—	1,185	198	(12)	1,373
Restructuring Charges	—	—	1	1	—	2
Total Costs and Expenses	2	—	2,415	1,553	(229)	3,741
Operating (Loss) Income	(2)	—	(369)	281	—	(90)
Other Income (Expense):						
Interest income	—	—	1	—	—	1
Interest expense	(199)	(377)	(2)	(8)	—	(586)
Interest income (expense) affiliates, net	795	1,298	(1,891)	(202)	—	—
Equity in net earnings (losses) of subsidiaries	(1,221)	(2,087)	218	—	3,090	—
Other, net	5	(55)	1	11	—	(38)
Other Income (Expense)	(620)	(1,221)	(1,673)	(199)	3,090	(623)
(Loss) Income Before Income Taxes	(622)	(1,221)	(2,042)	82	3,090	(713)
Income Tax (Expense) Benefit	—	—	(1)	92	—	91
Net (Loss) Income	\$ (622)	\$ (1,221)	\$ (2,043)	\$ 174	\$ 3,090	\$ (622)



## 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, 2009

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Broadwing Financial Services, Inc.	Other Non- Guarantor Subsidiaries	Eliminations	Total
	(dollars in millions)						
Revenue	\$ —	\$ —	\$ 1,642	\$ —	\$ 2,350	\$ (230)	\$ 3,762
Costs and Expenses:							
Cost of Revenue	—	—	737	—	1,047	(219)	1,565
Depreciation and Amortization	—	—	412	—	503	—	915
Selling, General and Administrative	2	—	1,108	—	239	(11)	1,338
Restructuring Charges	—	—	9	—	—	—	9
Total Costs and Expenses	2	—	2,266	—	1,789	(230)	3,827
Operating Income (Loss)	(2)	—	(624)	—	561	—	(65)
Other Income (Expense):							
Interest income	—	—	1	—	1	—	2
Interest expense	(211)	(374)	(2)	(1)	(7)	—	(595)
Interest income (expense) affiliates, net	795	1,180	(2,057)	—	82	—	—
Equity in net earnings (losses) of subsidiaries	(1,242)	(2,048)	387	—	—	2,903	—
Other income (expense), net	42	—	4	—	(5)	—	41
Other Income (Expense)	(616)	(1,242)	(1,667)	(1)	71	2,903	(552)
Income (Loss) Before Income Taxes	(618)	(1,242)	(2,291)	(1)	632	2,903	(617)
Income Tax Benefit (Expense)	—	—	2	—	(3)	—	(1)
Net Income (Loss)	\$ (618)	\$ (1,242)	\$ (2,289)	\$ (1)	\$ 629	\$ 2,903	\$ (618)



## 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 Non- Guarantor 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	(191)	(369)	—	(2)	(8)	—	(570)
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	85	—	7	—	120	—	212
Total Other Income (Expense)	(317)	(998)	(1,407)	(2)	177	2,204	(343)
Income (Loss) Before Income Taxes	(318)	(998)	(2,001)	(2)	803	2,204	(312)
Income Tax Benefit (Expense)	—	—	(5)	—	(1)	—	(6)

Net Income  
(Loss)

\$ (318) \$ (998) \$ (2,006) \$ (2) \$ 802 \$ 2,204 \$ (318)

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## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (16) Condensed Consolidating Financial Information (Continued)

Condensed Consolidating Balance Sheets  
December 31, 2010

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Non-Guarantor Subsidiaries	Eliminations	Total
	(dollars in millions)					
<b>Assets</b>						
Current						
Assets:						
Cash and cash equivalents	\$ 173	\$ 7	\$ 350	\$ 86	\$ —	\$ 616
Restricted cash and securities	—	—	1	1	—	2
Receivable, net	—	—	46	218	—	264
Due from (to) affiliates	11,927	11,424	(26,093)	2,742	—	—
Other	4	10	41	35	—	90
<b>Total Current Assets</b>	<b>12,104</b>	<b>11,441</b>	<b>(25,655)</b>	<b>3,082</b>	<b>—</b>	<b>972</b>
Property, Plant and Equipment, net	—	—	2,937	2,365	—	5,302
Restricted Cash and Securities	18	—	21	81	—	120
Goodwill and Other Intangibles, net	—	—	543	1,255	—	1,798
Investment in Subsidiaries	(10,437)	(17,176)	3,575	—	24,038	—
Other Assets, net	9	65	6	83	—	163
<b>Total Assets</b>	<b>\$ 1,694</b>	<b>\$ (5,670)</b>	<b>\$ (18,573)</b>	<b>\$ 6,866</b>	<b>\$ 24,038</b>	<b>\$ 8,355</b>
<b>Liabilities and Stockholders' Equity (Deficit)</b>						
Current						
Liabilities:						
Accounts payable	\$ 1	\$ —	\$ 57	\$ 271	\$ —	\$ 329
Current portion of long-term debt	176	—	2	2	—	180
Accrued payroll and employee benefits	—	—	78	6	—	84
Accrued						

interest	47	99	—	—	—	—
Current portion of deferred revenue	—	—	115	36	—	151
Other	—	1	65	—	—	66
<b>Total Current Liabilities</b>	<b>224</b>	<b>100</b>	<b>317</b>	<b>315</b>	<b>—</b>	<b>956</b>
Long-Term Debt, less current portion	1,612	4,564	24	68	—	6,268
Deferred Revenue, less current portion	—	—	673	63	—	736
Other Liabilities	15	107	154	276	—	552
Commitments and Contingencies						
Stockholders' Equity (Deficit)	(157)	(10,441)	(19,741)	6,144	24,038	(157)
<b>Total Liabilities and Stockholders' Equity (Deficit)</b>	<b>\$ 1,694</b>	<b>\$ (5,670)</b>	<b>\$ (18,573)</b>	<b>\$ 6,866</b>	<b>\$ 24,038</b>	<b>\$ 8,355</b>

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (16) Condensed Consolidating Financial Information (Continued)

Condensed Consolidating Balance Sheets  
December 31, 2009

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Non-Guarantor Subsidiaries	Eliminations	Total
	(dollars in millions)					
<b>Assets</b>						
Current						
Assets:						
Cash and cash equivalents	\$ 236	\$ 8	\$ 431	\$ 161	\$ —	\$ 836
Restricted cash and securities	—	—	1	2	—	3
Receivable, net	—	—	77	246	—	323
Due from (to) affiliates	11,404	10,397	(24,068)	2,267	—	—
Other	3	16	43	35	—	97
Total Current Assets	11,643	10,421	(23,516)	2,711	—	1,259
Property, Plant and Equipment, net	—	—	3,119	2,568	—	5,687
Restricted Cash and Securities	18	—	23	81	—	122
Goodwill and Other Intangibles, net	—	—	566	1,330	—	1,896
Investment in Subsidiaries	(9,222)	(15,037)	3,288	—	20,971	—
Other Assets, net	7	63	15	13	—	98
Total Assets	\$ 2,446	\$ (4,553)	\$ (16,505)	\$ 6,703	\$ 20,971	\$ 9,062
<b>Liabilities and Stockholders' Equity (Deficit)</b>						
Current						
Liabilities:						
Accounts payable	\$ 1	\$ —	\$ 136	\$ 227	\$ —	\$ 364
Current portion of long-term debt	151	551	2	1	—	705
Accrued payroll and employee benefits	—	—	46	5	—	51
Accrued interest	47	92	—	1	—	140



Current portion of deferred revenue	—	—	116	46	—	162
Other	—	1	61	35	—	97
<b>Total Current Liabilities</b>	<b>199</b>	<b>644</b>	<b>361</b>	<b>315</b>	<b>—</b>	<b>1,519</b>
Long-Term Debt, less current portion	1,722	3,936	26	71	—	5,755
Deferred Revenue, less current portion	—	—	662	78	—	740
Other Liabilities	34	93	156	274	—	557
Stockholders' Equity (Deficit)	491	(9,226)	(17,710)	5,965	20,971	491
<b>Total Liabilities and Stockholders' Equity (Deficit)</b>	<b>\$ 2,446</b>	<b>\$ (4,553)</b>	<b>\$ (16,505)</b>	<b>\$ 6,703</b>	<b>\$ 20,971</b>	<b>\$ 9,062</b>

## 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, 2010

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Non-Guarantor Subsidiaries	Eliminations	Total
	(dollars in millions)					
Net Cash						
(Used in)						
Provided						
by						
Operating						
Activities	\$ (156)	\$ (362)	\$ 76	\$ 781	\$ —	\$ 339
Cash Flows						
from						
Investing						
Activities:						
Capital						
expenditures	—	—	(161)	(275)	—	(436)
Decrease in						
restricted						
cash and						
securities,						
net	—	—	3	—	—	3
Proceeds						
from sale						
of						
property,						
plant and						
equipment						
and other						
assets	—	—	2	2	—	4
Net Cash						
Used in						
Investing						
Activities	—	—	(156)	(273)	—	(429)
Cash Flows						
from						
Financing						
Activities:						
Long-term						
debt						
borrowings,						
net of						
issuance						
costs	195	613	—	—	—	808
Payments						
on and						
repurchases						
of long-						
term debt,						
including						
current						
portion						
and						
refinancing						
costs	(328)	(599)	(1)	(2)	—	(930)
Increase						
(decrease)						

due from affiliates, net	226	347	—	(573)	—	—
Net Cash (Used in) Provided by Financing Activities	93	361	(1)	(575)	—	(122)
Effect of Exchange Rates on Cash and Cash Equivalents	—	—	—	(8)	—	(8)
Net Change in Cash and Cash Equivalents	(63)	(1)	(81)	(75)	—	(220)
Cash and Cash Equivalents at Beginning of Period	236	8	431	161	—	836
Cash and Cash Equivalents at End of Period	\$ 173	\$ 7	\$ 350	\$ 86	\$ —	\$ 616

## 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, 2009

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Broadwing Financial Services, Inc.	Other Non- Guarantor Subsidiaries	Eliminations	Total
	(dollars in millions)						
Net Cash Provided by (Used in) Operating Activities	\$ (142)	\$ (369)	\$ (154)	\$ —	\$ 1,022	\$ —	\$ 357
Cash Flows from Investing Activities:							
Capital expenditures	—	—	(121)	—	(192)	—	(313)
(Increase) decrease in restricted cash and securities, net	—	—	2	—	3	—	5
Proceeds from sale of property, plant and equipment	—	—	—	—	1	—	1
Net Cash Used in Investing Activities	—	—	(119)	—	(188)	—	(307)
Cash Flows from Financing Activities:							
Long-term debt borrowings, net of issuance costs	269	274	—	—	—	—	543
Payments on and repurchases of long- term debt, including current portion and refinancing costs	(518)	(6)	(1)	—	(2)	—	(527)
Increase							

(decrease) due from affiliates, net	560	99	150	—	(809)	—	—
Net Cash Provided by (Used in) Financing Activities	311	367	149	—	(811)	—	16
Effect of Exchange Rates on Cash and Cash Equivalents	—	—	—	—	2	—	2
Net Change in Cash and Cash Equivalents	169	(2)	(124)	—	25	—	68
Cash and Cash Equivalents at Beginning of Year	67	10	555	—	136	—	768
Cash and Cash Equivalents at End of Year	\$ 236	\$ 8	\$ 431	\$ —	\$ 161	\$ —	\$ 836

## 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	Broadwing Financial Services, Inc.	Other Non- Guarantor Subsidiaries	Eliminations	Total
	(dollars in millions)						
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 groups, net	—	—	—	—	124	—	124
(Increase) decrease in restricted cash and securities, net	—	—	3	—	(8)	—	(5)
Proceeds from sale of property, plant and equipment	—	—	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, net of issuance costs	400	—	—	—	—	—	400
Payments on and repurchases of long- term debt,							

including current portion and refinancing costs	(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 Year	—	27	588	—	99	—	714
Cash and Cash Equivalents at End of Year	<u>\$ 67</u>	<u>\$ 10</u>	<u>\$ 555</u>	<u>\$ —</u>	<u>\$ 136</u>	<u>\$ —</u>	<u>\$ 768</u>



## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (17) Subsequent Events

In January 2011, in two separate transactions, Level 3 Communications, Inc. issued a total of \$605 million aggregate principal amount of its 11.875% Senior Notes due 2019 ("11.875% Senior Notes due 2019"). The Company issued a portion of its 11.875% Senior Notes due 2019 to investors at a price of 98.173% of their principal amount. The 11.875% Senior Notes will mature on February 1, 2019 and are not guaranteed by the Company's subsidiaries. Interest on the notes accrues at 11.875% per year and is payable on April 1 and October 1 of each year, beginning April 1, 2011.

A portion of the net proceeds from the offering was used to redeem all of the Company's outstanding \$196 million aggregate principal amount of 5.25% Convertible Senior Notes due 2011 in February 2011 at a price of 100.75% of the principal amount. In addition, approximately \$300 million was issued in exchange for all of the Company's outstanding aggregate principal amount of its 9% Convertible Senior Discount Notes due 2013. Upon completion of this exchange transaction, all of the Company's outstanding 9% Convertible Senior Discount Notes were retired, and there was \$605 million aggregate principal amount of the Company's 11.875% Senior Notes due 2019 outstanding.

The offering of the 11.875% Senior Notes was not originally registered under the Securities Act of 1933, as amended, and the 11.875% Senior Notes may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. In connection with the offering, the Company entered into a registration rights agreement pursuant to which Level 3 agreed to file a registration statement to exchange the offered notes with new notes that are substantially identical in all material respects, and to use commercially reasonable efforts to cause the registration statement to be declared effective no later than 270 days after the issuance of the offered notes. The 11.875% Senior Notes were sold to "qualified institutional buyers" as defined in Rule 144A under the Securities Act of 1933, as amended, and non-U.S. persons outside the United States under Regulation S under the Securities Act of 1933, as amended.

The Company expects to recognize a loss of \$20 million in the first quarter of 2011 as a result of the redemption of the 5.25% Convertible Senior Notes due 2011 and exchange of the 9% Convertible Senior Discount Notes due 2013.

## (18) Unaudited Quarterly Financial Data

	Three Months Ended							
	March 31,		June 30,		September 30,		December 31,	
	2010	2009	2010	2009	2010	2009	2010	2009
	(dollars in millions except per share data)							
Revenue	\$ 910	\$ 980	\$ 908	\$ 942	\$ 912	\$ 916	\$ 921	\$ 924
Gross Margin	527	573	534	547	544	529	556	548
Operating Income								
(Loss)	(41)	12	(28)	(8)	(17)	(26)	(4)	(43)
Net Loss	(238)	(132)	(169)	(134)	(163)	(170)	(52)	(182)
Loss per share								
(Basic and Diluted)	\$ (0.14)	\$ (0.08)	\$ (0.10)	\$ (0.08)	\$ (0.10)	\$ (0.10)	\$ (0.03)	\$ (0.11)

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(18) Unaudited Quarterly Financial Data (Continued)**

Loss per share for each quarter is computed using the weighted-average number of shares outstanding during that quarter, while loss per share for the year is computed using the weighted-average number of shares outstanding during the year. Thus, the sum of the loss per share for each of the four quarters may not equal the loss per share for the year.

In the first quarter of 2010, the Company recognized a \$55 million loss on the early extinguishment of debt associated with the tender offer to repurchase the outstanding 12.25% Senior Notes. The Company also recognized a \$4 million loss during the second quarter of 2010 as a result of the redemption of its 10% Convertible Senior Notes due 2011.

In fourth quarter of 2010, the Company recognized a \$93 million tax benefit primarily as a result of releasing valuation allowances associated with net operating loss carryforwards from its foreign subsidiaries.

**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 25<sup>th</sup> day of February, 2011.

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 25, 2011
<u>/s/ JAMES Q. CROWE</u> James Q. Crowe	Chief Executive Officer and Director	February 25, 2011
<u>/s/ SUNIT S. PATEL</u> Sunit S. Patel	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	February 25, 2011
<u>/s/ ERIC J. MORTENSEN</u> Eric J. Mortensen	Senior Vice President and Controller (Principal Accounting Officer)	February 25, 2011
<u>/s/ R. DOUGLAS BRADBURY</u> R. Douglas Bradbury	Director	February 25, 2011
<u>/s/ DOUGLAS C. EBY</u> Douglas C. Eby	Director	February 25, 2011
<u>/s/ JAMES O. ELLIS, JR</u> James O. Ellis, Jr.	Director	February 25, 2011
<u>/s/ RICHARD R. JAROS</u> Richard R. Jaros	Director	February 25, 2011

<u>/s/ ROBERT E. JULIAN</u> Robert E. Julian	Director	February 25, 2011
<u>/s/ CHARLES C. MILLER, III</u> Charles C. Miller, III	Executive Vice President, Vice Chairman and Director	February 25, 2011
<u>/s/ MICHAEL J. MAHONEY</u> Michael J. Mahoney	Director	February 25, 2011
<u>/s/ RAHUL N. MERCHANT</u> Rahul N. Merchant	Director	February 25, 2011
<u>/s/ ARUN NETRAVALI</u> Arun Netravali	Director	February 25, 2011
<u>/s/ JOHN T. REED</u> John T. Reed	Director	February 25, 2011
<u>/s/ MICHAEL B. YANNEY</u> Michael B. Yanney	Director	February 25, 2011
<u>/s/ ALBERT C. YATES</u> Albert C. Yates	Director	February 25, 2011

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Exhibit 12

STATEMENTS RE COMPUTATION OF RATIOS

STATEMENT REGARDING COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

LEVEL 3 COMMUNICATIONS, INC.

	Fiscal Year Ended				
	2010	2009	2008	2007	2006
	(dollars in millions)				
Loss from Continuing Operations Before Taxes	\$ (713)	\$ (617)	\$ (312)	\$ (1,168)	\$ (810)
Interest on Debt, Net of Capitalized Interest	586	595	570	609	670
Amortization of Capitalized Interest	—	—	48	68	68
Interest Expense Portion of Rental Expense	69	68	68	63	44
Earnings (Losses) Available for Fixed Charges	<u>\$ (58)</u>	<u>\$ 46</u>	<u>\$ 374</u>	<u>\$ (428)</u>	<u>\$ (28)</u>
Interest on Debt	\$ 586	\$ 595	\$ 570	\$ 609	\$ 670
Preferred Dividends	—	—	—	—	—
Interest Expense Portion of Rental Expense	69	68	68	63	44
Total Fixed Charges	<u>\$ 655</u>	<u>\$ 663</u>	<u>\$ 638</u>	<u>\$ 672</u>	<u>\$ 714</u>
Ratio of Earnings to Fixed Charges	—	—	—	—	—
Deficiency	<u>\$ (713)</u>	<u>\$ (617)</u>	<u>\$ (264)</u>	<u>\$ (1,100)</u>	<u>\$ (742)</u>

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STATEMENTS RE COMPUTATION OF RATIOS STATEMENT REGARDING COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES LEVEL 3 COMMUNICATIONS, INC.



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**Exhibit 21**

**Significant Subsidiaries As of and for the Fiscal Year ending December 31, 2010**

Level 3 Communications, Inc.

Level 3 Financing, Inc.

Level 3 Communications, LLC

Broadwing, LLC

Broadwing Communications, LLC

TelCove Operations, LLC

WiTel Communications, 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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**Exhibit 23**

**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, 333-153644, 333-154976, 333-156709, 333-160493, and 333-162854) 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 25, 2011, with respect to the consolidated balance sheets of Level 3 Communications, Inc. and subsidiaries as of December 31, 2010 and 2009, 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, 2010, and the effectiveness of internal control over financial reporting as of December 31, 2010, which reports appear in the December 31, 2010 annual report on Form 10-K of Level 3 Communications, Inc.

/s/ KPMG LLP

Denver, Colorado  
February 25, 2011

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[Consent of Independent Registered Public Accounting Firm](#)

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Exhibit 31.1

**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 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 25, 2011

/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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Exhibit 31.2

**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 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 25, 2011

/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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[Exhibit 31.2](#)



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Exhibit 32.1

**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, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James Q. Crowe, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ JAMES Q. CROWE

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James Q. Crowe  
*Chief Executive Officer*  
February 25 2011

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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

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Exhibit 32.2

**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, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Sunit S. Patel, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ SUNIT S. PATEL

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Sunit S. Patel  
*Chief Financial Officer*  
February 25, 2011

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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