June 24, 2002

MCI and WorldCom merged in September 1998. Shortly after the merger, in April 1999, we sold the SHL business for $1.65B (subsequently finalized at $1.4B) and announced that we would be using the entire proceeds to further expand our capital spending to expand the Company's network. This was the beginning of an extended capital investment campaign that continued through the end of 2000 to increase the size of our Internet backbone, further build out our business local capabilities, expand our data network, to construct the first Pan European network including local facilities in Europe, and to expand spending in several areas – collocation, MMDS wireless spectrum, etc.

At the same time, the telecommunications industry was experiencing rapid development and increased competition from new entrants. With intense competition, it was important for the Company to have the ability to enter the market quickly, and offer the best network to our customers with very little provisioning time.

The decision to significantly increase capital investment was based upon the common belief at the time that the Internet and data demand would continue at the 8 times annual growth factor the industry was experiencing. It was this growth that supported the Company's goal of maintaining a strong double digit growth rate while expanding margins from using it's own facilities. Subsequently, neither materialized in the 2001 time period.

During this network growth period, the Company utilized long-term fixed rate leases to connect the owned network to the ILEC's facilities. These commitments were vital to network expansion and future revenue growth for the Company.

Additionally, the Company also entered into various network leases to complement the service offerings for data, Internet and local service. The lease commitments were entered into to obtain access to large amounts of capacity under the theory that revenue would follow and fully absorb these costs and to expedite "time to market." We believe that this provided an advantage over our competitors and created the leader in Internet backbone at OC 192-c . The commitments were entered into with the knowledge that we would incur an expense prematurely and the revenues would be earned subsequent to that date. The Company was willing to absorb this cost prior to recognizing the revenue stream because it believed that the future revenues would be matched up with these costs. These commitments were entered into as the result of customers for which services would be rendered and the lease commitments were entered into to expedite the customer provisioning and revenue stream in accordance with SAB 101 and as further supplemented by FASB 91, direct and indirect costs associated with obtaining a customer may be deferred and amortized over the revenue stream associated with that contract. The Company also factored in these costs in the development of pricing and all costs were

expected to be recovered through future revenue streams.
Subsequent to the asset being put into service, the Company continued to incur costs associated with network lease commitments as noted above. The portion of these commitments that were not being utilized was deferred until the related benefit (i.e. revenues) was generated.

At the time of the cost deferral, management had determined that future economic benefit would be derived from these contractual commitments as the revenues from these service offerings reached projected levels. At that time, management fully believed that the projected revenue increases would more than offset the future lease commitments and deferred costs under the agreements. Therefore, the cost deferrals for the unutilized portion of the contract was considered to be an appropriate inventory of this capacity and would ultimately be fully amortized prior to the termination of the contractual commitment.

The classification of these costs as an asset does not contradict the definition of an asset in FASB Concept Statement No. 6. "Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." (FASB CON No. 6, par. 25). "An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred." (FASB CON No. 6, par. 26).

At all times, management understood that an expense or loss would be recognized upon evidence that previously recognized future economic benefits of an asset would not ultimately be realized.

The second quarter of 2002 was the first time in the Company's history where there had been a sequential quarterly revenue decrease for two consecutive quarters on an equivalent business day basis. The decreases were the result of challenges of a weak economy, which directly affected WorldCom by the degree to which the Company's customers groomed and downsized their networks and to a lesser degree, bankruptcies, foreign exchange losses and product migrations.

Additionally, during the second quarter of 2002, the Company's President and CEO resigned, the Company's debt rating was lowered to junk status and there were widespread liquidity concerns. All of these events, including revenue for the May 2002 period, contributed to the Company's determination, in the second quarter of 2002, that future economic benefits of the deferred costs would not ultimately be realized.

The Company reviews and closes line costs on a quarterly basis. In the third month of each quarter, network management, line cost personnel and finance personnel meet to review line costs. During this meeting, trend analysis and network utilization reports are

reviewed and discussed. Based on the information compiled at these meetings a quarterly estimate of underutilized capacity is made to defer these costs.

The preparation of the Company's financial statements requires the Company to make estimates and assumptions that affect the reported amount of assets and liabilities as well as the reported amounts of expenses, including line costs. Significant management judgements and estimates must be made and used in connection with establishing these amounts.

Because of the volume and size of our network, the Company was not able to obtain a circuit by circuit analysis of the network for the cost deferral. Instead, estimates were made, based on information available and recorded at the end of each quarter.