

IV. GENERAL INFORMATION

A. The Debtor

The Debtor is a Delaware corporation, which, through its predecessor entities, was formed in 1994. The Debtor was originally organized as a Washington limited partnership, which in 1995 merged into a Washington limited liability company. Following several name changes, the Debtor became known as NEXTLINK Communications, L.L.C., a Washington limited liability Company. In January 1997, NEXTLINK Communications, L.L.C. merged into NEXTLINK Communications, Inc., a Washington corporation, which in June 1998 reincorporated in Delaware under the same name. On June 16, 2000, in connection with a merger with Concentric Network Corporation, NEXTLINK Communications, Inc. and Concentric Network Corporation merged into NM Acquisition Corp. and NM Acquisition Corp., as the surviving corporation in the merger, changed its name to NEXTLINK Communications, Inc. On September 25, 2000, XO began doing business as "XO Communications" and, on October 25, 2000, NEXTLINK Communications, Inc. changed its name to XO Communications, Inc. XO's principal executive and administrative offices are located at 11111 Sunset Hills Road, Reston, Virginia 20190, and its telephone number is (703) 547-2000.

XO is primarily a holding company, which owns, manages and controls, directly or indirectly, more than 60 Operating Subsidiaries. The telecommunications services described below are provided primarily by the Company through these Operating Subsidiaries, many of which hold regulatory authorizations and licenses required to provide telecommunication services in the jurisdictions in which they operate.

The Telecommunications Act of 1996 for the first time authorized competition in the local telephone service business. As one of the first companies to enter this market as a competitor to the incumbent telephone companies, the Company began providing high-quality telecommunication services to the business market in 1996. In June 2000, XO expanded its services through a merger with Concentric Network Corporation to include data communication services. As a result, the Company now provides both data and voice communications services to its customers, including local and long-distance telephone services, Internet access, virtual private networks, high-capacity data network services (including dedicated, wavelength and Ethernet services) and website hosting services.

The Company provides its services primarily using network facilities that it owns or controls, which include extensive metropolitan fiber-optic cable and fixed wireless networks in major metropolitan areas and an inter-city fiber-optic network that connects these metro facilities. The Company's networks incorporate state-of-the-art fiber optic cable and transmission equipment and fixed wireless spectrum and related equipment, each of which is capable of carrying high volumes of data, voice, video and Internet traffic. Substantially all of the operating assets of XO consist of its interests in the Operating Subsidiaries, which, in turn, own these network facilities. As of June 30, 2002, the Company operated in over 60 markets in over 20 states and the District of Columbia. The Company currently employs approximately 5,300 people.

B. Directors and Executive Officers of XO

The following table sets forth the names, ages and positions of the XO's Board of Directors. Their respective backgrounds are described following the table.

Name	Position	Age
Daniel F. Akerson	Chief Executive Officer and Chairman of the Board of Directors	53
Nathaniel A. Davis	President, Chief Operating Officer and Director	48
Joseph L. Cole	Director	46
Sandra J. Horbach(1)	Director	41
Nicolas Kauser	Director	62
Craig O. McCaw	Director	52
John H. Myers(2)	Director	56
Sharon L. Nelson	Director	55
Henry R. Nothhaft	Director	58
Jeffrey S. Raikes	Director	44
Peter C. Waal	Director	70
Dennis M. Weibling	Director	51

(1) Elected by holders of the series D preferred stock, held solely by two of the Forstmann Little Partnerships.

(2) Elected by holders of the series C preferred stock, held solely by one of the Forstmann Little Partnerships

Brief biographies of XO's directors are set forth below.

Daniel F. Akerson. Mr. Akerson has served as XO's Chairman of the Board of Directors and Chief Executive Officer since joining XO in September 1999. From March 1996 to February 2001, he was the Chairman of the Board of Directors of Nextel Communications, Inc. From March 1996 to July 1999, he was also Chief Executive Officer of Nextel Communications, Inc. Mr. Akerson currently serves as a director of the American Express Company and AOL Time Warner.

Nathaniel A. Davis. Mr. Davis has served as XO's President and Chief Operating Officer since joining XO in January 2000. In February 2000, he was elected to serve on XO's Board of Directors. From October 1998 to January 2000, Mr. Davis served as Vice President of Technical Services for Nextel Communications. From November 1996 to September 1998, Mr. Davis was Chief Financial Officer of U.S. Operations at MCI. Mr. Davis currently serves as a director of Mutual of America Capital Management Corporation and XM Satellite Radio, Inc.

Joseph L. Cole. Mr. Cole has been a director of XO since February 2000. Since January 1999, he has been Executive Vice President and General Counsel of Ampersand Holdings, Inc., an investment firm. Since October 2000, Mr. Cole also has been Publisher of the Santa Barbara News-Press. From 1984 to 1998, Mr. Cole was a partner of the law firm of Seed, Mackall & Cole LLP, where his practice emphasized corporate law.

Sandra J. Horbach. Ms. Horbach has been a director of XO since January 2000. Since January 1993, she has been a general partner of Forstmann Little. Ms. Horbach currently serves as a director of Community Health Systems, Inc., Citadel Broadcasting Corporation and certain subsidiaries thereof, and Yankee Candle Company, Inc.

Nicolas Kauser. Mr. Kauser has been a director of XO since February 1999. From 1994 to 1998, he was an Executive Vice President and Chief Technology Officer for AT&T Wireless Services.

Craig O. McCaw. Mr. McCaw has been a director of XO since September 1994. From September 1994 to July 1997, he was XO's Chief Executive Officer. Since 1993, Mr. McCaw has been Chairman, Chief Executive Officer and a member of Eagle River. Since 1993, Mr. McCaw has been Chairman and Co-Chief Executive Officer of Teledesic Corporation, a developer of a worldwide satellite-based telecommunications system. Mr. McCaw also currently serves as a director of Nextel Communications.

John H. Myers. Mr. Myers has been a director of XO since October 2001. Since 1997, he has been President and Chief Executive Officer of General Electric Asset Management Incorporated ("GEAM"). From 1986 to 1997, Mr. Myers was Executive Vice President of GEAM. Mr. Myers also serves as a trustee of the General Electric Pension Trust. Mr. Myers serves as a director of GE Capital Services, Inc., Hilton Hotels Corp. and the Pebble Beach Company, a golf management company. Mr. Myers is also a member of the Advisory Committee of Warburg Pincus, an investment advisor, a member of the Pension Managers Advisory Committee of the New York Stock Exchange and a trustee of Wagner College.

Sharon L. Nelson. Ms. Nelson has been director of XO since September 1997. Since September 2000, Ms. Nelson has been the Director of the Center for Law, Commerce and Technology at the University of Washington School of Law. From 1985 to 1997, she was Chairman of the Washington Utilities and Transportation Commission. Ms. Nelson also served on the Federal-State Joint Board on Universal Service created under the Telecommunications Act of 1996 and as one of the 20-member negotiating team appointed by the Governors of Washington, Idaho, Oregon and Montana to review the Northwest electric power system.

Henry R. Nothhaft. Mr. Nothhaft has served as a director of XO since June 2000. Since April 2001, Mr. Nothhaft has served as the Chief Executive Officer of SmartPipes, Inc. From June 2000 to April 2001, he was XO's Vice Chairman. From May 1995 to June 2000, he was President and Chief Executive Officer of Concentric, from August 1995 to June 2000, he served on the Board of Directors of Concentric, and, from January 1998 to June 2000, he served as the Chairman of the Board of Concentric.

Jeffrey S. Raikes. Mr. Raikes has been a director of XO since September 1997. Since July 1996, he has been a member of Microsoft Corporation's Executive Committee and, since January 1996, he has been a Group Vice President of Microsoft.

Peter C. Waal. Mr. Waal has been a director of XO since June 2000. Since 1998, Mr. Waal has been a private telecommunications consultant. From 1986 to 1998, he was Vice President, Strategic Planning and Business Development with DSC Communication Corporation. Mr. Waal currently serves as a director of Info Visa, S. A.

Dennis M. Weibling. Mr. Weibling has been a director of XO since January 1997. From September 1994 to January 1997, he was Executive Vice President of XO. Since January 2002, Mr. Weibling has been Vice Chairman of Eagle River Investments. Since April 2002, he also has been Vice President of One World Challenge, which owns and operates sailing vessels. From 1993 to December 2001, he was President of Eagle River Investments. Mr. Weibling is a member of Eagle River, and he currently serves as a director of Nextel Communications, Nextel International, Inc., and Nextel Partners, Inc.

1. Executive Officers

The following table sets forth the names, ages and positions of XO's executive officers. Their respective backgrounds are described following the table.

Name	Position	Age
Daniel F. Akerson	Chairman, Chief Executive Officer	53
Nathaniel A. Davis	President and Chief Operating Officer	48
Nancy B. Gofus	Executive Vice President, Marketing and Customer Care	48
Michael S. Ruley	Executive Vice President, Market Sales Operations	42
John H. Jacquay	Senior Vice President, National Sales.	49
Gary D. Begeman	Senior Vice President, General Counsel and Secretary	43
Mark W. Faris	Senior Vice President, Network	47

Name	Position	Age
	Operations	
Wayne M. Rehberger	Senior Vice President, Chief Financial Officer	46
R. Gerard Salemmme	Senior Vice President, Regulatory and Legislative Affairs	48

a. Executive Biographies

Brief biographies of XO's officers are set forth below. For biographies of Daniel F. Akerson and Nathaniel A. Davis, see "Director's Biographies" above.

Nancy B. Gofus. Ms. Gofus has served as XO's Executive Vice President, Marketing and Customer Care since September 2000 and was Senior Vice President and Chief Marketing Officer from January 2000 until September 2000. From March 1999 to December 1999, she was the Chief Operating Officer of Concert Management Services, Inc., which previously was a wholly-owned subsidiary of British Telecom and is a global provider of managed telecommunications services. From March 1995 to March 1998, Ms. Gofus was Concert's Senior Vice President of Marketing.

Michael S. Ruley. Mr. Ruley has been Executive Vice President, Market Sales Operations since March 2001. From June 1999 to March 2001, he was XO's President, West Region. From April 1998 to June 1999, he was the President of XO's Southwest Region. From June 1996 to April 1998, Mr. Ruley held various positions at TCG, including Regional Vice President of the Pacific Bell Territory and Vice President and General Manager of both the San Francisco and Colorado markets.

John H. Jacquay. Mr. Jacquay has been XO's Senior Vice President, National Sales since February 2002. From November 1999 to February 2002, he was Chairman and Chief Executive Officer of Pagoo, Inc. From January 1999 to July 1999, Mr. Jacquay was President and Chief Operating Officer of GRIC Communications. From 1997 to 1999, he was Chief Operating Executive -- Regulated Industries unit of MCI Systemhouse. From 1996 to 1997, Mr. Jacquay was President of Network services -- US ONE Communications.

Gary D. Begeman. Mr. Begeman has served as XO's Senior Vice President, General Counsel and Secretary since November 1999. From May 1997 to November 1999, he was Deputy General Counsel of Nextel Communications, and from August 1999 to November 1999, he also was a Vice President of Nextel Communications. From January 1992 to May 1997, Mr. Begeman was a partner of the law firm Jones, Day, Reavis & Pogue, specializing in corporate and securities law and mergers and acquisitions.

Mark W. Faris. Mr. Faris has served as XO's Senior Vice President, Network Operations since April 2001. From September 2000 to April 2001, he was Chief Operating Officer of Gemini Networks. From March 2000 to September 2000, Mr. Faris was President and

Chief Operating Officer of BlueStar Communications. Prior to that, he had been employed by Southwestern Bell for over 20 years.

Wayne M. Rehberger. Mr. Rehberger has served as XO's Senior Vice President, Chief Financial Officer since December 2000. From April 2000 to August 2000, he was Chief Financial Officer of Nettel Communications. On September 28, 2000, Nettel filed a voluntary petition under Chapter 11 of the U.S. Bankruptcy code. From August 2000 to October 2000, Mr. Rehberger was XO's Senior Vice President of Finance. From April 1999 to March 2000, Mr. Rehberger was Senior Vice President of Finance at MCI WorldCom. From June 1986 to March 1999, he held other senior level finance positions at MCI.

R. Gerard Salemmé. Mr. Salemmé has served as XO's Senior Vice President, Regulatory and Legislative Affairs since January 2000. From March 1998 to January 2000, he served as XO's Senior Vice President, External Affairs and Industry Relations. From July 1997 to March 1998, he was XO's Vice President, External Affairs and Industry Relations. From December 1994 to July 1997, Mr. Salemmé was Vice President, Government Affairs at AT&T Corp.

V. EVENTS LEADING TO COMMENCEMENT OF THE CHAPTER 11 CASE

A. Background

Competing effectively with the incumbent local telephone companies has required massive capital expenditures as well as significant investments in marketing efforts and operating expenses by the Company. From 1996, when Federal legislation first was enacted to promote competition in local telecommunications, until 2001, most emerging competitive telecommunications companies, including XO and its predecessors, were generally able to access the capital markets. Since inception, XO has raised billions of dollars in capital, including approximately \$840 million through sales of common stock⁹ and \$1.7 billion through sales of preferred stock. In addition, XO has incurred substantial borrowings, of which approximately \$5.7 billion (including approximately \$557 million of Notes held by a subsidiary of XO) was outstanding as of April 30, 2002.

XO's consolidated debt as of April 30, 2002 included \$1 billion in principal amount of outstanding borrowings under its secured Senior Credit Facility, approximately \$4.2 billion in aggregate principal amount and accreted value of discount notes outstanding under ten issues of Senior Notes (including approximately \$557 million of Notes held by a subsidiary of XO) and \$517.5 million in principal amount outstanding under one issue of Subordinated Notes¹⁰. As of April 30, 2002, XO also had outstanding eight classes of preferred stock¹¹, with an aggregate liquidation preference of approximately \$2.2 billion, approximately \$490 million of which is held by a subsidiary of XO. In addition, as of that date, XO had two classes of common stock, of which the largest holders, on an as converted basis, are Eagle River, Wendy P. McCaw and Forstmann Little & Co. Equity Partnership-VI, L.P.

As of April 30, 2002, XO's unaudited stand-alone books and records reflected total assets of approximately \$8.7¹² billion and total liabilities and long term obligations, including the debt and preferred stock obligations discussed above, of approximately \$8.5 billion. On June 30, 2002, the Company had approximately \$535.9 million in cash and marketable securities on hand (net of outstanding checks). XO wrote-off the entire book value of its goodwill during the quarterly period ended March 31, 2002 as a result of its implementation of recently adopted generally accepted accounting principles.

From inception, XO's business plans had always assumed that as long as it continued to demonstrate success in penetrating and operating profitably in its established markets, it would be able to access the capital markets to fund its operating expenses and

⁹ Excludes proceeds from the sale of common stock through employee plans.

¹⁰ For a complete list of the issuances of Senior Notes and Subordinated Notes, see "VIII Capitalization - C. Outstanding Notes".

¹¹ For a complete list of the issuances of this outstanding preferred stock, see "VIII Capitalization - B. Outstanding Old Preferred Stock.

¹² Approximately \$8.2 billion of these assets represent intercompany investments and receivables.

network construction costs until such time as the cash generated from operations would be sufficient to cover its total cash requirements. Until 2001, the Company's ability to raise capital had always validated this assumption.

In 2001, although the capital markets were becoming increasingly reluctant to finance many emerging telecommunications companies, including a number of the Company's competitors, XO continued to be able to raise investment capital. In January 2001, XO issued \$517.5 million in 5-3/4% Convertible Subordinated Notes due 2009. In June 2001, XO raised \$250 million in a private placement of common stock with one of the Forstmann Little Partnerships. As discussed further below, the Forstmann Little Partnerships had previously invested \$1.25 billion in XO convertible preferred stock.

Despite these financings, the Company recognized the changes taking place in the capital markets for telecommunications companies generally and took aggressive steps, beginning in the first half of 2001 and continuing through the remainder of the year, to significantly scale back its business plans and conserve available cash resources. These measures included (i) canceling plans for expansion in Europe, (ii) curtailing domestic expansion plans into new markets, (iii) reducing headcount from approximately 7,400 employees at the end of fiscal year 2000 to the Company's current workforce of approximately 5,300, (iv) outsourcing network capacity through a strategic agreement with Level 3 Communications, Inc. ("Level 3") and (v) centralizing customer care and network service operations. Despite these efforts, the Company needs a significant cash infusion to fund the operating expenses, capital expenditures and debt service necessary to bring its operations to cash-flow breakeven on a Company-wide basis.

Following a June 2001 equity investment by one of the Forstmann Little Partnerships, the Company continued to discuss its future capital needs with representatives of both Eagle River and Forstmann Little. The Company concluded at that time that deleveraging its balance sheet might put it in a position to obtain the additional capital required to fund the Company's business to break-even cash flows. The Company also consulted with numerous investment banks regarding the Company's prospects for obtaining the additional capital required to fund the Company's business to break-even cash flows. These investment banks generally agreed that the Company would be unable to secure additional equity financing at that time unless it significantly deleveraged its balance sheet. At June 30, 2001, the Company had approximately \$1.37 billion of cash and marketable securities, while at that same time, its senior notes and junior obligations were trading at substantial discounts to their face amounts. Thus, with a view to facilitating future equity investments and upon the advice of the investment banks, the Company repurchased Notes with a face amount and accreted value of approximately \$557 million and Old Preferred Stock with a liquidation preference of approximately \$490 million (which repurchases did not include any of the Old Preferred Stock held by the Forstmann Little Partnerships) for \$290 million primarily in the third quarter of 2001.

During the third and fourth quarters of 2001, the Company engaged in discussions with Forstmann Little, Eagle River and several other prospective investors regarding possible investment and restructuring opportunities. Substantial due diligence activities by the potential investors ensued, including discussions with the Company's senior management, review of the Company's operating strategies and review of the Company's business plan and other

confidential financial information. The Company also consulted with numerous investment banks regarding the Company's prospects for obtaining the additional capital required to fund the Company's business to breakeven cash flows. These investment banks generally agreed that the Company would be unable to secure additional equity financing at that time unless it significantly deleveraged its balance sheet.

Conditions in the telecommunications capital markets continued to deteriorate and, in the latter part of 2001, those markets were closed entirely for all practical purposes. In the third and fourth quarters of 2001, the market valuations of the debt and equity securities of telecommunications companies, especially emerging providers such as the Company, experienced catastrophic declines, leading to a wave of bankruptcies throughout the industry. The capital markets began to focus more attention on the degree to which each telecommunications company was leveraged, irrespective of the amount of cash each telecommunications company had available. At the same time, several telecommunications providers had recently filed or were believed to be about to file for bankruptcy protection, and resulting increased customer concerns regarding the stability and sustainability of their telecommunications provider required that the Company obtain additional capital to deleverage its balance sheet and address the concerns of its customers.

B. Development of the Restructuring

It became clear to the Company in the fourth quarter of 2001 that obtaining additional capital that the Company required to fund operations until it was expected to achieve positive cash flow would require a much more significant balance sheet restructuring than had previously been contemplated. In October 2001, XO retained Houlihan Lokey as its outside financial advisor to assist it in exploring a variety of deleveraging alternatives, including both a stand-alone restructuring and third-party investment scenarios, both in and out of bankruptcy. The Company then concluded, based on its estimates regarding future operating results under a business plan that assumed both continued significant growth and the continued payment of interest on the Senior Credit Facility, that it would require a minimum of \$500 million of new capital to be reasonably assured of reaching a cash flow breakeven point without having to raise other additional funding, even assuming a successful balance sheet restructuring that eliminated all cash interest and preferred dividend payments on XO's Notes and Old Preferred Stock.

During the second half of 2001, the Company continued to revise its business plans and projections in light of the deteriorating conditions in the telecommunications sector and general economic conditions, including the impact from the events of September 11, 2001 amid input from prospective investors. Extensive analysis and consultations with Houlihan Lokey confirmed the fact that additional capital would likely not be available without a significant restructuring of the Company's capitalization.

At the Company's request, Houlihan Lokey prepared solicitation materials and, beginning in November 2001, contacted over fifty potential investors, both strategic and financial, in an effort to raise the required new capital, and actively engaged in discussions with Forstmann Little, Eagle River and other potential investors concerning the Company's business plans and a potential equity investment. Houlihan Lokey approached potential third-party investors that had previously or currently had investments in the telecommunications industry

and/or had the financial wherewithal to make a minimum \$500 million investment in the Company on their own or in connection with one or more financial partners. At this time, Forstmann Little and Eagle River continued their due diligence activities that had begun in the third quarter of 2001.

C. Discussions with Forstmann Little and Telmex

On November 21, 2001, Forstmann Little, on behalf of the Forstmann Little Investors, submitted a draft term sheet that proposed a \$700 million equity investment in the Company by the Forstmann Little Investors and a then-unnamed third-party investor (later identified as Telmex), conditioned on, among other things, a substantially deleveraged balance sheet. The terms of the proposal contemplated the elimination of all or substantially all of XO's outstanding equity, including the common and preferred stock that the Forstmann Partnerships had purchased for a total of \$1.5 billion, and offered 16% of Reorganized XO's equity to unsecured noteholders, along with \$100 million in cash. Proceeds from the Investment were to be used to fund the continued development of the Company's broadband telecommunications network, ongoing business operations and payments under the contemplated deleveraging process.

Because of the Forstmann Little Partnerships' board representation, and the possibility that Eagle River might participate in a financing proposal, the Board of Directors formed a subcommittee of non-management directors unaffiliated with either Forstmann Little or Eagle River to evaluate the merits of the Forstmann Little proposal in consultation with Houlihan Lokey and the Company's legal advisors. While Houlihan Lokey continued its search for alternative investors, XO and its financial and legal advisors, under the supervision of this subcommittee, engaged in extensive discussions and negotiations with the Forstmann Little Investors with respect to all the terms of their proposed investment, and obtained agreement to substantial improvements to those terms. As a result of these negotiations, among other things, the total amount to be invested increased to \$800 million, the equity percentage in Reorganized XO allocable to unsecured noteholders increased from 16% to 18% and the proposed restructuring included \$200 million in cash (increased from \$100 million in the original proposal) available to be paid to unsecured noteholders. In addition, the amount of the break-up payment was reduced, and the break-up payment provisions made applicable only upon the execution of a definitive agreement relating to an alternative transaction.

On November 28, 2001, XO entered into a non-binding term sheet with the Investors providing for an \$800 million investment in XO and the next morning announced publicly all the material terms and conditions of the proposed investment. Telmex, the leading telecommunications company in Mexico, is not affiliated with XO, the Forstmann Little Partnerships or the Forstmann Little Investors. Also on November 28, 2001, the Forstmann Little Investors, Telmex and Eagle River informed XO that the Forstmann Little Investors and Telmex had reached a preliminary understanding with Eagle River under which Eagle River would be given an opportunity to participate in a portion of the \$800 million investment contemplated under the Term Sheet.

From November 28, 2001 to January 15, 2002, XO engaged in extensive negotiations regarding the terms and conditions of the Investment Agreement with the Forstmann

Little Investors and Eagle River. In the meantime, Houlihan Lokey continued to attempt to identify other potential strategic and financial investors, including other third parties who became aware of the situation through publicly available information regarding the terms of the Investors' proposed investment, in an effort to procure a competing proposal prior to the execution of the Investment Agreement. During this time, although several prospective alternative investors conducted preliminary due diligence with the Company, no preliminary indications of interest or proposals were received. On January 14, 2002, Eagle River informed XO that it would not be participating in the investment by the Investors. On January 15, 2002, after extensive additional discussion and negotiation with the Forstmann Little Investors and Telmex, and having received no investment proposals from any other prospective investor, XO executed the Investment Agreement and announced the execution of the Investment Agreement the following day. Notwithstanding the foregoing, Houlihan Lokey continued to hold discussions with potential alternative sources of capital after the execution of the Investment Agreement.

D. Discussions with the Holders of Notes

1. Senior Note Committee

a. Restructuring Proposal by the Investors

Concurrently with the discussions and negotiations with the Investors, certain Holders of Senior Notes formed the Senior Note Committee to discuss the terms of the proposed restructuring with XO and the Investors, and the Senior Note Committee retained Akin, Gump, Strauss, Hauer & Feld as its legal counsel and Jefferies & Company, Inc. as its financial advisor. From January 2002 through March 2002, XO and the Investors held discussions with representatives of the Senior Note Committee, its legal counsel and financial advisors in an effort to develop the terms of a restructuring proposal that would be acceptable to the Investors and members of the Senior Note Committee.

During the course of these discussions and negotiations, the Investors proposed, among other things, to increase their investment from \$400 million each to \$410 million each, or a total of \$820 million, in order to fund an increased cash payment of \$220 million (compared to the \$200 million contemplated by the Investment Agreement) to the Holders of Senior Notes, and that the Company issue to the Holders of Senior Notes new warrants to purchase New Class A Common Stock. Under this revised proposal, the outstanding common stock remaining after the Investment (other than that portion allocated to XO's management), approximately 18% of the outstanding common equity of Reorganized XO, new warrants representing an additional 4% of the outstanding common equity of Reorganized XO and the \$220 million in cash would have been allocated pro rata to Holders of Allowed Senior Note Claims. On March 8, 2002, the Senior Note Committee rejected these proposals by the Investors.

b. Restructuring Proposal by the Senior Note Committee

On March 8, 2002, in connection with the rejection by the Senior Note Committee of the Investors' most recent proposal, XO received a preliminary restructuring proposal made by certain Holders of its Senior Notes regarding the terms of a potential financing and

restructuring (the "Senior Noteholder Proposal") that was intended to replace the Investment and related transactions provided for in the Investment Agreement.

The Senior Noteholder Proposal contemplated a pre-negotiated bankruptcy, in which the Holders of Senior Notes and Senior Secured Lenders would be offered the right to subscribe to a fully committed \$500 million rights offering. In exchange for the \$500 million, the subscribing investors would receive, among other things, (a) \$300 million in 10% super priority secured notes due 2009; (b) seven year warrants to purchase 10% of the fully-diluted common stock of the Company at an exercise price equal to the \$600 million implied equity value of the Senior Noteholder Proposal and (c) \$433.9 million principal amount in 8% convertible subordinated discount notes due 2012 (initial accreted value of \$200 million) convertible into 28.3% of the fully diluted common shares of XO. In addition, 55% of the fully diluted common shares of XO would be distributed, pro rata, to the Holders of Senior Notes.

Certain members of the Senior Note Committee along with other parties offered to commit to underwrite the \$500 million Senior Noteholder Proposal. As consideration for this commitment, these parties would receive seven year warrants to purchase 5% of the fully-diluted common stock of the Company at an exercise price equal to the \$600 million implied equity value of the Senior Noteholder Proposal.

XO's management carefully reviewed the Senior Noteholder Proposal, and its advisors analyzed it and presented their advice both to XO's management and to XO's Board of Directors. Based on their advice, XO concluded that the Senior Noteholder Proposal would not represent a feasible alternative for the successful restructuring of XO. Specifically, XO noted that the Senior Noteholder Proposal would not result in XO being fully funded (with an adequate cash reserve) based on its estimated future requirements based on its business plan that assumed both significant growth and the continued payment of interest on the Senior Credit Facility and did not have, and was unlikely to win the support of the Holders of Senior Secured Lender Claims both as to the overall restructuring plan and with respect to expected modifications to the Senior Credit Facility. Based on this assessment, on March 11, 2002, XO rejected the debt financing proposal of the Senior Note Committee.

c. Restructuring Proposal by the Icahn Group

On March 22, 2002, the Icahn Group and the Senior Note Committee submitted a draft term sheet to the Company contemplating a \$500 million equity investment in the Company for an indirect 50% equity ownership interest in the Company as an alternative to the transaction contemplated by the Investment Agreement. XO's Board of Directors, with the assistance of its financial and legal advisors, carefully reviewed this proposal and concluded that it represented an inferior proposal to the Investment Agreement. Concurrently, Forstmann Little informed XO that it would not increase the consideration provided in the Investment Agreement in response to proposals by the Icahn Group. On March 27, 2002, XO delivered a letter to the Icahn Group and the Senior Note Committee containing the terms and conditions necessary before a proposal could be viewed as superior to the Investment contemplated by the Investment Agreement.

On April 1, 2002, the Icahn Group submitted the Icahn Proposal contemplating a corporate reorganization, described below, and the purchase by the Icahn Group of a 55%

ownership interest in the business and assets currently operated by the Company for \$550 million in cash. The Icahn Group advised XO that the Icahn Proposal had the support of, among others, the Senior Note Committee.

As part of the consideration for this transaction contemplated by the Icahn Proposal, the Company would have been required to engage in a corporate reorganization in which a limited liability company subsidiary ("XO Holdings") would be required to serve as an intermediate holding company holding interests in newly created limited liability company subsidiaries that would, following the corporate reorganization, conduct substantially all of the Company's business and hold substantially all of its operating assets.

Under the plan of reorganization contemplated by the Icahn Proposal, XO's equity and subordinated debt would have been cancelled, and senior noteholders and holders of certain other claims against XO would receive common equity interests in Reorganized XO. As part of the plan of reorganization, the Icahn Group would have purchased, and the Senior Notes held by the Icahn Group would have been converted into, a separate class of common stock initially having 49% of the voting power in Reorganized XO, and the Icahn Group would initially nominate a majority of the members of the Company's Board of Directors.

The \$550 million investment provided for in the Icahn Proposal would have been implemented by the Icahn Group's purchase of 50% of XO Holdings' common equity for \$500 million, leaving Reorganized XO as the owner of the remaining 50% common equity interest in XO Holdings, and the purchase by the Icahn Group of 10% of the common stock of Reorganized XO (representing an indirect interest in 5% of XO Holdings' equity) from the Company for \$50 million. The plan of reorganization contemplated by the Icahn Proposal would also have provided for the establishment of a stock option plan covering 14% of reorganized XO's common stock (representing an indirect interest in 7% of the common equity of XO Holdings.) After the restructuring, holders of equity in Reorganized XO would have certain tag-along rights and other protections for minority holders for three and a half years.

The investment and corporate reorganization transactions contemplated by the Icahn Proposal would have been contingent upon the approval of the Senior Secured Lenders, including their consent to longer maturities and extension of prepayment dates, as well as significant modifications to their rights, including changes in a number of financial and operational covenants.

Throughout April and into May 2002, XO, the Icahn Group and the Senior Note Committee prepared the documentation necessary for, and engaged in the negotiation with XO as to, the investment and corporate reorganization transactions contemplated by the Icahn Proposal. Concurrently with these negotiations, XO and the Icahn Group engaged in negotiations with the Senior Lenders Committee to amend the Senior Credit Facility in a manner that would permit and facilitate the investment contemplated by the Icahn Proposal. In early May 2002, these negotiations ended without an agreement. Subsequently, the Icahn Group delivered a letter to the Senior Lenders Committee stating that they would attempt to block and contest any other transaction.

On July 10, 2002, High River Limited Partnership, an Delaware limited partnership controlled by Mr. Icahn, announced an offer to purchase up to an aggregate of \$331 million in principal amount of the loans outstanding under the Senior Credit Facility (the "Senior Secured Loans") at a purchase price of \$0.40 per \$1.00 in principal amount of the Senior Secured Loans (the "Icahn Purchase Offer"). According to the announcement in the New York Times on July 10, 2002, the Icahn Purchase Offer will be conducted on a "first-come first-served" basis and, if on or prior to July 17, 2002, the Requisite Lenders (as defined in the Senior Credit Facility) rescind the June 11, 2002 amendment to the Senior Credit Facility, the Icahn Purchase Offer will be deemed to be made for any and all of the Senior Secured Loans. According to the Icahn Purchase Offer, it may be amended or modified at any time by High River Limited Partnership.

d. Stand-Alone Plan

On July 18, 2002, the Official Committee of Unsecured Creditors reached an agreement with a subgroup of the Senior Lenders Committee on the terms and conditions of the Stand-Alone Plan. On July 19, 2002, the Official Committee of Unsecured Creditors informed the Bankruptcy Court that they would support both the FL/Telmex Plan and the Stand-Alone Plan.

2. Subordinated Noteholder Committee

Concurrently with the discussions and negotiations with the Senior Secured Lenders and the Senior Note Committee, certain Holders of the Subordinated Notes formed an informal committee (the "Subordinated Noteholder Committee") to discuss the terms of the proposed restructuring with XO. Although representatives of XO met with representatives of the Subordinated Noteholder Committee, as of the Petition Date no agreement has been reached with the Subordinated Noteholder Committee.

E. Discussions with Senior Secured Lenders

1. Development of the Agreement with the Senior Secured Lenders

Concurrently with the negotiation of the terms of the Investment Agreement, XO contacted the Senior Secured Lenders under its \$1 billion Senior Credit Facility, who had formed the Senior Lenders Committee. In January and February of 2002, Forstmann Little and Telmex engaged in extensive negotiations with the Senior Lenders Committee relating to the Amended and Restated Senior Credit Facility. The Investors requested substantial concessions from the Senior Lenders Committee in connection with the transactions contemplated by the Investment Agreement. These negotiations resulted in the Bank Amendment Term Sheet included as Exhibit B to the Bank Plan Support Agreement, attached hereto as Appendix E. Subsequently, at the request of the Investors, counsel for the Senior Lenders Committee distributed to the Holders of Senior Secured Lenders Claims a lock-up agreement supporting the transactions contemplated by the Investment Agreement, in a form approved by the Investors, together with the Bank Amendment Term Sheet and a request that those Holders execute the lock-up agreement. As of March 2002, Holders of more than two-thirds of the Senior Secured Lender Claims had executed

a lock-up agreement. However, these lock-up agreements were never executed by the Investors or the Company and have been superseded by the Bank Plan Support Agreement.

Later, in April 2002, this Senior Lenders Committee engaged in extensive discussions and negotiations with XO and the Icahn Group to amend the Senior Credit Facility in a manner that would permit and facilitate the transactions contemplated by the Icahn Proposal. However, in early May 2002, (as discussed above) the negotiations ended without an agreement.

2. The Stand-Alone Term Sheet Proposal by Senior Lenders

Subsequently, and in light of the uncertainty as to whether the conditions in the Investment Agreement would be met, the Senior Lenders Committee asked XO to prepare a modified business plan contemplating a stand-alone investment that assumed no receipt of additional third-party equity capital. While management of XO revised its business plan to reflect a stand-alone restructuring with no third-party equity capital, representatives for the Senior Lenders Committee conducted due diligence and Houlihan Lokey continued to search for other potential investors. In late May 2002, XO and the Senior Lenders Committee held discussions on a standalone restructuring plan under which \$500 million in principal amount (plus accrued interest) of senior secured loans would be converted into all of the equity of Reorganized XO, subject to dilution from their gifts of a \$200 million rights offering to junior security holders, New Warrants to be distributed to Holders of Senior Notes and General Unsecured Claims in certain events and New Options to be granted to management and other employees. The remaining \$500 million of senior secured loans would be converted into \$500 million in principal amount of Junior Secured Loans with cash interest required to be paid by Reorganized XO only if Reorganized XO achieves specified financial targets. To the extent the Rights Offering raised less than \$200 million, a senior secured Exit Facility of up to \$200 million was also contemplated.

Recognizing both the superior financial terms of the transactions contemplated by the Investment Agreement and the uncertainty engendered by conditions thereto, the Company concluded that the most appropriate course of action would be to advance a plan of reorganization contemplating the consummation of the transactions contemplated by the Investment Agreement, and also contemplating the restructuring contemplated by the Stand-Alone Term Sheet if the Investment Agreement were to be terminated or if XO were to conclude, after discussion with the Administrative Agent, that the Investors will not comply with their obligations to close under the Investment Agreement upon satisfaction of the applicable conditions thereunder. In furtherance of the Plan, on May 24, 2002, the Senior Lenders Committee circulated Bank Plan Support Agreements to the senior secured lenders providing for them to support the transactions contemplated by the Investment Agreement, with a view to delivering them to the Company on May 31.

On May 31, 2002, however, the Senior Lenders Committee informed XO that the Bank Plan Support Agreement had not been executed due to a request by Forstmann Little that XO delay its anticipated chapter 11 bankruptcy filing for a seven to ten day period to permit another round of due diligence on the part of Forstmann Little and discussions between the Senior Lenders Committee and Forstmann Little with respect to a less conditional investment transaction at a lower valuation.

On June 6, 2002, the Investors informed XO and the Senior Lenders Committee that it would not submit a revised proposal, and later that evening counsel for the Investors delivered a letter addressed to counsel for XO stating that they considered it "virtually impossible" that the conditions to the Investment Agreement would ever be satisfied and asking the Company to release the Investors from their obligations under the Investment Agreement. On June 7, 2002, XO replied that it had made substantial progress in satisfying the conditions to the Investment Agreement. XO advised the Investors that, under the circumstances, XO saw no reason to believe that the closing conditions could not be satisfied, did not believe the Investors had any right to terminate their obligations unilaterally, and was not in a position to release the Investors from their obligations under the Investment Agreement without substantial consideration. Subsequently, the Investors have reiterated their belief that the conditions to closing the Investment Agreement will be "virtually impossible" to satisfy.

On June 11, 2002, XO and holders of a majority of the Senior Secured Loans under the Senior Credit Facility executed an amendment to the Senior Credit Facility, which requires the written consent of the Requisite Lenders (as defined in the Senior Credit Facility) to sell, assign, transfer or participate in the Senior Secured Loans until the earlier of September 15, 2002 and the date the amendment is rescinded by the Requisite Lenders.

On June 13, 2002, holders of a majority of Senior Secured Loans under the Senior Credit Facility delivered Bank Plan Support Agreements to XO binding them to vote to accept a plan that provides them with the treatment agreed to the Bank Amendment Term Sheet. Also on June 13, 2002, XO received a letter from Toronto Dominion (USA), Inc. on behalf of Toronto Dominion (Texas), Inc. the Administrative Agent confirming the Senior Lenders Committee's willingness to support the transactions contemplated by a draft stand-alone term sheet if the Investment Agreement does not close for any reason.

On July 16, 2002, XO received a letter from the Administrative Agent confirming the Senior Lenders Committee's willingness to support the transactions contemplated by the Stand-Alone Term Sheet if the Investment Agreement does not close for any reason, attached hereto as Appendix F.

On July 18, 2002, a subgroup of the Senior Lenders Committee reached an agreement with the Official Committee of Unsecured Creditors on the terms and conditions of the Stand-Alone Plan.

3. Bank Plan Support Agreement

The following description summarizes the terms of the Bank Plan Support Agreement and does not modify the Bank Plan Support Agreement. In all instances of ambiguity or inconsistency, the Bank Plan Support Agreement controls.

On June 13, 2002, Senior Secured Lenders holding \$584,990,000 in aggregate principal amount of the Senior Credit Facility (approximately 58% of Class 1 Claims) executed the Bank Plan Support Agreement with XO and XO Management (as defined below) requiring such Senior Secured Lenders, subject to certain conditions, to vote in favor of a plan implementing the terms of the Investment Agreement.

a. Acceptance of the Restructuring

Pursuant to the terms of the Bank Plan Support Agreement, so long as the Bank Plan Support Agreement is in effect, each of the Senior Secured Lenders that are parties thereto (each a "Consenting Participant"):

- i. accepts the terms and conditions of the Restructuring (as such term is defined in the Bank Plan Support Agreement) and agrees to vote to accept any plan of reorganization, whether on a prepackaged or prearranged basis, that incorporates the terms and conditions of the Restructuring (as such term is defined in the Bank Plan Support Agreement), the Bank Amendment Term Sheet and the Investment Agreement, pursuant to Section 1126 of the Bankruptcy Code.
- ii. agree that, as long as the Bank Plan Support Agreement and the Investment Agreement both remain in effect, and subject to (iii) below, such Consenting Participant will not (A) object to, delay, impede or take any other action to prevent the acceptance, confirmation or implementation of the Plan or otherwise commence any proceeding to oppose or alter the Plan or all documents implementing the Plan (the "Plan Documents") to the extent the Plan and the Plan Documents are not inconsistent with the terms and conditions set forth in the Bank Amendment Term Sheet; (B) exercise any of its remedies against any subsidiary of XO that is not a party to the Chapter 11 Case ; (C) vote for, consent to, support, encourage or participate, directly or indirectly, in the formulation of any other plan of reorganization or liquidation proposed or filed or to be proposed or filed in the Chapter 11 Case; (D) directly or indirectly seek, solicit, support, vote for, consent to or encourage any other plan, sale, proposal or offer of dissolution, winding up, liquidation, reorganization, merger or restructuring of XO or any of its subsidiaries that could reasonably be expected to prevent, delay or impede the successful restructuring of XO as contemplated by the Plan or the Plan Documents; (E) object to, delay, impede or take any other action to prevent approval of, the disclosure statement or the solicitation of consents to the Plan; or (F) take any other action that is inconsistent with the Plan or the Plan Documents, or that would delay confirmation of, the Plan.
- iii. agree that nothing contained in the Bank Plan Support Agreement shall be construed to prohibit any party thereto from developing or negotiating one or more plans of reorganization intended to serve as contingency plans in the event (and only in the event) that the Investment Agreement is terminated in accordance with its terms or otherwise not consummated, or from including such a

contingency plan in the Plan and Disclosure Statement on that basis.

b. Agreement to make Adequate Protection Payments to Senior Secured Lenders.

As consideration for the Bank Plan Support Agreement, XO Management Services, Inc. ("XO Management"), a guarantor under the Senior Credit Facility, has agreed to pay the fees and expenses of the Professionals for the Administrative Agent during the pendency of the Bankruptcy Case, and upon consummation of the transactions contemplated by the Investment Agreement to make payment in cash to the Senior Secured Lenders of all accrued and unpaid interest that would have been due to the Senior Secured Lenders under the Senior Credit Facility notwithstanding the commencement of the Chapter 11 Case.

c. Termination.

The Bank Plan Support Agreement may be terminated by any party thereto (except as expressly provided therein) by delivery of a written notice to each of the other parties thereto and the Administrative Agent upon the occurrence of any of the following events, provided, however, that such delivery of such written notice by any Consenting Participant shall terminate the Bank Plan Support Agreement only with respect to such Consenting Participant and not with respect to any other Consenting Participant or XO:

- (i) XO has failed to commence its Chapter 11 Case on or before the tenth (10th) business day following the date on which all of the conditions set forth in Section 1 of the Bank Plan Support Agreement have been satisfied or waived by the parties thereto;
- (ii) XO has failed to file the Plan and Disclosure Statement, each in a form reasonably acceptable to the Administrative Agent, on or before the second (2nd) business day following the Petition Date;
- (ii) the Disclosure Statement has not been approved by the Bankruptcy Court on or before the seventy-fifth (75th) day following the Petition Date;
- (iii) the Plan has not been confirmed by the Bankruptcy Court on or before the one hundred and twentieth (120th) day following the Petition Date;
- (iv) the Plan has not been consummated by the date on which either Investor has the right, under Section 6.1(b) of the Investment Agreement, to terminate its own rights and obligations under the Investment Agreement;
- (v) solely with respect to a termination by any Consenting Participant, and subject to Section 2(c) of the Bank Plan Support Agreement, XO takes any action inconsistent with (a) the Bank Plan Support Agreement, (b) effectuating the Restructuring (as defined in the Bank Plan Support Agreement), (c) seeking prompt confirmation of the Plan, or (d) consummating the Investment under the Investment Agreement, in any

case only if such action is materially detrimental with respect to such Consenting Participant as a Lender, or (e) the Bank Amendment Term Sheet;

- (vi) solely with respect to a termination by any Consenting Participant, XO does not stay in compliance with the Budget (as defined in the Bank Plan Support Agreement) ;
- (vii) solely with respect to a termination by any Consenting Participant, Consenting Participants holding at least a majority of principal amounts of claims held by the Consenting Participants then holding a claim have agreed in writing to terminate the Bank Plan Support Agreement;
- (viii) XO, and subject to Section 2(c) of the Bank Plan Support Agreement, the Consenting Participants take any action materially inconsistent with (a) the Bank Plan Support Agreement, (b) effectuating the Restructuring (as defined in the Bank Plan Support Agreement), (c) seeking prompt confirmation of the Plan, or (d) consummating the Investment under the Investment Agreement; or
- (vii) the Investment Agreement is (a) terminated in accordance with its terms or by order of court or (b) amended or modified in any manner inconsistent with the terms of the Bank Plan Support Agreement.

4. Amended and Restated Senior Credit Facility

The following description summarizes the Bank Amendment Term Sheet attached as Exhibit A to the Bank Plan Support Agreement (the "Bank Amendment Term Sheet"). In all instances of ambiguity or inconsistency, the Bank Amendment Term Sheet controls.

Some of the principal proposed amendments to the Senior Credit Facility as set forth in the Bank Amendment Term Sheet include the following:

- a. the maturity and repayment dates of the loans have been extended for three years;
- b. minimum cash balance, minimum EBITDA and maximum capital expenditure covenants have been added, while the consolidated total debt to annualized consolidated EBITDA and consolidated EBITDA to consolidated cash interest expense covenants have been revised to become effective on later dates and with different ratios; all other financial covenants have been eliminated;
- c. the amount of permitted pari passu borrowing from third parties under any future incremental term loan facility has been reduced from \$1.0 billion to \$250 million, subject to further reduction under certain circumstances;
- d. other Permitted Indebtedness, Permitted Equipment Financing, Acquired Debt and Capital Leases (as such terms are defined in the Senior Credit Facility) are limited to

\$500 million, in the aggregate, subject to reduction by amounts utilized by the incremental facility and designated net asset sale proceeds of up to \$250 million;

e. proceeds from net asset sales remain subject to reinvestment within 270 days and must be reinvested in hard assets that become collateral, provided, that under the Amended and Restated Senior Credit Facility no more than \$25 million of net asset sale proceeds may be outstanding pending such reinvestment at any given time, provided, that a designated amount of additional net asset sale proceeds, not in excess of \$250 million in the aggregate, may be subject to the reinvestment option, but such amount shall offset the amount otherwise available under the basket of additional indebtedness described in (d) above;

f. there are new limitations with respect to Restricted Payments, Permitted Acquisitions, Investments and Joint Ventures (as such terms are defined in the Senior Credit Facility);

g. the revolving credit facility (which is fully drawn) will be converted into a term loan facility;

h. a mandatory prepayment will be triggered if any third party other than the Forstmann Little Investors or Telmex owns more than 50% of XO's voting stock;

i. there are additional covenants with respect to financial reporting;

j. the full amount of the credit facilities will be guaranteed by all wholly-owned domestic subsidiaries;

k. the credit facilities will be secured by substantially all the assets of XO and the guarantors; and

l. all prepayments under the Amended and Restated Senior Credit Facility will be applied pro rata across all the term facilities then outstanding thereunder.

Many of the maturity dates, repayment dates and other dates with respect to financial covenants will be further extended if the closing of the Investment is delayed beyond June 30, 2002.

F. The Restructuring

The Debtor has developed the Plan and this related Disclosure Statement, the former of which is being filed with the Bankruptcy Court contemporaneously herewith with the input and support of the Senior Lenders Committee. The Plan provides for the implementation of either the FL/Telmex Plan or the Stand-Alone Plan in the event the FL/Telmex Plan is not consummated. Under the FL/Telmex Plan, the Debtor will be reorganized through the consummation of the Investment Agreement with the Investors. In the event (a) the Investment Agreement is terminated by the Investors or XO or (b) XO, after discussions with the Administrative Agent (either because one or more conditions to the Investors' obligations have been satisfied in full or otherwise), concludes that the Investors will not consummate the transactions contemplated by the Investment Agreement and delivers the Stand-Alone Notice to

the Administrative Agent, with a copy of such notice to be delivered to each of the Investors, XO will file the Stand-Alone Notice with the Bankruptcy Court and pursue consummation pursuant to the Stand-Alone Plan, unless a superior alternative is presented to XO.

Although the Investment Agreement remains in full force and effect at this time, consummation of the FL/Telmex Plan remains subject to the satisfaction of a number of conditions, and could be terminated if certain conditions are not met. The Investors have advised XO that they intend to avail themselves of any available conditions to their obligations under the Investment Agreement applicable at the time of the closing. In particular, but without limitation, the Investors have informed XO that neither the Plan, the Bank Amendment Term Sheet nor the Shareholder Stipulation are satisfactory to them and the pending lawsuit brought by the Treasurer of the State of Connecticut is covered by the "litigation condition" of Section 5.2(u) of the Investment Agreement.

The Investors have also informed XO that in their opinion their right to terminate the Investment Agreement and collect the Break-Up Fee pursuant to Section 6.1(i) of the Investment Agreement may have already been triggered by actions taken by XO with respect to the Stand-Alone Plan. At present, however, the Investors have not terminated or purported to terminate the Investment Agreement. See "XI. Risk Factors --The Investors Do Not Believe the Closing Conditions Can be Met." If the Investment Agreement is terminated, or XO concludes that the Investors will not comply with their obligations to close thereunder upon satisfaction of the applicable conditions, XO presently intends to file the Stand-Alone Notice with the Bankruptcy Court, unless a superior alternative is presented to XO.

All claims against and interests in XO that exist on the Petition Date are divided into eleven classes. The Holders of Other Secured Claims (Class 2), the Non-Tax Priority Claims (Class 3) and Convenience Claims (Class 4) will be unimpaired.

Under the FL/Telmex Plan, the Senior Secured Lender Claims (Class 1) will remain outstanding subject to the terms of the Senior Credit Facility, as amended and restated by the Amended and Restated Senior Credit Facility. The Note Common Stock and \$200 million will be distributed to the class of Holders of Allowed General Unsecured Claims (Class 5) and Senior Note Claims (Class 6). Holders of Subordinated Note Claims (Class 7), Securities Claims in XO (Class 8), Old Preferred Stock Interests (Class 9) and Old Common Stock Interests (Class 10) and Other Old Equity Interests in XO (Class 11) will receive no distribution under the FL/Telmex Plan.

Under the Stand-Alone Plan, Holders of the Senior Secured Lender Claims (Class 1) will receive \$500 million in aggregate principal amount of New Junior Secured Loans, (a) if two-thirds or more of the Unaffiliated Senior Note Claims voting with respect to the Stand-Alone Plan vote to approve it, and the Official Committee of Unsecured Creditors has recommended a vote in favor of confirmation of the Stand-Alone Plan and not withdrawn such recommendation, 90,250,000 shares of the New Reorganization Common Stock representing 95% of all issued and outstanding shares of New Reorganization Common Stock on the Effective Date, or (b) if less than two-thirds of the Unaffiliated Senior Note Claims voting with respect to the Stand-Alone Plan vote to approve its confirmation, 95,000,000 shares of the New Reorganization Common Stock representing 100% of all issued and outstanding shares of New Reorganization Common

Stock on the Effective Date (in each case subject to dilution resulting from the exercise of the New Warrants, if any, allocated to the Senior Note Claims and General Unsecured Claims, issuance of shares pursuant to the Rights Offering and the exercise of New Options under the Management Incentive Program, all gifted by the Holders of the Senior Secured Lender Claims out of their entitled distribution); and certain residual rights under the Rights Offering.

Holders of Class 5 and Class 6 are not entitled to receive any Distribution under the Stand-Alone Plan. However, based upon negotiations among the Debtor, the Official Committee of Unsecured Creditors and a subset of the Senior Lender Committee, (a) Nontransferable Rights to purchase up to \$200 million (subject to increase in certain events) of common equity in Reorganized XO; (b) if two-thirds or more of the Unaffiliated Senior Note Claims voting with respect to the Stand-Alone Plan vote to approve it, and the Official Committee of Unsecured Creditors has recommended a vote in favor of confirmation of the Stand-Alone Plan and not withdrawn such recommendation, 4,750,000 shares of the New Reorganization Common Stock (representing 5% of all issued and outstanding shares of New Reorganization Common Stock on the Effective Date), New Series A Warrants to purchase 9,500,000 shares of New Reorganization Common Stock (representing 10% of all issued and outstanding shares of New Reorganization Common Stock on the Effective Date), New Series B Warrants to purchase 7,125,000 shares of New Reorganization Common Stock (representing 7.5% of all issued and outstanding shares of New Reorganization Common Stock on the Effective Date), New Series C Warrants to purchase 7,125,000 shares of New Reorganization Common Stock (representing 7.5% of all issued and outstanding shares of New Reorganization Common Stock on the Effective Date) and 10% of the FL/Telmex Recovery; and (c) if less than two-thirds of the Unaffiliated Senior Note Claims voting with respect to the Stand-Alone Plan vote to approve its confirmation, but the Official Committee of Unsecured Creditors has recommended a vote in favor of the Stand-Alone Plan, has not withdrawn such recommendation and the Debtor believes, in its reasonable judgment, that all of the members of such Committee have voted their Claims in favor of confirmation of the Stand-Alone Plan, New Series B Warrants to purchase 4,750,000 shares of New Reorganization Common Stock (representing 5% of all issued and outstanding shares of New Reorganization Common Stock on the Effective Date), will be distributed to such class of Holders of Allowed General Unsecured Claims (Class 5) and/or Senior Note Claims (Class 6) out of the entitled distribution of the Senior Lenders. Holders of Subordinated Note Claims (Class 7), Old Preferred Stock Interests (Class 9) and Old Common Stock Interests (Class 10) are not entitled to receive any Distribution under the Stand-Alone Plan. However, based upon negotiations among the Debtor, the Official Committee of Unsecured Creditors and a subset of the Senior Lenders Committee, Holders of Classes 7, 9 and 10 will receive a contingent redistribution of Nontransferable Rights, if any, out of the entitled distribution of the Senior Secured Lenders, subject to the priority and allocation rules described in Section X.E. herein under "Rights Offering".

G. Post-Restructuring

The Company believes that as demand for telecommunication services increases, its track record of winning market share from incumbent providers, its advanced technology, its national scope, and its ability to serve multi-market accounts will, upon completion of the restructuring, allow it to continue to expand its business and eventually achieve positive cash flow. The Company's extensive portfolio of advanced telecommunications assets enables it to

provide end-to-end service; that is, services provided primarily over its own network, from point of origination of the voice or data transmission to the point of termination. As volume increases, the strategy of owning facilities, rather than paying incumbents to use portions of their networks, is projected to result in higher profit margins.

In order to preserve value in the Company and enhance its long-term viability and continued operational success, the Company determined that the restructuring of its obligations as contemplated by the Investment Agreement or the Stand-Alone Term Sheet could best be achieved through a Chapter 11 filing. Numerous communications companies have sought bankruptcy protection recently. These bankruptcies, together with the substantial quantity of communications network facilities held by communications companies in operation, has severely depressed -- and in some cases eliminated -- the market for telecommunication assets, making this a very unfavorable environment for liquidation. Consequently, and in light of the significant revenues that the Company's operations generate, the Company believes that restructuring its capitalization will generate substantially more value (and thus greater recoveries for its creditors) than would a liquidation.

Customers have become increasingly wary of over-leveraged emerging telecommunications service providers during the past twelve to eighteen months as a result of numerous bankruptcy filings and ultimate liquidations within the industry. Consequently, the Company believes that it is vital that a restructuring be completed in as expeditious a manner as possible to minimize the negative impact of the Company's existing capital structure on its ability to attract and maintain customers and continue to improve cash flows.

H. Agreements in Connection with the Investment

The descriptions of the Investment Agreement and the ancillary agreements set forth below are summaries only and are qualified in their entirety by the Investment Agreement and each such ancillary agreement, as applicable.

1. Investment Agreement

XO and the Investors have entered into the Investment Agreement, as amended, which provides for the sale of 79,999,998 shares of New Class A Common Stock and two shares of New Class D Common Stock to the Forstmann Little Investors for \$400 million in cash, and the sale of 80,000,000 shares of New Class C Common Stock to Telmex for \$400 million in cash ("New Investor Common Stock"). The shares of New Investor Common Stock issuable to the Investors is required to represent approximately eighty percent (80%) of XO's common stock outstanding as of the closing of the Investment Agreement and the number of shares issued to the Investors shall be adjusted accordingly.

a. Break-up Payments

The Investment Agreement provides that if XO proposes to terminate the Investment Agreement because either (a) XO's Board of Directors determines that termination is necessary in order for XO to accept an alternate Proposal (as defined in the Investment Agreement) or the Bankruptcy Court orders XO to terminate the Investment Agreement in order to accept an alternate Proposal (Section 6.1(h) of the Investment Agreement) or (b) the

Forstmann Little Investors or Telmex terminates the Investment Agreement because XO has entered into a written agreement with respect to an alternate Proposal (Section 6.1(i) of the Investment Agreement), then XO must pay a break-up payment to each terminating Investor equal to 1% of the implied, pre-money enterprise value of the Company, which represents a payment of approximately \$30 million based on the valuation of the Company implied by the Investment Agreement. The precise break-up payment is based on a calculation of the implied, pre-money enterprise value of the Company set forth in the Investment Agreement.

The only clauses in the Investment Agreement which trigger the payment of the Break-Up Fee are Sections 6.1(h) and 6.1(i) of the Investment Agreement.

Furthermore, if XO terminates the Investment Agreement pursuant to Section 6.1(k) thereof, it may not be required to pay the Break-Up Fee. Under Section 6.1(k), the Investment Agreement may be terminated by the Company "if the Closing shall not have been consummated on or before the date specified in Section 6.1(b), including the extensions provided for in each of the three provisos contained therein, if applicable." If (a) the Investors have not previously terminated the Investment Agreement and (b) such termination occurs after the termination dates set forth in Section 6.1(b) of the Investment Agreement, XO may terminate the Investment Agreement without paying the Break-Up Fee.

On July 19, 2002, the Bankruptcy Court entered an order granting XO's motion for approval of the Break-Up Fee and expense reimbursement provisions of the Investment Agreement. In granting such relief, the Bankruptcy Court did not make a ruling as to whether the Break-Up Fee was triggered as of the date of the order. **The Debtor believes that the Investor's right to the Break-Up Fee has not been triggered, although the Investors may disagree with the Debtor's view.**

b. Releases

The Investment Agreement requires that XO use its reasonable best efforts to ensure that the confirmation order provides that the directors of the Company and each Investor and its affiliates, members, managers, shareholders, partners, representatives, employees, attorneys and agents are released from any and all Litigation (as defined in the Investment Agreement) related to the Company, its business, its governance, its securities disclosure practices, the purchase or sale of any of XO's equity or debt securities, the Investment or the Restructuring Transaction (as defined in the Investment Agreement). The Debtor is requesting releases in the Plan to meet the requirements of the Investment Agreement. For a complete description of the releases being sought by the Debtor, see "VII. Plan - C. Certain Matters Regarding Classification and Treatment of Claims and Interests - 12. Effect of Plan Confirmation - d. Releases".

c. Closing Conditions

As conditions to the Investors' obligation to close the Investment, the Investment Agreement requires that:

- i. XO and the Investors execute and deliver the Stockholders Agreement, which sets forth certain rights and obligations of the parties, and a Registration Rights Agreement with respect to the New Common Stock;
- ii. XO amends and restates its certificate of incorporation and bylaws in the form contemplated by the Investment Agreement;
- iii. the Investment is not prohibited by law or court order;
- iv. all required consents have been obtained;
- v. the Confirmation Order has been granted by the Bankruptcy Court and has become final and non-appealable;
- vi. the representations and warranties of XO and the Investors are true and correct as of the closing date or such other date referred to therein, and XO and the Investors shall have performed, satisfied and complied in all material respects with all of their respective covenants and agreements of the Investment Agreement and other transaction documents;
- vii. no Material Adverse Effect (as defined in the Investment Agreement) has occurred;
- viii. no shares of Old Class B Common Stock are outstanding;
- ix. the New Class A Common Stock of Reorganized XO shall have been approved for listing on the NASDAQ National Market System ("NASDAQ") or the New York Stock Exchange, unless the Investors do not permit the Company to take any actions reasonably necessary to meet any applicable listing requirements regarding a minimum number of stockholders;
- x. the Senior Credit Facility has been amended in a manner reasonably acceptable to the Investors, and remains in full force and effect;
- xi. regulatory approvals required in order to consummate the Investment will have been obtained by Final Order (as defined in the Investment Agreement) or waived in whole or part by the Investors, other than a regulatory approval the absence of which

will not reasonably be a Material Adverse Effect (as defined in the Investment Agreement);

- xii. a business plan for Reorganized XO that is reasonably acceptable to the Investors has been adopted by XO;
- xiii. at the closing of the Investment, the total amount of any and all fees, commissions and expenses and other amounts payable by XO in connection with the Investment, excluding (A) expenses with respect to the settlement of litigation related to the Investment and (B) XO's obligation to pay the expenses of the Senior Secured Lenders or any commercial bank or other financial institution in connection with the Amended and Restated Credit Facility, will not exceed \$45 million;
- xiv. upon the closing, after giving effect to the issuance of the New Investor Common Stock, the complete capital structure of Reorganized XO will be the new capitalization attached to the Investment Agreement as Exhibit A, as amended, in all material respects (the "New Capitalization"); and
- xv. Daniel F. Akerson continues to be employed by XO as Chief Executive Officer and shall not have expressed any intention to leave XO and other specified offices must be held by their current holders or other person acceptable to the Investors and such persons employed in such other specified offices shall not have expressed any intention to leave XO.

As an additional condition to the Investors' obligation to close the Investment, the Investment Agreement also requires that any litigation, pending or threatened against the Company or its affiliates, officers, directors, employees, representatives, attorneys and agents, and any and all litigation pending or threatened against either Investor or its respective affiliates, officers, directors, managers, partners, members, stockholders, employees, representatives, attorneys and agents, related to the Company, its business, its governance, its securities regulatory disclosure practices, the purchase or sale of any of the Company's equity or debt securities, the Investment or the restructuring of the Company, shall have been resolved in a manner that is satisfactory to each Investor in its sole discretion, except such litigation as rendered moot by the entry of the Confirmation Order by the Bankruptcy Court. Neither Investor, however, shall be able to assert the failure of this condition to be satisfied solely as a result of pending ordinary course litigation.

For further information on certain lawsuits of XO, see "V. Events Leading to Commencement of the Chapter 11 Case – K. Litigation" and Appendix D hereto.

d. Termination

The Investment Agreement may be terminated at any time by XO and the Investors upon their mutual written agreement.

The Investment Agreement may be terminated by either Investor, but only with respect to its own rights and obligations thereunder and not those of the other Investor:

- i. for a breach of a representation, warranty or covenant by XO or the other Investor which constitutes or would reasonably be expected to have a Material Adverse Effect (as defined therein) that cannot be reasonably expected to be cured by the closing date;
- ii. if a closing condition cannot be reasonably expected to be met by XO, and such expectation cannot be cured within 20 days of written notice of such event;
- iii. if the break-up payment and expense reimbursement provisions of the Investment Agreement are not approved by the Bankruptcy Court by August 1, 2002, unless such date is tolled or otherwise extended as a result of the Investors' prior conduct;
- iv. if the other Investor has terminated the Investment Agreement;
- v. if the closing conditions other than regulatory approvals have not been satisfied on or before September 15, 2002, unless such date is tolled or otherwise extended as a result of the Investors' prior conduct;
- vi. if the required regulatory approvals have not been obtained by the earlier of (x) January 15, 2003 and (y) the date on which XO shall notify each Investor in writing that such regulatory approvals cannot be obtained;
- vii. if the required regulatory approvals have not been obtained by a Final Order (as such term is defined in the Investment Agreement) by the earlier of (x) March 15, 2003 and (y) the date on which XO shall notify each Investor in writing that such regulatory approvals cannot be obtained by a Final Order; or
- viii. if the Company enters into a written agreement with respect to a new proposed investment.

The Investment Agreement may be terminated by XO:

- i. if the Board of Directors determines in good faith the termination is necessary to accept a new proposed investment or a Bankruptcy Court has ordered the acceptance of a new proposed investment;

- ii. if an Investor has terminated the Investment Agreement and the other Investor has not assumed such terminated Investor's portion of the Investment;
- iii. if the closing conditions other than regulatory approvals have not been satisfied on or before September 15, 2002;
- iv. if the required regulatory approvals have not been obtained by the earlier of (x) January 15, 2003 and (y) the date on which XO shall notify each Investor in writing that such regulatory approvals cannot be obtained. In the event either Investor elects to delay the closing beyond the third day following satisfaction or waiver of all of the conditions of the Investment Agreement, these dates shall be extended by the actual number of days of such delay;
- v. for a breach by either Investor of a representation, warranty or covenant causing a Material Adverse Effect, which cannot be reasonably expected to be cured by the closing date; or
- vi. if a closing condition cannot be reasonably expected to be met by either Investor and such expectation cannot be cured within 20 days written notice of such event.

In addition, the Investment Agreement may be terminated by either Investor or XO if any court or similar authority has permanently restrained, enjoined or prohibited the Investment.

2. Stockholders Agreement

The Stockholders Agreement to be entered into by and among Reorganized XO and the Investors pursuant to the Investment Agreement (the "Stockholders Agreement") provides for certain rights and obligations associated with the Investors' ownership of the New Investor Common Stock commencing on the closing date of the transactions contemplated by the Investment Agreement and terminating when either the Forstmann Little Investors or Telmex no longer owns at least 10% of the outstanding shares of Reorganized XO common stock. The following summary of the Stockholders Agreement is qualified in its entirety by reference to the Stockholders Agreement. See "IX. Description of Securities to be Issued under the FL/Telmex Plan" and "XII. Certain Charter and Bylaw Provisions" for a summary of the related New Common Stock and Amended Certificate of Incorporation and Bylaws of Reorganized XO.

a. Election of Directors

The Stockholders Agreement provides that, following the Effective Date and prior to the Board Representation Date (defined below), the number of directors on the Board of Directors of Reorganized XO shall be fixed at twelve and, at and after the Board Representation Date, the Board of Directors may be expanded to include such number of directors as are required by any stock exchange or quotation system on which Reorganized XO's common stock is quoted or listed. The Stockholders Agreement contemplates that the initial Board of Directors

of Reorganized XO will include those designees appointed or nominated by the Investors as described below, the Chief Executive Officer of Reorganized XO and such number of other independent directors as shall be required by any stock exchange or quotation system on which the New Class A Common Stock is quoted or listed and which independent directors shall be approved by each of the Investors. The term "Board Representation Date" means the earlier of: (i) the first date on which the Board of Directors has received written notice from Telmex that Telmex desires to designate directors to the Board pursuant to the Stockholders Agreement, and Telmex has determined in good faith, after consultation with its legal counsel, which counsel shall be an outside law firm of national reputation, that one or more directors, officers or employees of Telmex or a subsidiary of Telmex can become directors without violating applicable law; and (ii) the first date upon which any director, officer or employee of Telmex or a subsidiary of Telmex is elected or appointed as a director of Reorganized XO.

The Stockholders Agreement and Amended Bylaws provide that, following the Effective Date and prior to the Board Representation Date, so long as the Forstmann Little Investors beneficially own shares of common stock of Reorganized XO representing at least 10% of the outstanding shares of common stock of Reorganized XO, the Forstmann Little Investors shall have the right to appoint or nominate to the Board of Directors of Reorganized XO the number of directors equal to the sum of (A) (i) a fraction in which the numerator is the total number of outstanding shares of common stock of Reorganized XO beneficially owned by the Forstmann Little Investors, and the denominator is the total number of shares of common stock of Reorganized XO outstanding, multiplied by (ii) the total number of directors on the Board of Directors, rounded up to the nearest whole number, plus (B) (i) a fraction in which the numerator is the total number of outstanding shares of common stock of Reorganized XO beneficially owned by Telmex, and the denominator is the total number of shares of common stock of Reorganized XO outstanding multiplied by (ii) the total number of directors on the Board of Directors, rounded up to the nearest whole number. Notwithstanding the foregoing, the Stockholders Agreement provides that the Forstmann Little Investors shall, in connection with such appointment or nomination, include among its appointees or nominees, if so requested by Telmex by written notification, up to that number, rounded up to the next whole number, of individuals nominated by Telmex (the "Telmex Independent Designees"), who are independent of, and not affiliated with, either Telmex or Reorganized XO, equal to the product of (i) the total number of directors on the board multiplied by (ii) a fraction in which the numerator is the total number of outstanding shares of Reorganized XO common stock beneficially owned by Telmex, and the denominator is the total number of shares of common stock of Reorganized XO outstanding; provided that the total number of Telmex Independent Designees may at no time exceed the number of directors on the Board of Directors appointed or nominated by the Forstmann Little Investors (excluding Telmex Independent Designees). At the Board Representation Date, the Telmex Independent Designees shall resign from the Board of Directors and shall be replaced by directors nominated or appointed by Telmex pursuant to the following paragraph.

The Stockholders Agreement and Restated Bylaws provide that at and after the Board Representation Date, so long as an Investor beneficially owns shares of common stock of Reorganized XO representing at least 10% of the outstanding shares of common stock of Reorganized XO, such Investor shall have the right to appoint or nominate to the Board of Directors such number of directors, rounded up to the next whole number, equal to the product of

(i) a fraction in which the numerator is the total number of outstanding shares of common stock of Reorganized XO owned by such Investor, and the denominator is the total number of shares of common stock of Reorganized XO outstanding, multiplied by (ii) the total number of directors on the Board of Directors.

The Stockholders Agreement further provides that, both before and after the Board Representation Date, the Forstmann Little Investors and Telmex will vote their respective shares of common stock of Reorganized XO for the election of the nominees of the other Investor to the Board of Directors of Reorganized XO.

b. Quorum Requirements

The Stockholders Agreement and the Amended and Restated Certificate of Incorporation further provide that, during such time as the Forstmann Little Investors beneficially own shares of common stock of Reorganized XO representing at least 10% of the outstanding shares of common stock of Reorganized XO, the Board of Directors may not take any action unless a quorum consisting of at least one designee of the Forstmann Little Investors is present, and during such time as Telmex beneficially owns shares of common stock of Reorganized XO representing at least 10% of the outstanding shares of common stock of Reorganized XO, the Board of Directors may not take any action unless a quorum consisting of at least one Telmex designee (which, prior to the Board Representation Date, shall be a Telmex Independent Designee, to the extent a Telmex Independent Designee has been designated pursuant to the Stockholders Agreement) is present.

c. Non-Voting Observer and Consultation Rights

In addition to its right to designate directors (or prior to the Board Representation Date, Telmex Independent Designees) to the Board of Directors of Reorganized XO, the Stockholders Agreement provides that, prior to the Board Representation Date and so long as Telmex beneficially owns shares of common stock of Reorganized XO representing 10% or more of the outstanding shares of common stock of Reorganized XO, Telmex shall have the right to designate up to two non-voting observers to the Board of Directors which observers shall have access to certain information concerning the business and operations of Reorganized XO and shall be entitled to attend all regular and special meetings of the Board of Directors, and any meeting of any committee thereof, but shall not have any right to vote at such meetings. Moreover, prior to the Board Representation Date, the Forstmann Little Investors shall consult with representatives of Telmex at least monthly and, to the extent consistent with applicable law, shall share information with Telmex regarding the business, finances and prospects of Reorganized XO.

d. Committees

The Stockholders Agreement and the Restated Bylaws provide that, subject to certain conditions and exceptions, so long as an Investor beneficially owns shares of common stock of Reorganized XO representing at least 10% of the outstanding shares of common stock of Reorganized XO, each Investor shall have the right to have at least one of its director designees (which, in the case of Telmex, prior to the Board Representation Date, shall be a

Telmex Independent Designee, to the extent a Telmex Independent Designee has been designated pursuant to the Stockholders Agreement) sit on each committee of the Board of Directors. The Stockholders Agreement and the Amended and Restated Certificate of Incorporation further provide for the creation of a five-member executive committee (the "Executive Committee"), which shall include the Chief Executive Officer of Reorganized XO. Prior to the Board Representation Date, the Forstmann Little Investors shall have the right to have (i) three of their director designees on the Executive Committee so long as the Forstmann Little Investors beneficially own shares of common stock of Reorganized XO representing 15% or more of the outstanding shares of common stock of Reorganized XO and (ii) two of their director designees on the Executive Committee so long as the Forstmann Little Investors beneficially own shares of common stock of Reorganized XO representing at least 10% of the outstanding shares of common stock of Reorganized XO but less than 15% of the outstanding shares of common stock of Reorganized XO. Prior to the Board Representation Date, Telmex shall have the right to have one Telmex Independent Designee on the Executive Committee so long as Telmex beneficially owns shares of common stock of Reorganized XO representing at least 10% of the outstanding shares of common stock of Reorganized XO. After the Board Representation Date, each Investor shall have the right to have (i) two of its director designees on the Executive Committee so long as such Investor beneficially owns shares of common stock of Reorganized XO representing 15% or more of the outstanding shares of common stock of Reorganized XO or (ii) one of its director designees on the Executive Committee so long as such Investor owns shares of common stock of Reorganized XO representing at least 10% of the outstanding shares of common stock of Reorganized XO but less than 15% of the outstanding shares of common stock of Reorganized XO. The Stockholders Agreement contemplates that the initial Executive Committee will consist of the Chief Executive Officer of Reorganized XO, three designees of the Forstmann Little Investors and one Telmex Independent Designee.

The Stockholders Agreement and Amended Certificate of Incorporation provide that Reorganized XO shall not, without the approval of, (x) prior to the Board Representation Date, at least three-fifths of the members of the Executive Committee, or (y) at and after the Board Representation Date, at least two-thirds of the members of the Executive Committee: (i) adopt a new business plan, materially modify the business plan or take any action that would constitute a material deviation from the business plan; (ii) approve or recommend a merger (other than a merger of a wholly-owned subsidiary of Reorganized XO with and into Reorganized XO), consolidation, reorganization or recapitalization of Reorganized XO or any sale of all or a substantial portion of the assets of the Company, taken as a whole (a "Major Event"); (iii) acquire, by purchase, merger or otherwise, in one transaction or a series of related transactions, any equity or other ownership interest in, or assets of, any person in exchange for consideration with a fair market value greater than \$100 million; (iv) with certain limited exceptions, authorize for issuance or issue any equity securities or equity derivative securities in one transaction or a series of related transactions with a fair market value at the time of issuance in excess of \$100 million; (v) purchase, redeem, prepay, acquire or retire for value any shares of its capital stock or securities exercisable for or convertible into shares of its capital stock other than as required under the terms of such capital stock or securities; (vi) declare, incur any liability to declare, or pay any dividends, or make any distributions in respect of, any shares of its capital stock other than as required under the terms of such capital stock; (vii) redeem, retire, defease, offer to purchase or change any material term, condition or covenant in respect of outstanding long-term indebtedness other than as required under the terms of such indebtedness;

(viii) with certain limited exceptions, incur indebtedness in one transaction or a series of related transactions in excess of \$100 million in aggregate principal amount; (ix) make any material change in its accounting principles or practices (other than as required by GAAP or recommended by Reorganized XO's outside auditors), or remove Reorganized XO's outside auditors or appoint new auditors; or (x) appoint, or terminate or modify the terms of the employment of, any member of Reorganized XO's senior management as described in the Stockholders Agreement, and any of their successors or replacements, and any other persons of a similar level of authority and responsibility in the organizational structure who are appointed after the date of the Stockholders Agreement.

Notwithstanding the foregoing, the Stockholders Agreement and Amended and Restated Certificate of Incorporation further provide that if any of such significant corporate actions are proposed but not approved by the Executive Committee by the requisite three-fifths majority (or, at and after the Board Representation Date, the requisite two-thirds majority) of the Executive Committee, then the Investor designees on the Executive Committee shall attempt in good faith to resolve any objections any such Investor designee may have to the proposal and, if the Investor designees on the Executive Committee are unable to resolve in good faith the disagreement within 30 days after the Executive Committee meeting at which the matter was not approved, any member of the Executive Committee shall be entitled to present such issue to the Board of Directors where the issue may be adopted or rejected by a majority vote of the Board of Directors.

e. Veto Rights

The Stockholders Agreement and Amended and Restated Certificate of Incorporation also provide that so long as (i) an Investor owns shares of New Class A Common Stock representing at least 20% of the outstanding common stock of Reorganized XO and (ii) no Major Event nor any acquisition by any "person" or any "group" of persons (as such terms are used for purposes of Rules 13d-1 and 13d-5 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), of more than 50% of the total number of outstanding shares of common stock of Reorganized XO shall have occurred, the approval of at least one director designee of such Investor shall be required before Reorganized XO may take any of the following actions: (i) amend, alter or repeal its certificate of incorporation or bylaws, or any part thereof, or amend, alter or repeal any constituent instruments of any Reorganized XO subsidiary, or any part thereof; (ii) enter into any transaction with any affiliate (other than a wholly owned subsidiary of Reorganized XO), officer, director or stockholder of Reorganized XO, except for compensation and benefits paid to directors and officers in the ordinary course of business and other than those entered into concurrently with or prior to the Effective Date; (iii) file any voluntary petition for bankruptcy or for receivership (including a voluntary petition for the liquidation, dissolution or winding up of Reorganized XO or any of its subsidiaries other than a liquidation of a subsidiary in which all the assets of the liquidating subsidiary are distributed to Reorganized XO or another subsidiary of Reorganized XO) or make any assignment for the benefit of creditors; (iv) adopt any stockholder rights plan or other anti-takeover provisions in any document or instrument; or (v) issue or agree to issue any Reorganized XO preferred stock.

f. Voting Rights

In addition to the corporate governance rights of the Investors arising out of their participation on the Board of Directors of Reorganized XO or on the Executive Committee described above, the Amended and Restated Certificate of Incorporation also provides that the Investors shall have certain additional governance rights through their ownership of New Class C Common Stock and New Class D Common Stock.

Pursuant to the Amended and Restated Certificate of Incorporation, at any time at which there remain outstanding any shares of New Class C Common Stock or New Class D Common Stock, the affirmative vote of the holders of a majority of the outstanding shares of New Class C Common Stock, voting as a separate class, and the affirmative vote of the holders of a majority of the outstanding shares of New Class D Common Stock, voting as a separate class, shall be required before Reorganized XO may consummate a Major Event. In addition, if, at any time prior to the Board Representation Date, there are any outstanding shares of New Class C Common Stock, the affirmative vote of the holders of a majority of the outstanding shares of New Class C Common Stock, voting as a separate class, shall be required before Reorganized XO may (i) acquire, by purchase, merger or otherwise, in one transaction or a series of related transactions, any equity or other ownership interest in, or assets of, any person in exchange for consideration with a fair market value greater than 20% of Reorganized XO's consolidated net assets determined in accordance with GAAP; (ii) with certain limited exceptions, authorize for issuance or issue any equity securities or equity derivative securities in one transaction or a series of related transactions with a fair market value at the time of issuance in excess of \$100 million; (iii) with certain limited exceptions, incur indebtedness in one transaction or a series of related transactions in excess of \$100 million in aggregate principal amount; (iv) amend Reorganized XO's certificate of incorporation or bylaws; or (v) issue or agree to issue any Reorganized XO preferred stock.

g. Standstill Provisions

The Stockholders Agreement provides that, with certain limited exceptions (including the preemptive rights described below), each Investor agrees that, so long as the other Investor beneficially owns shares of common stock of Reorganized XO representing 20% or more of the outstanding shares of common stock of Reorganized XO, it shall not, and will cause each of its affiliates not to, either alone or as part of a "group" (as such term is used in Section 13d-5 of the Exchange Act), and such Investor will not, and will cause each of its affiliates not to, advise, assist or encourage others to, directly or indirectly, without the prior written consent of the other Investor: (i) acquire, or offer or agree to acquire, or become the beneficial owner of or obtain rights in respect of any shares of common stock of Reorganized XO, other equity securities of Reorganized XO or other securities convertible or exchangeable into equity securities of Reorganized XO; (ii) solicit proxies or consents or become a "participant" in a "solicitation" (as such terms are defined or used in Regulation 14A under the Exchange Act) of proxies or consents with respect to any voting securities of Reorganized XO or initiate or become a participant in any stockholder proposal or "election contest" with respect to Reorganized XO or induce others to initiate the same, or otherwise seek to advise or influence any person with respect to the voting of any voting securities of Reorganized XO in connection with the election of directors or with respect to an amendment to Reorganized XO's certificate of

incorporation or bylaws that would increase or decrease the number of directors on the Board of Directors; (iii) form, encourage or participate in a "person" within the meaning of Section 13(d)(3) of the Exchange Act for the purpose of taking any actions described in this paragraph; (iv) initiate any stockholder proposals for submission to a vote of stockholders with respect to Reorganized XO; or (v) offer, seek, or propose to enter into any merger, acquisition, tender offer, sale transaction involving a substantial portion of Reorganized XO's assets or other business combination involving Reorganized XO.

h. Transfer Restrictions

In addition to the foregoing provisions, the Stockholders Agreement contains certain restrictions on the sale or transfer by the Investors and their permitted transferees of common stock of Reorganized XO. Generally, except for certain limited exceptions or with the prior written approval of the other Investor, no Investor may, prior to the fourth anniversary of the Effective Date, directly or indirectly, sell, assign, transfer or otherwise dispose of, by merger, consolidation or otherwise (including by operation of law), or pledge or otherwise encumber, any common stock of Reorganized XO acquired by such Investor pursuant to the Investment Agreement and any securities issued or issuable with respect to such shares of common stock by way of a stock split, stock dividend or stock combination, or any shares of common stock issued in connection with a recapitalization, merger, consolidation or other reorganization.

i. Preemptive Rights

The Stockholders Agreement provides that, except for certain excluded issuances, Reorganized XO shall not issue, or agree to issue: (i) any equity securities of the Company; (ii) any options, warrants or other rights to subscribe for, purchase or otherwise acquire any equity securities of the Company; or (iii) any other securities of Reorganized XO or any of its subsidiaries that are convertible into or exchangeable for any equity securities of Reorganized XO or any of its subsidiaries unless, in each case, Reorganized XO shall have first offered to each Investor the opportunity to purchase its pro rata percentage of any such issuance. The number of securities (or principal amount of debt securities) to be offered to each Investor in connection with the exercise of its preemptive rights shall be an amount equal to the product of (i) the total number of securities (or total principal amount of debt securities) to be issued in the issuance multiplied by (ii) a fraction in which the numerator is the number of shares of common stock of Reorganized XO beneficially owned by such Investor and the denominator is the aggregate number of shares of common stock of Reorganized XO beneficially owned by all Investors exercising preemptive rights, in each case immediately prior to such issuance. So long as there remain outstanding any shares of New Class C Common Stock, and subject to certain limitations, Telmex shall have the right to purchase shares of New Class C Common Stock in the exercise of its preemptive rights and the Forstmann Little Investors shall have the right to purchase shares of New Class D Common Stock in the exercise of its preemptive rights.

j. Right of First Refusal.

The Stockholders Agreement further provides that, from and after the fourth anniversary of the Effective Date, if Reorganized XO receives a bona fide proposal from any person for a Major Event (a "Major Event Proposal"), Reorganized XO shall notify the Investors

of the Major Event Proposal and provide them with certain information. Promptly upon receipt of notice of a Major Event Proposal, the Investors shall engage in good faith discussions regarding the desirability and timing of the proposed Major Event and shall endeavor, within a specified period of time, to agree as to whether to support or reject the Major Event Proposal. If the Investors agree to support or reject the Major Event Proposal, then the Major Event Proposal shall be submitted to the Executive Committee for approval or rejection in accordance with the provisions described above. If the Investors are unable to agree on whether to support or reject the Major Event Proposal, then the Investor which objects to approval of the Major Event Proposal shall be entitled, for a specified period of time, and subject to certain conditions and restrictions, to solicit a bona-fide proposal for an alternative Major Event (a "Competing Proposal") and negotiate or otherwise engage in discussions with any person with respect to such Competing Proposal.

Following this solicitation period, a meeting of the Board of Directors shall be held at which the Board of Directors shall consider both the Competing Proposal and the Major Event Proposal. The Board of Directors shall adopt the Competing Proposal if the Board of Directors determines, by majority vote, that the Competing Proposal is at least as favorable to XO's stockholders in all material respects, and is as likely or more likely to be consummated, as the Major Event Proposal. If the Board of Directors approves the Competing Proposal, such Competing Proposal shall be recommended by the Board of Directors to the stockholders of Reorganized XO. If the Board of Directors approves the Major Event Proposal, Reorganized XO may enter into a definitive agreement with respect to, and consummate a transaction substantially on, the terms set forth in such Major Event Proposal.

I. Stand-Alone Term Sheet

On July 16, 2002, XO received a letter from the Administrative Agent stating "the informal steering committee of lenders under the [Senior Credit Facility] has indicated that it is prepared to support, and recommend that the lenders under the [Senior Credit Facility] approve, the stand-alone restructuring contemplated by the stand-alone term sheet. . . subject to the preparation of definitive documentation and the completion of customary internal bank approval process."

1. The Stand-Alone Events

In the event (a) the Investment Agreement is terminated by the Investors or XO or (b) XO, after discussions with the Administrative Agent, concludes that the Investors will not consummate the transactions contemplated by the Investment Agreement and delivers the Stand-Alone Notice to the Administrative Agent, with a copy of such notice to be delivered to each of the Investors, XO will file a notice with the Bankruptcy Court, after discussions with the Administrative Agent, expressing (a) either (i) that the Investment Agreement has been terminated by the Investors or XO or (ii) that XO has concluded that the Investors will not consummate the transactions contemplated by the Investment Agreement (either because one or more conditions to the Investors' obligations have not been satisfied or otherwise), and (b) XO's intention to proceed with the transactions contemplated by the Stand-Alone Term Sheet, unless a superior alternative is presented to XO.

2. FL/Telmex Recovery

If the Stand Alone Events occur and two-thirds or more of the Unaffiliated Senior Note Claims voting with respect to the Stand-Alone Plan vote to approve it, and the Official Committee of Unsecured Creditors has recommended a vote in favor of confirmation of the Stand-Alone Plan and not withdrawn such recommendation, the Holders of General Unsecured Claims and Holders of Senior Note Claims shall be entitled to 10% of the amount obtained by the Debtor or the Reorganized Debtor in respect of any money judgment against the Forstmann Little Investors and/or Telmex and the amount of any cash received by the Debtor or Reorganized Debtor pursuant to any settlement with both Investors or either Investor, in respect of any claims the Debtor or the Reorganized Debtor has or shall have against the Investors with respect to the Investment Agreement, net of the portion thereof payable for the reasonable expenses of the Debtor or the Reorganized Debtor relating to such judgment or settlement (including, without limitation, attorney's fees and out-of pocket expenses) and pursuant to the Shareholder Stipulation and, subject to the consent of the Official Committee of Unsecured Creditors, not to be unreasonably withheld, any similar agreements ("FL/Telmex Recovery"). The remaining 90% of the FL/Telmex Recovery shall remain in the Debtor or the Reorganized Debtor, subject to the mandatory prepayment provisions of the Junior Secured Loans. See "Description of Securities to be Issued under the Stand-Alone Plan – C. New Junior Secured Loans".

For a description of the securities to be issued in connection with the Stand-Alone Term Sheet, see Section "X. Description of Securities to be Issued under the Stand-Alone Plan".

J. Management Stock Purchases, Options and Retention Plans

1. Investment Agreement and Management Stock Purchases

If the Investment Agreement is approved, certain key executives of XO are being given the opportunity to participate in the XO Communications, Inc. Equity Participation Program (the "Management Stock Purchases"). Under the program, these executives will have the opportunity to purchase a pool of approximately 4,000,000 shares of Class E Common Stock of XO at a purchase price of \$1.67 per share. The Management Stock Purchases are intended to promote the interests of XO and its stockholders by providing certain members of senior management with the opportunity to purchase Management Common Stock at a discount and subject to certain restrictions. The Management Stock Purchases will encourage these executives to continue to be employees of the Company and to acquire a proprietary interest in the long-term success of XO. See "IX. Description of Securities to be Issued under the FL/Telmex Plan – E. New Class E Common Stock" for a more detailed description of the rights and restrictions of the Management Common Stock.

The Investment Agreement also contemplates a more broadly-based stock option plan for XO officers and employees covering up to 5% of Reorganized XO's equity as of the Effective Date.

2. Stand-Alone Term Sheet and Management

a. Management Incentive Program

The Stand-Alone Term Sheet includes authorization for the adoption of a stock option plan providing for the grant to the officers, employees and directors of Reorganized XO and its subsidiaries as determined by the Board of Directors of XO and consented to by the Board of Directors of Reorganized XO (such consent not to be unreasonably withheld) of New Options to acquire shares of New Reorganization Common Stock representing initially up to 7% of the fully diluted shares of the Post-Termination Securities, with an additional 3% reserved for issuance post-consummation by the Board of Directors of Reorganized XO in their discretion, of all then outstanding shares of New Reorganization Common Stock on a fully diluted basis. Twenty-five percent of the New Options included in the initial grant shall vest on the Effective Date with the remainder vesting over a three-year period. The exercise price of the New Options issued in the initial grant will be based upon the post-Rights Offering equity value (\$475 million plus the amount subscribed to in the Rights Offering) of Reorganized XO assumed in the restructuring (the "Management Incentive Program").

b. Retention Bonus Plan

The Stand-Alone Term Sheet includes authorization for a retention bonus plan not to exceed \$25 million in aggregate, of which no more than 25% shall be payable upon consummation of the Chapter 11 Case. The remaining amount shall be payable as follows (assuming an Effective Date on or before December 31, 2002): one-half of such remaining amount shall be contingently payable upon delivery of Reorganized XO's quarterly financial statements for the fiscal quarter ending March 31, 2003 and one-half of such remaining amount shall be contingently payable upon delivery of Reorganized XO's quarterly financial statements for the fiscal quarter ending September 30, 2003 (provided that if the Effective Date is after December 31, 2002, the foregoing dates shall be the second and fourth full quarters, respectively, ending after the Effective Date), with the amount actually payable on each such date to depend on Reorganized XO's actual Consolidated EBITDA (as defined in the Senior Credit Facility excluding reorganization expenses) for the two trailing quarters just ended as of each such date in comparison to the XO's projected Consolidated EBITDA (excluding reorganization expenses) for such two quarters as reflected in the XO's financial model dated May 9, 2002, as follows:

Actual Consolidated EBITDA as <u>a Percentage of Model</u>	Percentage of Maximum Payable <u>Amount Actually</u> <u>Payable</u>
≤75%	0%
75-100%	75%
>100%	100%

K. Litigation

A number of shareholder actions against XO, XO's directors, Forstmann Little and the Forstmann Little Investors have been brought since the announcement in November 2001 of the agreement in principle with the Forstmann Little Investors and Telmex that led to the Investment Agreement. Pursuant to the Plan, prepetition indemnification obligations with

respect to stockholder litigation will be Reinstated on the Effective Date. For information with respect to injunctions, exculpation and releases relating to litigation under the Plan, see "VII. The Plan – C. Certain Matters Regarding Classification and Treatment of Claims and Interests – 12. Effect of Plan Confirmation." The various lawsuits are described more particularly below.

1. The Actions Filed in Federal Court

By order dated January 23, 2002, the Honorable Leonie Brinkema, United States District Court Judge, consolidated the various actions pending in the United States District Court for the Eastern District of Virginia into a single case identified as *In re XO Communications, Inc. Securities Litigation*, Civil Action No. 01-1832-A (the "Consolidated Class Action").¹³ By order dated February 15, 2002, Judge Brinkema appointed James Gillin lead plaintiff and Cohen, Milstein, Hausfeld and Toll lead counsel for the Consolidated Class Action.

On March 29, 2002, the lead plaintiff in the Consolidated Class Action filed a consolidated amended complaint (the "Amended Complaint"). The Amended Complaint named as defendants Daniel F. Akerson, XO's Chief Executive Officer and Chairman of the Board; Nathaniel A. Davis, an XO director and XO's President and Chief Operating Officer, and the following members of the Company's Board of Directors: Joseph L. Cole, Sandra J. Horbach, Nicholas Kauser, Craig O. McCaw, Sharon L. Nelson, Henry R. Nothhaft, Jeffrey S. Raikes, Peter C. Waal and Dennis M. Weibling. The Amended Complaint also named as defendants the Forstmann Little Investors. The Amended Complaint did not name XO as a defendant. The Amended Complaint alleged that (a) Mr. Akerson was liable under Section 10(b) of the Exchange Act (and Rule 10b-5 promulgated thereunder) for material misstatements that artificially inflated the market price of XO stock and (b) XO's director defendants breached their fiduciary duties to XO's shareholders by entering into the proposed Investment Agreement with the Forstmann Little Investors and Telmex. The Amended Complaint also alleged that the Forstmann Little Investors aided and abetted these breaches of fiduciary duty.

The Consolidated Class Action's federal securities claims were purportedly brought on behalf of all persons who acquired XO common stock from April 4, 2001 through November 29, 2001. For these claims, the Amended Complaint sought unspecified compensatory damages, with interest, and any costs and expenses incurred. The Consolidated Class Action's breach of fiduciary duty claims were brought on behalf of XO's current shareholders. In respect of those claims, the Amended Complaint sought to enjoin defendants from taking further steps to consummate the Investment Agreement, as well as damages. Excluded from these classes were officers and directors of XO, their families and representatives, and any entity controlled by the defendants.

On April 18, 2002, the XO directors moved to dismiss the Amended Complaint on the grounds that (i) the federal securities claims failed to state a claim for which relief can be granted; and (ii) the court lacked subject matter jurisdiction over the claims for breach of

¹³ Another federal securities action, *Gable*, was initially filed in the United States District Court for the Southern District of California, but was transferred to the District Court for the Eastern District of Virginia by order dated May 6, 2002.

fiduciary duty. The Forstmann Little Investors also moved to dismiss plaintiffs' claims for aiding and abetting a breach of fiduciary duty for lack of subject matter jurisdiction. On May 13, 2002, the *Gable* defendants joined the XO directors' pending motion to dismiss the Amended Complaint.¹⁴

On May 31, 2002, following a hearing on the motion, the Court dismissed the action with prejudice and declined plaintiffs' request for leave to file a further amended complaint. By order dated June 3, 2002, the Court dismissed the *Gable* action as well.

On June 12, 2002, plaintiffs submitted a motion for reconsideration requesting that the dismissal with prejudice of the Amended Complaint be amended to a dismissal without prejudice. By order dated June 17, 2002, the Court denied plaintiffs' motion for reconsideration.

The remaining defendants in the above-mentioned action may be entitled to indemnification from XO under the certificate of incorporation and bylaws of XO, existing employment agreements, and/or the terms of the Investment Agreement.

2. The Actions Filed in State Court

In December 2001 and January 2002, four state law complaints alleging claims for breach of fiduciary duty were filed against XO and/or its directors, among others, by alleged shareholders of XO, purportedly on behalf of themselves and others similarly situated. Three such actions were filed in the New York State Supreme Court for Nassau County, and one was filed in the Delaware Court of Chancery. These state law breach of fiduciary duty class actions are listed on Appendix D attached hereto.

The New York actions were consolidated by order dated April 5, 2002 with the matter styled as *Irving Schoenfeld et al v. XO Communications, Inc. et al.*, Index No. 01-018358. On May 24, 2002, the plaintiffs in *Schoenfeld* filed a Consolidated Class Action Complaint which names as defendants XO and the following members of XO's Board of Directors: Daniel F. Akerson, Sandra J. Horbach, Nathaniel A. Davis, Henry R. Nothhaft, Jeffrey S. Raikes, Craig O. McCaw, Nicolas Kauser, Sharon L. Nelson, Joseph L. Cole, Dennis M. Weibling and Peter C. Waal. The *Schoenfeld* action also names as additional defendants Forstmann Little and Telmex.

Riley, the Delaware breach of fiduciary duty action, does not name XO or Telmex. It names Daniel F. Akerson, Sandra J. Horbach, Nathaniel A. Davis, Henry R. Nothhaft, Jeffrey S. Raikes, Craig O. McCaw, Nicolas Kauser, Sharon L. Nelson, Joseph L. Cole, Dennis M. Weibling, Peter C. Waal and the Forstmann Little Investors.

The *Schoenfeld* and *Riley* complaints each allege that XO's directors breached their fiduciary duties to XO's shareholders by, among other things, approving the Investment Agreement without undertaking steps to obtain the best offer possible. The *Schoenfeld* complaint also alleges that Forstmann Little and Telmex aided and abetted these alleged

¹⁴ The complaint in *Gable v. XO Communications, Inc. et al.* names as defendants XO, Daniel F. Akerson, Nathaniel A. Davis, Craig O. McCaw and Does 1-50.

breaches of fiduciary duty, and the *Riley* complaint alleges that the Forstmann Little Investors aided and abetted these alleged breaches of fiduciary duty.

The purported class of plaintiffs on whose behalf the claims in *Schoenfeld* and *Riley* have been asserted consists of all shareholders of XO (except the defendants and any person or entity related to or affiliated with the defendants). The *Schoenfeld* complaint seeks (a) declarations that defendants have breached their fiduciary duties and that the proposed agreement is a legal nullity; (b) unspecified compensatory damages, with interest, and any costs and expenses incurred, and (c) rescission of the Investment Agreement if consummated. The *Riley* complaint seeks (a) declarations that the Investment Agreement is unfair to plaintiffs, is void or voidable, and should be put to a vote by stockholders; and (b) costs and disbursements. In addition, the *Schoenfeld* and *Riley* complaints seek to enjoin defendants from taking further steps to consummate the Investment Agreement.

By order dated June 12, 2002, following a preliminary conference held on that date, Judge Geoffrey O'Connell established May 14, 2003 as the end date for all discovery in the *Schoenfeld* action.

The defendants in the above-mentioned actions other than XO may be entitled to indemnification from XO under the certificate of incorporation and bylaws of XO, existing employment agreements, and/or the terms of the Investment Agreement.

XO has not yet been required to respond to the complaints in these actions. Due to the early stage of the proceedings and the inherent uncertainties of litigation, XO is unable to predict the outcome of these proceedings. However, XO believes that these claims are without merit and intends to defend the actions vigorously.

In April 2002, two state law actions -- *Weiner* and *Wardall* -- were filed against XO pursuant to 8 Del. Code § 220 by alleged shareholders of XO. These state law actions are listed on Appendix D attached hereto. The plaintiffs in these actions seek access to certain corporate books and records regarding XO's Investment Agreement with the Forstmann Little Investors and Telmex. The actions are pending in the Delaware Court of Chancery. XO has denied all material allegations and has asserted appropriate defenses. XO believes that these claims are without merit and intends to defend the actions vigorously.

3. Shareholder Litigation Settlement

Pursuant to a Stipulation of Compromise and Settlement dated July 11, 2002 (the "Shareholder Stipulation") XO and the plaintiffs in the *Schoenfeld* action agreed to a settlement whereby the plaintiff class would dismiss and release all claims and causes of action against any of the Released Parties (generally, defendants in that action and their respective affiliates and current and former officers, partners, directors, employees, agents, members, shareholders, advisors, including any attorneys, financial advisors, investment bankers and other professionals retained by such persons), based upon or relating to XO or any of the facts or events alleged in the action, in exchange for the following consideration:

a. If the FL/Telmex Plan is consummated:

The Senior Secured Lenders shall waive their right to receive the first \$20,000,000 in cash interest otherwise payable to them upon consummation of the FL/Telmex Plan and Investment (the "Settlement Fund"), which XO or Reorganized XO, as applicable, shall pay into escrow on behalf of the Holders of Old Class A Common Stock Interests within seven (7) business days after the later of (a) consummation of the FL/Telmex Plan and the Investment; or (b) the date such interest would otherwise be due and payable under the FL/Telmex Plan. The Settlement Fund, less any taxes, expenses, costs and attorneys' fees and expenses awarded by the court shall be distributed on the Distribution Date or as soon thereafter as is practicable to the Holders of Old Class A Common Stock Interests.

b. If the Stand-Alone Plan is consummated:

Holders of Old Class A Common Stock Interests will be entitled to 33 1/3% of any cash recovery by XO against the Investors through a lawsuit or settlement of any litigation brought for breach of the Investment Agreement, up to a maximum of one third of \$60,000,000 (\$20,000,000), plus 3% the gross value of any cash recovery in excess of \$60,000,000 (collectively, a "Successful Recovery"). In the event that a Successful Recovery involves the receipt by any party of consideration other than cash or cash equivalents (including, without limitation, an alternative transaction superior in value to the transactions contemplated by the Stand-Alone Term Sheet), then the value of the Successful Recovery will be determined by agreement of two independent financial advisors hired by the plaintiffs in the *Schoenfeld* action and XO, respectively, and if they cannot agree, then by a neutral third financial advisor. After the agreement or neutral determination of the value of the Successful Recovery (the "Successful Recovery Fund"), any amounts owed to Holders of Old Class A Common Stock Interests shall be promptly liquidated (or, at XO's or Reorganized XO's election, the value thereof determined as described above shall be paid in cash by XO or Reorganized XO) and the proceeds of such liquidation or the value of such non-cash consideration, as the case may be, together with that portion of the Successful Recovery that does not involve non-cash consideration, shall be distributed in the same manner and to the same persons or entities as any cash consideration portion of a Successful Recovery; provided, however, that the amounts payable to Holders of Old Class A Common Stock Interests in respect of any non-cash consideration portion of a Successful Recovery shall in no event exceed twenty million dollars (\$20,000,000).

Under the Stand-Alone Plan, the Plan will contain a rights offering of equity securities in Reorganized XO no less favorable to the Holders of Old Class A Common Stock Interests than the following: (i) XO will make a rights offering to its creditors and equity holders of Nontransferable Rights of no less than \$50 million to purchase Reorganized XO Common Stock, (ii) provision will be made to ensure that Nontransferable Rights to invest at least \$16,666,666 are made available to Holders of Old Class A Common Stock Interests on a pro rata basis based on the number of shares held, and, in the event such amount is not taken up in full on that basis, on a pro rata basis based upon subscription request amounts by such Holders of Old Class A Common Stock Interests, (iii) Holders of Old Class A Common Stock Interests shall have the opportunity, on an equal basis with Holders of Subordinated Note Claims and Old Preferred Stock Interests, to exercise Nontransferable Rights prior to their reversion to Holders of Senior Secured Lender Claims pro rata based on subscription request amounts.

Counsel for the plaintiffs in the *Schoenfeld* action intend to apply to the court for an award of attorneys' fees, as follows: (1) under the FL/Telmex Plan, an amount not to exceed 25% of the Settlement Fund; or (2) if the Stand-Alone Plan is implemented or an alternative transaction occurs, (a) an amount not to exceed 25% of the Successful Recovery Fund; and (b) the opportunity to exercise Nontransferable Rights in an amount not to exceed 25% of the Rights Shares; and (3) reimbursement of expenses and disbursements.

The Shareholder Stipulation is subject to certain conditions, including approval by the Bankruptcy Court; approval by the New York Supreme Court; the dismissal of the Consolidated Class Action not having been appealed by plaintiffs in that action, or any appeal having been dismissed without the need for any court approval or with such court approval as is necessary; the *Riley* action shall have been dismissed by plaintiffs in that action without the need for court approval or with such court approval as is necessary. In addition, the Shareholder Stipulation is conditioned on each of such other conditions being satisfied (or their waiver by XO) on or before September 15, 2002.

VI. CHAPTER 11 CASE

A. Continuation of Business; Stay of Litigation

On June 17, 2002, the Debtor filed a petition for relief under Chapter 11 of the Bankruptcy Code. The Debtor continues to operate as debtor in possession subject to the supervision of the Bankruptcy Court and in accordance with the Bankruptcy Code. Under the Bankruptcy Code, the Debtor is required to comply with certain statutory reporting requirements, including the filing of monthly operating reports. As of the date hereof, the Debtor has complied with such requirements and the Debtor will continue to so comply. The Debtor is authorized to operate its business in the ordinary course of business, with transactions out of the ordinary course of business requiring Bankruptcy Court approval.

An immediate effect of the filing of the Debtor's bankruptcy petition is the imposition of the automatic stay under the Bankruptcy Code, which, with limited exceptions, enjoins the commencement or continuation of all collection efforts by creditors, the enforcement of liens against property of the Debtor and the continuation of litigation against the Debtor. This relief provides the Debtor with the "breathing room" necessary to assess and reorganize its business. The automatic stay remains in effect, unless modified by the Bankruptcy Court, until consummation of a plan of reorganization.

B. First-Day Orders

On the first day of these cases, the Debtor filed several motions seeking certain relief by virtue of so-called "first-day orders." First-day orders are intended to facilitate the transition between a debtor's prepetition and postpetition business operations by approving certain regular business practices that may not be specifically authorized under the Bankruptcy Code or as to which the Bankruptcy Code requires prior approval by the Bankruptcy Court. Many of the first-day orders obtained in this case are typical for large Chapter 11 cases. Other first-day relief pertained to establishing certain procedures and scheduling certain dates in connection with the Plan process.

The descriptions of the relief sought or obtained in the Chapter 11 Case set forth below and throughout this Disclosure Statement are summaries only. All pleadings filed in the Chapter 11 Case and all orders entered by the Bankruptcy Court are publicly available and may be found, downloaded and printed from the Bankruptcy Court's website located at <http://www.nysb.uscourts.gov>.

In addition to addressing certain administrative matters, the more typical first-day orders in the Chapter 11 Case authorized the Debtor to, among other things:

1. retain the following Professionals to serve on behalf of the Debtor: (i) Willkie Farr & Gallagher, as bankruptcy counsel; (ii) Houlihan Lokey, as financial advisor; (iii) Ernst & Young LLP, as independent public accountant, auditor and tax advisor, (iv) Davis Wright Tremaine LLP, as special counsel in connection with matters unrelated to the Chapter 11 Case, and (v) Bankruptcy Services LLC, as notice, claims and balloting agent (the "Claims Agent");
2. continue retention of professionals regularly employed by the Debtor in the ordinary course of business in matters unrelated to the Chapter 11 Case;
3. maintain the Company's bank accounts and operate its cash management system substantially as such system existed prior to the Petition Date;
4. pay employees' wages and employee benefit claims, including some portions that may constitute accrued prepetition amounts;
5. continue utility services uninterrupted during the pendency of the Chapter 11 Case without additional deposits, subject to certain objections; and
6. pay certain critical vendor claims.

VII. THE PLAN

THIS SECTION PROVIDES A SUMMARY OF THE STRUCTURE, CLASSIFICATION, TREATMENT AND IMPLEMENTATION OF THE PLAN AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO THE PLAN, WHICH ACCOMPANIES THIS DISCLOSURE STATEMENT, AND TO THE EXHIBITS ATTACHED THERETO.

THE PLAN ITSELF AND THE DOCUMENTS REFERRED TO THEREIN WILL CONTROL THE TREATMENT OF CREDITORS AND EQUITY SECURITY HOLDERS UNDER THE PLAN AND WILL, UPON THE EFFECTIVE DATE, BE BINDING UPON HOLDERS OF CLAIMS AGAINST, OR INTERESTS IN, THE DEBTOR, REORGANIZED XO AND OTHER PARTIES IN INTEREST.

A. Overview of Chapter 11

Chapter 11 is the principal business reorganization Chapter of the Bankruptcy Code. Under Chapter 11 of the Bankruptcy Code, a debtor is authorized to reorganize its business for the benefit of itself, its creditors and interest holders. Another goal of Chapter 11 is