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May 4, 2000

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CHARLES H. HOWARD (1925-1970)
JOHN E. BURRUSS, JR. (1933-1985)
GERALD E. ROARK (1956-1995)

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henand@socket.net

FILED

MAY 4 2000

Missouri Public
Service Commission

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102

Re: In the Matter of the Application of Allied Riser of
Missouri, Inc. for a Certificate of Authority to Provide
Basic Local and Telecommunications Services within the
State of Missouri - Case No. TA-2000-736

Dear Mr. Roberts:

Enclosed please find an original plus 14 copies of the
Application filed on behalf of Allied Riser of Missouri, Inc., in
the above-captioned matter. We will be filing EXHIBIT D
(Performance Bond), as a late filed Exhibit.

If you should have any questions concerning the enclosed
materials, please do not hesitate to contact me. Thank you.

Very truly yours,

HENDREN AND ANDRAE, L.L.C.


Richard S. Brownlee, III

RSB/s
Enclosures
cc: Office of Public Counsel
General Counsel
Kirk Peterson

FILED

MAY 4 2000

BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

Missouri Public
Service Commission

In the Matter of the Application of)
Allied Riser of Missouri, Inc.)
for a Certificate of Service)
Authority to provide Basic Local and)
Interexchange and Telecommunications)
Services within the State of Missouri)

TA-2000-736
Case No. ~~TA-2000-372~~

APPLICATION

Allied Riser of Missouri, Inc. ("Allied Riser" or "Applicant"), files this verified application respectfully requesting that the Missouri Public Service Commission ("Commission") issue an order that:

- A. grants Applicant a Certificate of Services Authority to provide basic local exchange and interexchange telecommunications services pursuant to Chapter 392 of the Missouri Revised Statutes;
- B. grants competitive status to the Applicant; and,
- C. waives certain Commission rules and statutory provisions pursuant to Section 392.420, RSMo. Cum. Supp. 1992.

In support of its request, Applicant states:

1. The mailing address of the Applicant is:

Allied Riser of Missouri, Inc.
Attention: Ried R. Zulager
1700 Pacific Avenue, Suite 400
Dallas, TX 75201
(214) 560-4111
(214) 210-3009 (Facsimile)

Allied Riser is a Delaware Corporation authorized to do business in Missouri, with a copy of its Certificate of Authority attached hereto as **Exhibit A**.

2. Name and address of Applicant's in-state attorney is:

Richard S. Brownlee, III
HENDREN AND ANDRAE, L.L.C.
221 Bolivar Street, P.O. Box 1069
Jefferson City, MO 65102
(573) 636-8135
(573) 636-4905 (Facsimile)

3. Allied Riser intends to provide basic local exchange and interexchange telecommunications service as a non-facility based provider and on a resale basis. This will be provided in all exchanges currently served by the incumbent local exchange telecommunications company of Southwestern Bell Telephone Company (SWBT), Sprint/United Telephone Company ("United"), and GTE Midwest, Inc. ("GTE"). The specific incumbent local exchanges within which Allied Riser proposes to offer service are listed in the incumbent providers' respective local exchange tariffs and will be specifically included in the Allied Riser tariff. Pursuant to applicable law, and subject to Applicant's right under federal or state laws to seek to offer, and offer and provide service in geographical areas smaller than an exchange or in market segmentations or to offer customer specific pricing, similarly situated subscribers located within the listed exchanges will receive services on equal terms and conditions as set forth in Applicant's tariffs.

4. Pursuant to this application Allied Riser seeks to offer and provide all forms of basic local telecommunications service and interexchange telecommunications services.

5. The Applicant possesses the technical experience and financial resources necessary to provide telecommunications service to the residents and businesses of Missouri. Applicant's affiliates are certificated to provide similar telecommunication services in other states. Applicant's affiliate Allied Riser Operations Corporation has a technical staff with personal experience as set forth in **Exhibit B**. Applicant's parent Allied Riser Communications Corporation financial statements are attached hereto as **Exhibit C**. Applicant's performance bond is attached hereto as **Exhibit D**.

6. Applicant intends to offer its services in accord with its tariffs, which shall be filed in accordance with Commission rules.

7. Applicant agrees that:

- A. It will file and maintain basic local exchange service tariff(s) with the Commission in the same manner and form as the Commission requires of incumbent local exchange telecommunications companies with which applicant will compete;
- B. It will meet the minimum basic local service standards, including quality of service and billing standards, as the Commission may require of the incumbent local exchange telecommunications companies with which it will compete;
- C. It will offer basic local telecommunications service as a separate and distinct service and will offer

basic service within the exchange boundaries of the incumbent local companies unless authorized by this Commission, or any other agency having jurisdiction to offer and provide service in areas smaller than an exchange pursuant to Section 392.200.4 RSMo, or other applicable law, and

- D. In accord with state and federal law, and with Commission rules and regulations on the issue, but without waiver of applicant's right to appear in any rulemaking proceeding or other proceeding regarding the same. Applicant will provide equitable access to subscribers within the area proposed to be served. See Section 392.455.(5), RSMo.

8. Applicant requests classification as a competitive telecommunications company within the State of Missouri. Applicant believes that its proposed services will be subject to sufficient competition to justify a lesser degree of regulation. Granting of this application will allow greater price and service options for telephone users.

9. Applicant also requests, pursuant to Section 392.420 RSMo (Cum. Supp. 1992), that the Commission waive the application of the following rules and statutory provisions as it relates to the regulation of the Applicant. The following list identifies Commission rules and statutes previously waived by the Missouri Public Service Commission for other competitive telecommunications companies.

STATUTES

392.210.2
392.270
393.280
392.290.1
382.300.2
392.310
392.320
392.330
392.340

REGULATIONS

4 CSR 240-10.020
4 CSR 240-30.040
4 CSR 240.35

Applicant also requests waiver of 4 CSR 240-2.060(4)(H) requiring a proposed tariff with a forty-five (45)-day effective date.

The above-referenced rules and statutory provision have been waived to other interexchange carriers in prior cases.

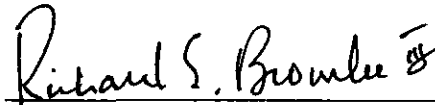
10. Pursuant to Section 386.570, (Cumm. Supp. 1992), Applicant will comply with all applicable Commission rules except those which are specifically waived by the Commission pursuant to a request filed by the Applicant.

11. Applicant states that considerations of the public interest and particularly equitable access for potential subscribers to service who reside in the area sought to be certificated warrant the granting of this application in that Applicant will extend the benefits of competition into the intrastate interexchange market, increase the diversity of choice and supply of telecommunications services and products in exchanges in which it will offer service and shall increase consumer access to competitive and affordable telecommunications services.

WHEREFORE, Allied Riser of Missouri, Inc., respectfully

requests that the Public Service Commission of Missouri grant it a Certificate of Service which authorizes the Applicant to provide basic local exchange and interexchange telecommunications services within the State of Missouri. In addition, Applicant requests classification as a competitive telecommunications company in the State. Finally, Applicant requests a waiver of the above-referenced rules and statutory provisions.

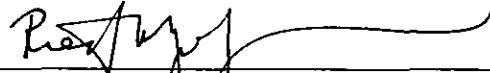
Respectfully submitted,



Richard S. Brownlee, III
MO Bar #22422
Hendren and Andrea, L.L.C.
221 Bolivar St., P.O. Box 1069
Jefferson City, MO 65102
(573) 636-8135
(573) 686-4905 (Facsimile)

ATTORNEY FOR Allied Riser of
Missouri, Inc.

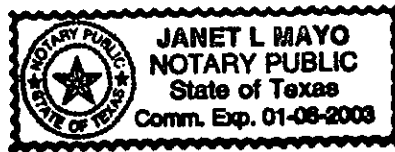
I hereby certify that the information contained in the foregoing Application is true and correct.



Ried R. Zulager, Secretary
Allied Riser of Missouri, Inc.

State of Texas)
)
County of)

Sworn to and subscribed before me, the undersigned Notary Public, By Ried R. Zulager, Secretary, Allied Riser of Missouri, Inc., on this the 4th day of May 2000.


Notary Public

My Commission Expires: 01-06-03

BEFORE THE PUBLIC SERVICE COMMISSION

STATE OF MISSOURI

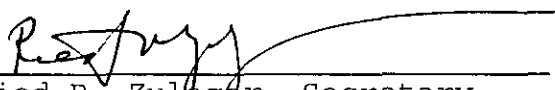
In the Matter of the Application of)
Allied Riser of Missouri, Inc.)
for a Certificate of Authority)
to Provide Interexchange)
Telecommunications Services in)
portions of the State of Missouri)

Case No. TA-2000-736

STATE OF TEXAS)
) ss
COUNTY OF)

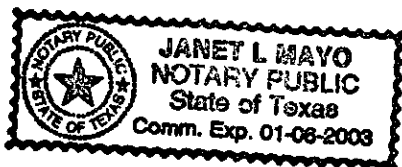
AFFIDAVIT


I Ried R. Zulager, Secretary, Allied Riser of Missouri, Inc., hereby authorize Richard S. Brownlee, III, or any member of the law firm of Hendren and Andrae, L.L.C., 221 Bolivar Street, P.O. Box 1069, Jefferson City, Missouri 65102, to sign all pleadings and documents necessary to receive the approval of the Missouri Public Service Commission for the Application in the above captioned matter.



Ried R. Zulager, Secretary
Allied Riser of Missouri, Inc.

Subscribed and sworn to before me, a Notary Public, in and for the State of Texas, this 4th day of May, 2000.





Notary Public

01-06-03
Commission Expires

BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of the Application of)
Allied Riser of Missouri, Inc.)
for a Certificate of Authority to)
Provide Interexchange)
Telecommunications Services in)
portions of the State of Missouri)

Case No. _____

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

VERIFICATION BY ATTORNEY

Now, on this 4th day of May, 2000, appears before me
Richard S. Brownlee, III, attorney for applicant and states that
the information contained in the attached Application is true and
accurate to his best information and belief.

Richard S. Brownlee III
Richard S. Brownlee, III

Subscribed and sworn to before me.

Laura J. Stratman
Notary Public

My Commission Expires: 9-13-2003



EXHIBIT A
CERTIFICATE OF AUTHORITY
ALLIED RISER OF MISSOURI, INC.



STATE OF MISSOURI
OFFICE OF SECRETARY OF STATE
JEFFERSON CITY 65102

Dear Corporation:

We have enclosed the Certificate of Incorporation/ Authority and Articles of Incorporation/Application for Authority which have been filed in this office. We wish you every success in the new business enterprise.

The law requires that the first annual registration report and a franchise tax report be completed and returned to this office as of the due date shown on the report. Some corporations will be exempt from filing the franchise tax report if their outstanding shares and surplus at the date of incorporation/qualification is less than \$200,000. These reports will be sent to the corporation's registered agent within the next few weeks.

The officers of the corporation may wish to familiarize themselves with the Missouri Uniform Securities Act (Chapter 409 RSMo). The act defines a security and provides that it is unlawful for any person to offer or sell any security in the State of Missouri unless it is registered under the Act or the security or transaction is exempted under Section 409.402 of the Act. Additionally, the Act provides that unless the transaction in which a security is offered for sale or sold is exempt from registration, or the person is excluded by definition, such person must be registered as a Securities Agent. This requirement does not apply to not-for-profit corporations.

Please feel free to contact our corporation or the Securities Division if we can be of any further assistance to you.

Sincerely,

REBECCA M. COOK
Secretary of State

Ltr. #11

STATE OF MISSOURI



Rebecca McDowell Cook
Secretary of State

CORPORATION DIVISION - CERTIFICATE OF AUTHORITY

WHEREAS,
 ALLIED RISER OF MISSOURI, INC.

USING IN MISSOURI THE NAME
 ALLIED RISER OF MISSOURI, INC.

HAS COMPLIED WITH THE GENERAL AND BUSINESS CORPORATION LAW WHICH GOVERNS FOREIGN CORPORATIONS; BY FILING IN THE OFFICE OF THE SECRETARY OF STATE OF MISSOURI AUTHENTICATED EVIDENCE OF ITS INCORPORATION AND GOOD STANDING UNDER THE LAWS OF THE STATE OF DELAWARE.

NOW, THEREFORE, I, REBECCA McDOWELL COOK, SECRETARY OF STATE OF THE STATE OF MISSOURI, DO HEREBY CERTIFY THAT SAID CORPORATION IS FROM THIS DATE DULY AUTHORIZED TO TRANSACT BUSINESS IN THIS STATE, AND IS ENTITLED TO ALL RIGHTS AND PRIVILEGES GRANTED TO FOREIGN CORPORATIONS UNDER THE GENERAL AND BUSINESS CORPORATION LAW OF MISSOURI.

IN TESTIMONY WHEREOF, I HAVE SET MY HAND AND IMPRINTED THE GREAT SEAL OF THE STATE OF MISSOURI, ON THIS, THE 28TH DAY OF SEPTEMBER, 1999.

Rebecca McDowell Cook
 Secretary of State



\$155-00



State of Missouri

Rebecca McDowell Cook, Secretary of State

Corporation Division

Application for Foreign Corporation For a Certificate of Authority

SEP 28 1999

(Submit in duplicate with filing fee of \$155.00)

Rebecca McDowell Cook
SECRETARY OF STATE

- (1) The corporation's name is ALLIED RISER OF MISSOURI, INC.
and it is organized and existing under the laws of DELAWARE
- (2) The name it will use in Missouri is ALLIED RISER OF MISSOURI, INC.
- (3) The date of its incorporation was 09-10-99, and the period of its duration is: perpetual
month/day/year
- (4) The address of its principal place of business 1700 PACIFIC, #400, DALLAS, TX 75201
Address City/State/Zip
- (5) The name and address of its registered agent and office in the State of Missouri is
Corporation Service Company d/b/a CSC-Lawyers Incorporating Service Company
221 Bolivar Street, Jefferson City, Missouri 65101
Name Address City/State/Zip
- (6) The specific purpose(s) of its business in Missouri are: communications services

- (7) The name of its officers and directors and their business addresses are as follows:

(Officers)	Name	Address	City/State/Zip
President	<u>See attached officers/directors rider</u>		
Vice President	<u></u>		
Secretary	<u></u>		
Treasurer	<u></u>		

(Board of Directors)

Director	<u>See attached officers/directors rider</u>
Director	<u></u>
Director	<u></u>
Director	<u></u>

- (8) The effective date of this document is the date it is filed by the Secretary of State of Missouri, unless you indicate a future date, as follows:

(Date may not be more than 90 days after the filing date in this office)

In affirmation thereof, the facts stated above are true.

Reed R. Zulager
(Authorized signature of officer or chairman of the board)

REED R. ZULAGER CORPORATE SECRETARY

(Title)

14/7/99
(Date of Signature)

Note: You must have a current certificate of good standing or certificate of existence with this application. This may be obtained from the Secretary of State or other authority that issues corporate charters.

EXHIBIT B

TECHNICAL STAFF OF

ALLIED RISER OPERATIONS CORPORATION

KEY EMPLOYEES
ALLIED RISER OPERATIONS CORPORATION

David H. Crawford has served as our chief executive officer since July 1998, was elected to our board of directors in July 1998, and from July 1998 to May 1999 also served as our president. From March 1997 until July 1998, Mr. Crawford was senior vice president – administration, general counsel – property operations and assistant secretary at Equity Office Properties Trust. From February 1991 until December 1996, Mr. Crawford held senior vice president, general counsel and other senior management positions at Equity Office Properties and their affiliates and was of counsel to Rosenberg & Liebenritt. Mr. Crawford was an associate at Kirkland & Ellis, a national law firm based in Chicago, Illinois, from June 1988 until February 1991.

John M. Todd has served as our president and chief operating officer since May 1999 and was elected to our board of directors in May 1999. From February 1996 to May 1999, Mr. Todd was vice president – sales support services for Sprint Business and vice president – technology integration for Sprint Business. From February 1986 until February 1996, Mr. Todd held various officer and senior management positions at MCI, including vice president for professional services, product management and marketing.

John H. Davis, Ph.D., has served as our chief technology officer since July 1999 and was elected to our board of directors in December 1998. Since September 1997, Dr. Davis has been a principal of GeoPartners Research. Prior to September 1997, Dr. Davis held senior management positions at Bell Labs and AT&T, culminating in his role as the chief technology officer for AT&T Communications Services from 1993 until September 1997. Dr. Davis presently serves on the board of directors of Acoustics Technologies, a start-up company in Phoenix, Arizona.

Todd C. Doshier has served as our chief financial officer since December 1996 and served as our chief operating officer from December 1996 to May 1999. From May 1991 until December 1996, Mr. Doshier was a principal in Doshier & Co. (later Perry, Nestman & Doshier), which provided corporate consulting, financial advisory and management services.

Michael R. Carper has served as our senior vice president and general counsel since June 1999. From August 1995 to June 1999, Mr. Carper was assistant general counsel and assistant secretary of Nextel Communications. From August 1993 until July 1995, Mr. Carper was vice president – general counsel of OneComm Communications, when it merged with Nextel. Prior to August 1993, Mr. Carper

Ms. Hardesty held senior management positions at Accugraph Corporation/ Architel Systems in the areas of human resources, customer support and customer services.

John D. Keys has served as our vice president – construction since November 1997. Prior to joining us as a consultant in March 1997 and since 1968, Mr. Keys founded two international electrical construction firms and has served as a senior officer of Blount, Foley Enterprises and Fishbach & Moore.

Douglas J. Morgan has served as our vice president – strategic national initiative since July 1999. Since 1991, Mr. Morgan has held officer and senior management positions at Winstar and Unisys in the areas of enhanced services, sales, business development, marketing, product management, training, strategic initiatives and media relations.

Steve L. Reichert has served as our vice president – information technology since June 1999. Since 1994, Mr. Reichert has held officer and senior management positions at Pagenet and Pro Staff in the areas of business systems development, IT consulting services, customer systems development, network systems development and technical architecture planning.

Charles W. Yeargain has served as our vice president – finance since December 1996. Since 1984, Mr. Yeargain has founded an investment and consulting firm and has held officer positions at AMRESKO Management and Texas American Bank.

EXHIBIT C

FINANCIAL STATEMENTS OF

ALLIED RISER COMMUNICATIONS CORPORATION

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders of
Allied Riser Communications Corporation:

We have audited the accompanying consolidated balance sheets of Allied Riser Communications Corporation (a Delaware corporation) and subsidiaries as of December 31, 1997 and 1998, and the related consolidated statements of operations, stockholders' deficit and cash flows for the period from inception (December 19, 1996) to December 31, 1997 and the year ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Allied Riser Communications Corporation and subsidiaries as of December 31, 1997 and 1998, and the results of their operations and their cash flows for the period from inception (December 19, 1996) to December 31, 1997 and the year ended December 31, 1998, in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Dallas, Texas,
January 11, 1999 (except with
respect to the matters discussed in
Note 12, as to which the date
is April 29, 1999)

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS — DECEMBER 31, 1997 AND 1998

ASSETS

	<u>1997</u>	<u>1998</u>
CURRENT ASSETS:		
Cash and cash equivalents	\$ 187,919	\$ 41,371,453
Accounts receivable, net of reserve of \$2,123 in 1998	—	19,979
Stock subscription receivable	—	7,371
Prepaid expenses and other current assets	3,390	131,023
Total current assets	191,309	41,529,826
PROPERTY AND EQUIPMENT, net of accumulated depreciation and amortization of \$10,477 and \$509,674 in 1997 and 1998, respectively	1,250,353	13,004,626
OTHER ASSETS	44,951	1,037,065
Total assets	<u>\$ 1,486,613</u>	<u>\$ 55,571,517</u>

LIABILITIES AND STOCKHOLDERS' DEFICIT

CURRENT LIABILITIES:		
Accounts payable	\$ 341,641	\$ 271,756
Accrued liabilities	318,694	2,842,503
Current maturities of debt	2,517,715	—
Current maturities of capital lease obligations	—	722,338
Total current liabilities	3,178,050	3,836,597
DEBT, net of current maturities	50,107	—
CAPITAL LEASE OBLIGATIONS, net of current maturities	—	1,420,385
Total liabilities	3,228,157	5,256,982
COMMITMENTS AND CONTINGENCIES		
CONVERTIBLE REDEEMABLE PREFERRED STOCK, \$.0001 par value, 1,000 shares authorized, Series A, 66 shares issued and outstanding in 1998 (aggregate redemption of \$66,451,781)	—	66,451,781
STOCKHOLDERS' DEFICIT:		
Common stock, \$.0001 par value, 1,000,000,000 shares authorized, 3,621,498 and 385,745,936 shares issued and outstanding in 1997 and 1998, respectively	362	38,575
Additional paid-in capital	162,333	338,752
Accumulated deficit	(1,904,239)	(16,514,573)
Total stockholders' deficit	(1,741,544)	(16,137,246)
Total liabilities and stockholders' deficit	<u>\$ 1,486,613</u>	<u>\$ 55,571,517</u>

The accompanying notes are an integral part of these consolidated balance sheets.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

**For the Period From Inception (December 19, 1996) to
December 31, 1997 and the Year Ended December 31, 1998**

	For the Period from Inception to December 31, 1997	For the Year Ended December 31, 1998
NETWORK SERVICES REVENUE	\$ —	\$ 212,285
OPERATING EXPENSES:		
Network operations	79,624	2,358,196
Selling expense	—	1,623,292
General and administrative expenses	1,348,451	9,735,336
Depreciation and amortization	10,477	499,197
Total operating expenses	<u>1,438,552</u>	<u>14,216,021</u>
OPERATING INCOME (LOSS)	<u>(1,438,552)</u>	<u>(14,003,736)</u>
OTHER INCOME (EXPENSE):		
Interest expense	(123,196)	(724,777)
Interest income	37,421	117,179
Other income, net	27,116	1,000
Total other income (expense)	<u>(58,659)</u>	<u>(606,598)</u>
NET INCOME (LOSS) BEFORE INCOME TAXES	<u>(1,497,211)</u>	<u>(14,610,334)</u>
PROVISION FOR INCOME TAXES	—	—
NET INCOME (LOSS)	<u>(1,497,211)</u>	<u>(14,610,334)</u>
ACCRUED DIVIDENDS ON PREFERRED STOCK	—	(451,781)
NET INCOME (LOSS) APPLICABLE TO COMMON STOCK	<u>\$(1,497,211)</u>	<u>\$(15,062,115)</u>
NET INCOME (LOSS) PER COMMON SHARE	<u>\$ (.50)</u>	<u>\$ (.49)</u>
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	<u>3,013,252</u>	<u>30,841,031</u>

The accompanying notes are an integral part of these consolidated financial statements.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
For the Period from Inception (December 19, 1996) to December 31, 1997
And the Year Ended December 31, 1998

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total
	Number of Shares	Amount			
BALANCE, December 19, 1996 (date of inception)	—	\$ —	\$ —	\$ —	\$ —
Issuance of common stock in conjunction with the DPI Tech and DPI merger (see Note 1) ...	3,000,000	300	156,180	(407,028)	(250,548)
Issuance of common stock	621,498	62	6,153	—	6,215
Net income (loss)	—	—	—	(1,497,211)	(1,497,211)
BALANCE, December 31, 1997	3,621,498	362	162,333	(1,904,239)	(1,741,544)
Issuance of common stock	382,124,438	38,213	—	—	38,213
Stock issuance costs	—	—	(351,580)	—	(351,580)
Capital contribution by SZI and EOP	—	—	979,780	—	979,780
Accrued cumulative dividends on preferred stock	—	—	(451,781)	—	(451,781)
Net income (loss)	—	—	—	(14,610,334)	(14,610,334)
BALANCE, December 31, 1998	<u>385,745,936</u>	<u>\$38,575</u>	<u>\$ 338,752</u>	<u>\$(16,514,573)</u>	<u>\$(16,137,246)</u>

The accompanying notes are an integral part of these consolidated financial statements

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Period from Inception (December 19, 1996) to December 31, 1997
And the Year Ended December 31, 1998

	For the Period from Inception to December 31, 1997	For the Year Ended December 31, 1998
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$(1,497,211)	\$(14,610,334)
Adjustments to reconcile net loss to net cash used in operating activities —		
Depreciation and amortization	10,477	499,197
Changes in assets and liabilities —		
Increase in accounts receivable, net	—	(19,979)
Increase in prepaid expenses and other current assets	(3,390)	(127,633)
Increase in other assets	(44,062)	(992,114)
Increase in accounts payable and accrued liabilities	305,556	830,567
Net cash used in operating activities	<u>(1,228,630)</u>	<u>(14,420,296)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(1,260,830)	(8,115,325)
Cash received in the merger and liquidation in the net assets of DPI and DPI Tech (see Note 1)	173,059	—
Net cash used in investing activities	<u>(1,087,771)</u>	<u>(8,115,325)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from debt	2,505,803	15,100,000
Payments of debt	(7,698)	(17,667,822)
Payments on capital lease obligations	—	(372,065)
Proceeds from related party loans	160,000	—
Payments on related party loans	(160,000)	—
Capital contribution by SZI and EOP	—	979,780
Proceeds from issuance of common stock	6,215	30,842
Proceeds from issuance of preferred stock	—	66,000,000
Stock issuance costs	—	(351,580)
Net cash provided by financing activities	<u>2,504,320</u>	<u>63,719,155</u>
INCREASE IN CASH AND CASH EQUIVALENTS	187,919	41,183,534
CASH AND CASH EQUIVALENTS, beginning of period	—	187,919
CASH AND CASH EQUIVALENTS, end of period	<u>\$ 187,919</u>	<u>\$ 41,371,453</u>
SUPPLEMENTAL CASH FLOW DISCLOSURES:		
Cash paid for interest	\$ 11,602	\$ 113,457
Noncash investing and financing activities —		
Equipment acquired under capital leases	—	2,514,788
Accrued dividends on preferred stock	—	451,781
Accrued property and equipment additions	—	1,623,357

The accompanying notes are an integral part of these consolidated financial statements.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1997 and 1998

1. Organization:

Allied Riser Communications Corporation ("ARC Corporation") (collectively including all predecessors, the "Company") was incorporated on November 2, 1998, as a Delaware corporation. Immediately following its incorporation, a reorganization of its predecessor, RCH Holdings, Inc. ("RCH"), occurred. The wholly owned subsidiaries of RCH, Allied Riser Communications, Inc. ("ARC"), a Texas corporation, and Carrier Direct, Inc. ("Carrier Direct"), a Texas corporation, distributed their assets and liabilities to RCH in a complete liquidation and dissolution. Thereafter, RCH transferred all of its assets and liabilities to ARC Corporation in exchange for shares of ARC Corporation common stock. ARC Corporation then contributed the assets and liabilities acquired to its wholly owned subsidiary, Allied Riser Communications, Inc., a Delaware corporation.

RCH was incorporated on December 19, 1996, as a Texas corporation. Concurrent with its formation, RCH purchased 100% of the outstanding common stock of two newly formed corporations, ARC (formerly RiserCorp, Inc.) and Carrier Direct. For the period from December 19, 1996 through December 31, 1996, RCH had no operations.

On February 14, 1997, DPI Technology Resources, Inc. ("DPI Tech") and Digital Packet Interface Solutions, Inc. ("DPI"), two affiliates under common control, merged with and into RCH. The stockholders of DPI Tech and DPI exchanged all the outstanding stock for stock of RCH. DPI Tech and DPI had no significant operations before the merger with RCH and concurrent with the merger, the Company made a decision to discontinue the operations and business activities of DPI Tech and DPI. Accordingly, substantially all of the net assets of DPI Tech and DPI were liquidated subsequent to the merger. Due to the merger and subsequent liquidation and as the DPI Tech and DPI operations were separate and distinctly different from RCH's business plan, historical financial results of DPI Tech and DPI for 1996 have not been presented. In 1996, DPI Tech and DPI incurred a combined loss of \$363,653. The merger of the companies was accounted for as an exchange between companies under common control, as such, the assets and liabilities were recorded on a historical cost basis at the date of inception of RCH.

The Company is a facilities-based provider of broadband data, video, and voice communications services to small-and-medium-sized businesses in major metropolitan areas in the United States. The Company's services, which today include ultra high-speed Internet access, business-oriented television for display on the computer desktop, and Internet-enhanced voice conferencing calling services, among others, are typically delivered to the Company's customers over its own fiber optic network built inside multi-tenant commercial office buildings. In addition to selling services to the commercial tenants of buildings in which the Company owns and operates these advanced communications networks, the Company leverages its market presence and brand by offering end-to-end connectivity on a resold basis to businesses located outside these buildings.

Until April 29, 1999, the Company was in the development stage (see Note 12). Since its inception on December 19, 1996, the Company's principal activities have included developing its business plans, procuring governmental authorizations, raising capital, hiring management and other key personnel, working on the design and development of its high capacity fiber-optic networks, acquiring equipment and facilities, and negotiating interconnection agreements. Accordingly, the Company has incurred operating losses and operating cash flow deficits.

The Company's success will be affected by the problems, expenses and delays encountered by early stage companies and the competitive environment in which the Company intends to

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

operate. Certain key risk factors which may impact the Company include: the Company's ability to successfully market its products and services and to generate profitable results, the availability of adequate financial and capital resources to finance the execution of the Company's business plan, the Company's industry is highly competitive and competitive threats are expected to increase, the Company operates in an industry subject to rapid technological changes and future changes may negatively impact the Company's ability to successfully market its products and services, the availability of adequate network capacity from other communication carriers and the Company's ability to manage its anticipated growth. The Company's failure to mitigate these significant risk factors will have a material adverse effect on the Company's business, financial condition and results of operations. Although management believes that the Company will be able to successfully mitigate these risks, management cannot give assurances that it will be able to do so or that the Company will ever operate profitably.

2. Summary of Significant Accounting Policies:

Consolidation

The accompanying financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and marketable securities with original maturities of three months or less.

Property and Equipment

Property and equipment are stated at cost and depreciated once placed in service using the straight-line method. Interest is capitalized during the construction period of system infrastructure based on the rates applicable to borrowings outstanding during the period. Equipment held under capital lease obligations is amortized over the estimated useful life of the asset. Equipment held under capital lease obligations amounted to approximately \$2,453,000, net of accumulated amortization of approximately \$62,000, as of December 31, 1998. No equipment was held under capital leases as of December 31, 1997.

The Company periodically evaluates its long-lived assets, including property and equipment, to determine whether events or changes in circumstances have occurred that indicate the remaining asset balances may not be recoverable and an impairment loss should be recorded. Repair and maintenance costs are expensed as incurred.

Revenue Recognition

Network services revenue is recognized in the month in which the service is provided. All expenses related to services provided are recognized as incurred.

Network Operations

Network operations includes all costs associated with service delivery, ARC network management, and customer support.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Selling Expense

Selling expense includes employee salaries and commissions, marketing, advertising, and promotional expenses and costs associated with leasing and operating sales demonstration centers.

Income Taxes

Deferred income tax assets and liabilities are recorded for the differences between the tax and financial reporting basis of the assets and liabilities and are based on the enacted income tax rates which are expected to be in effect in the period in which the difference is expected to be settled or realized. A change in tax laws would result in adjustments to the deferred tax assets and liabilities.

Use of Estimates in Financial Statements

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. *Actual results may differ from those estimates.*

New Accounting Standards

The American Institute of Certified Public Accountants issued Statement of Position (SOP) 98-5, "Reporting on the Costs of Start-Up Activities," in April 1998. Effective for financial statements for fiscal years beginning after December 15, 1998, SOP 98-5 requires costs of start-up activities and organization costs to be expensed as incurred. Start-up activities are defined as those one-time activities related to opening a new facility, introducing a new product or service, conducting business in a new territory, conducting business with a new class of customer or beneficiary, initiating a new process in an existing facility, or commencing some new operation. The Company has not capitalized any expenses with such characteristics for financial reporting purposes. Therefore, the Company believes adoption of this SOP will not materially impact the consolidated financial statements.

Net Income (Loss) Per Share

Net income (loss) per share is presented in accordance with the provisions of Statement of Financial Accounting Standards No. 128, "Earnings Per Share," (SFAS 128). SFAS 128 requires a presentation of basic EPS and diluted EPS. Basic EPS excludes dilution for common stock equivalents and is computed by dividing income or loss available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock and resulted in the issuance of common stock.

Convertible redeemable preferred stock was outstanding at December 31, 1998. These securities were not considered in a computation of diluted EPS at December 31, 1998 as the conversion is dependent upon a qualifying public offering or qualifying recapitalization, as defined in the articles of incorporation.

Diluted EPS is not presented as all potentially dilutive securities would be antidilutive.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

3. Property and Equipment:

Property and equipment as of December 31, consist of the following:

	Average Estimated Useful Lives (Years)	1997	1998
Office equipment	4	\$ 156,587	\$ 1,944,527
Furniture and fixtures	7	892	71,770
Leasehold improvements	5	639	450,818
System infrastructure	10	—	2,420,834
System equipment	5	—	2,240,357
Construction-in-progress		1,102,712	6,385,994
		1,260,830	13,514,300
Less —			
Accumulated depreciation and amortization		(10,477)	(509,674)
Property and equipment, net		<u>\$1,250,353</u>	<u>\$13,004,626</u>

Capitalized interest for the period from inception (December 19, 1996) to December 31, 1997 and the year ended December 31, 1998 was approximately \$41,000 and \$221,000, respectively.

4. Other Assets:

Other assets as of December 31, consist of the following:

	1997	1998
Restricted cash	\$ —	\$ 550,000
Deposits	44,951	487,065
	<u>\$44,951</u>	<u>\$1,037,065</u>

Restricted cash represents cash securing a letter of credit issued by a bank in accordance with an operating lease for office space.

5. Accrued Liabilities:

Accrued liabilities as of December 31, consist of the following:

	1997	1998
Property and equipment additions	\$ —	\$1,751,779
Legal fees	—	50,000
General operating expenses	—	285,000
Rent	—	264,333
Interest	151,240	—
Property taxes	—	145,795
Other taxes	—	100,192
Other	167,454	245,404
	<u>\$318,694</u>	<u>\$2,842,503</u>

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

6. Debt:

Debt as of December 31, consist of the following:

	1997	1998
Credit agreement due August 10, 1998, bearing interest at prime plus 2%, secured by all property of the Company ..	\$ 2,500,000	\$ —
Bank loan agreement due April 28, 2001, bearing interest at prime plus 2%, secured by property of the Company	67,822	—
	2,567,822	
Current maturities	(2,517,715)	—
Debt, net of current maturities	<u>\$ 50,107</u>	<u>\$ —</u>

On May 16, 1997, the Company entered into a credit agreement with S Z Investments, L.L.C. ("SZI") to finance the initial network installation and other general corporate purposes (see Notes 8, 9 and 11). Between January 15, 1998 and November 18, 1998, the Company and SZI executed several amendments to the credit agreement, which effectively increased the original principal amount of \$2,500,000 to a total aggregate amount of \$14,000,000. As part of the agreement, SZI received a security interest in all of the Company's assets and outstanding common shares. On November 23, 1998, the Company repaid the entire outstanding balance of \$14,000,000 under the credit agreement. In May 1998, EOP Operating Limited Partnership ("EOP") advanced the Company \$3,600,000 for the construction of certain infrastructure in Equity Office Properties Trust ("EOPT") buildings. The Company repaid the entire \$3,600,000 advance on November 23, 1998 (see Notes 8, 9 and 11).

Accrued interest totaling \$979,780 was contributed by SZI and EOP. As both SZI and EOP are related parties, the contribution has been accounted for as a capital transaction and included in the accompanying consolidated statements of stockholders' deficit (see Notes 8, 9 and 11).

On May 29, 1997, the Company issued a \$75,520 promissory note to a bank. The note was paid off in November 1998 in conjunction with the Company's equity funding (see Notes 8 and 9).

7. Commitments and Contingencies:

Operating Leases

The Company has entered into various operating lease agreements, with expirations through 2004, for leased space and equipment. Future minimum lease obligations as of December 31, 1998, related to the Company's operating leases are as follows:

1999	\$1,312,219
2000	1,319,126
2001	1,288,708
2002	1,152,993
2003	1,207,270
Thereafter	24,098
Total minimum lease obligations	<u>\$6,304,414</u>

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Total rent expense for the period from inception (December 19, 1996) to December 31, 1997, and for the year ended December 31, 1998, was approximately \$94,000 and \$586,000, respectively.

Capital Leases

The Company has entered into various capital leases for equipment. Future minimum lease obligations as of December 31, 1998, related to the Company's capital leases are as follows:

1999	\$ 918,493
2000	987,805
2001	571,596
Thereafter	—
Total minimum lease obligations	2,477,894
Less — Amounts representing interest	(335,171)
Present value of minimum lease obligations	2,142,723
Current maturities	(722,338)
Capital lease obligations, net of current maturities	<u>\$1,420,385</u>

Connectivity Contracts

In order to provide its services, the Company must connect each intra-building network to a local network and each metropolitan point of presence to a national fiber optic backbone. The Company has secured contracts that range from monthly to five years for local transport and up to three years for national inter-city transport. The Company incurs fixed monthly charges for local connectivity. For national backbone connectivity, the Company incurs fixed monthly charges plus incremental charges for customer usage above a certain volume. In addition, in the event the Company fails to meet its minimum volume commitments for national backbone connectivity, it may be obligated to pay underutilization charges.

Future minimum obligations as of December 31, 1998, related to the Company's connectivity contracts are as follows:

1999	\$328,679
2000	49,800
2001	34,950
2002	30,000
2003	25,000
Total minimum lease obligations	<u>\$468,429</u>

Litigation

The Company is involved in certain litigation arising in the ordinary course of business. Management believes that such litigation will be resolved without material effect on the Company's financial position or results of operations.

8. Convertible Redeemable Preferred Stock:

Pursuant to the Investment Agreement dated November 23, 1998, in November and December 1998, the Company issued to a group of investors 41 and 25 shares of Series A convertible redeemable preferred stock (the "Preferred Stock"), respectively, for \$41,000,000

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

and \$25,000,000 in cash, respectively. Proceeds from the issuance were used to repay all outstanding indebtedness (see Note 6).

The shareholders of the Preferred Stock are entitled to certain rights as described below:

•*Redemption* — Upon the occurrence of a qualifying public offering or qualifying recapitalization as defined in the Articles of Incorporation, the holders of at least a majority of the outstanding shares of Preferred Stock may elect to redeem all or any part of the Preferred Stock at a price per share equal to the liquidation value (\$1,000,000 per share) plus accrued and unpaid dividends (\$451,781 for all preferred shares as of December 31, 1998).

•*Conversion Rights* — Upon the occurrence of a qualifying public offering or qualifying recapitalization as defined in the Articles of Incorporation, the holders of at least a majority of the outstanding shares of Preferred Stock may elect to convert all or any portion of their Preferred Stock into shares of common stock computed by dividing the liquidation value of the Preferred Stock by the applicable market value of the common stock. Regardless of the foregoing, all issued and outstanding shares of Preferred Stock not redeemed shall be automatically converted into shares of common stock upon a qualifying public offering.

•*Dividends* — Dividends shall accrue on a daily basis at a rate of 10% per annum on the liquidation value (\$1,000,000 per share). The dividends shall be cumulative such that all accrued and unpaid dividends shall be fully paid or declared before any dividend may be made with respect to any common shares. Additionally, in certain situations upon occurrence of a qualifying initial public offering or qualifying recapitalization (1) no further dividends shall accrue on the Series A Preferred Stock (2) any accrued but unpaid dividends on the Series A Preferred Stock shall be waived and (3) each holder of shares of Series A Preferred Stock shall return all previous paid dividends to the Company.

•*Liquidation Preference* — Each share of Preferred Stock outstanding at the time of a "liquidating event," as defined in the Articles of Incorporation, shall be paid \$1,000,000 per share, plus any accrued and unpaid dividends.

As a result of the redemption provision, the Preferred Stock has been presented outside of stockholders' deficit.

9. Common Stock:

On February 14, 1997, DPI Tech and DPI, two affiliates under common control, merged with and into RCH. The stockholders of DPI Tech exchanged 75,000 shares, and the stockholders of DPI exchanged 151,266 shares, which represented the total outstanding shares of both entities, respectively, for 3,000,000 shares of RCH (see Note 1).

In early 1997, after the formation of RCH and the merger with DPI Tech and DPI, RCH sold 621,498 shares at par, \$.01, to executives and various other related parties. As discussed in Note 6, all shares were pledged as security for the loan from SZI.

On November 16, 1998, the stockholders of RCH approved an amendment to the Articles of Incorporation increasing authorized shares to 55,000,000 shares from 10,000,000 shares and reducing the par value to no par from \$.01.

In November 1998, ARC Corporation, the successor to RCH, authorized the issuance of up to 1,000,001,000 shares of capital stock, par value \$.0001 per share, of which 1,000,000,000 shares were designated as common stock and 1,000 shares were designated as

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Series A convertible redeemable preferred stock. The consolidated financial statements and the notes thereto have been adjusted to reflect the change in par value on a retroactive basis.

In conjunction with the reorganization, RCH transferred all of its assets and liabilities to ARC Corporation in exchange for 52,436,790 shares of ARC Corporation common stock, which represented the 3,000,000 shares issued in the DPI Tech and DPI mergers, the 621,498 shares issued to executives and various other related parties during 1997, and 48,815,292 shares to be issued to management, current and former employees, and non-employee stockholders for \$.0001 per share during 1999. Certain of these shares are subject to vesting as described below in the stockholders' agreement.

Pursuant to an investment agreement dated November 23, 1998, the Company issued to a group of investors 199,046,347 shares of common stock for \$.0001 per share, which management believes represented the fair value of the shares. Subject to a subscription agreement, 13,911,992 additional shares of common stock were reserved by the Company in connection with this transaction. Subscription agreements entered into by the former RCH stockholders granted protection against dilution, in the event of certain issuances of ARC Corporation common stock. Certain of these shares are subject to vesting as described below in the stockholders' agreement. The subscribers were entitled to purchase common stock in an amount equal to 25% of the total common stock outstanding up to \$60,000,000 of cash equity investments in ARC Corporation (including the capital invested by the group of investors upon their purchase of ARC Corporation preferred stock in connection with the reorganization and recapitalization).

On December 30, 1998, the Company issued to a second group of investors 109,366,125 shares of common stock for \$.0001 per share. In accordance with the subscription agreement described above, 24,896,674 shares of common stock were issued to RCH for distribution to management, current and former employees, and non-employee stockholders for \$.0001 per share, and an additional 5,809,411 shares of common stock were reserved by the Company. As a result of this transaction, ARC Corporation equity investment exceeded \$60,000,000, effectively terminating all anti-dilution rights. Including the 52,436,790 shares exchanged for the RCH common stock to be issued to management, current and former employees, and non-employee stockholders, and the 199,046,347 shares issued to a group of investors in November 1998, the aggregate common shares issued by the Company during 1998 totaled 385,745,936. Of the 385,745,936 shares issued during 1998, 73,711,966 shares were issued to RCH for subsequent issuance to management, current and former employees and non-employee stockholders subject to subscription agreements. The subscription agreements were ratified and the shares were distributed by RCH on January 11, 1999. Reserved shares totaling 19,721,403 will be used by management for issuance to new employees and potentially for issuance under a stock option agreement. Issuance costs of approximately \$351,580 were offset against additional paid-in capital.

Stockholders' Agreement

As a condition of the investment agreement discussed above, on November 5, 1998, a stockholders' agreement was established which stipulates the terms under which the Company's shares can be sold or transferred. Among other things, the agreement states that any stockholder wishing to sell his shares must first allow the Company and certain other stockholders the option to purchase the shares. The agreement shall terminate at the election of all the Series A Preferred stockholders and at least 50% of the common stockholders.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

With respect to stockholders who are employees of the Company or its successors, the subscription agreements provide that the shares of ARC Corporation common stock held by such subscribers shall be restricted, non-transferable, and subject to repurchase by the Company, or its successors, until vested. Unvested shares vest over four years in equal monthly installments commencing upon their issuance. The vesting schedule may be accelerated upon the occurrence of certain extraordinary events. Upon the resignation or termination of an employee subscriber for any reason, all unvested shares will be subject to repurchase by the Company, or its successors, at the price paid by the employee.

The vesting schedule for the shares that have been issued or subscribed through December 31, 1998, for the years ending December 31 is:

1998	29,739,084
1999	9,042,564
2000	9,042,564
2001	9,042,564
2002	8,289,015

Prior to the reorganization, the Company had both outstanding warrants to purchase common stock and outstanding stock rights. At November 23, 1998, all outstanding warrants and stock rights were extinguished, except for warrants to purchase approximately 72,000 shares of common stock held by one individual. It is management's opinion that these warrants are currently not exercisable.

10. Income Taxes:

The provision (benefit) for income taxes for the year ended December 31 consist of the following:

	<u>1997</u>	<u>1998</u>
Current	\$—	\$—
Deferred	—	—
Total	<u>\$—</u>	<u>\$—</u>

The differences between the statutory federal income tax rates and the Company's effective income tax rate for the year ended December 31, are as follows:

	<u>1997</u>	<u>1998</u>
Computed statutory tax expense	(34.0)%	(34.0)%
Non-deductible expenses and non-book income	0.3 %	2.4 %
Valuation allowance	<u>33.7 %</u>	<u>31.6 %</u>
	<u>—</u>	<u>—</u>

Deferred taxes reflect the impact of temporary differences between the amount of assets and liabilities for financial reporting purposes and such amounts as incurred by tax laws and regulations.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table discloses the components of the deferred tax amounts at December 31:

	1997	1998
Deferred tax assets —		
Temporary difference for basis in and depreciation of property and equipment	\$ 5,698	\$ 157,754
Start-up costs	406,246	3,896,352
Net operating loss	92,895	811,920
Other	—	76,090
Total deferred tax assets	504,839	4,942,116
Deferred tax liability	—	—
Net deferred tax asset	504,839	4,942,116
Less — Valuation allowance	(504,839)	(4,942,116)
Net deferred tax amount	<u>\$ —</u>	<u>\$ —</u>

The Company had approximately \$2,388,000 of net operating loss carryforward for federal income tax purposes at December 31, 1998. The net operating loss carryforward will expire in the year 2018 if not previously utilized. Under existing income tax law, all operating expenses incurred prior to a company commencing its principal operations are capitalized and amortized over a five-year period for tax purposes. On November 23, 1998, the Company commenced its principal operations for tax purposes and no longer capitalizes operating expenses as start-up costs.

A valuation allowance must be provided when it is more likely than not that some portion of the deferred tax asset will not be realized. Management has decided to record this allowance due to the uncertainty of future operating results. In subsequent periods, the Company may reduce the valuation allowance, provided that utilization of the deferred tax asset is more likely than not, as defined by SFAS No. 109.

11. Related Parties:

One member of the group of investors that purchased common stock and Preferred Stock on November 23, 1998, was EGI-ARC Investors, L.L.C. ("EGI-ARC"). The managing member of EGI-ARC is indirectly controlled by Samuel Zell. EGI-ARC purchased 85,305,577 shares of common stock and 15 shares of Series A Preferred Stock. Further, an affiliate of Samuel Zell is a passive investor in Telecom Partners, L.P. ("TP"). TP purchased 74,368,965 shares of common stock and 17 shares of Series A Preferred Stock.

Samuel Zell owns and controls SZI, a lender who had provided the majority of the Company's debt prior to November 23, 1998 (see Note 6). Affiliates of Samuel Zell own an interest in and/or control a number of entities with which the Company has entered into contractual or other relationships. Samuel Zell is Chairman of the Board of Trustees of EOPT, a publicly held Real Estate Investment Trust. The Company has telecommunications license agreements with 40 EOPT properties. In certain of these properties, the Company paid approximately \$155,900 to EOPT for rent and other related costs during the year ended December 31, 1998. In addition, EOP advanced the Company \$3,600,000 for infrastructure in EOPT buildings (see Note 6).

Samuel Zell is Chairman of Anixter International, Inc., ("Anixter") a supplier of wiring systems, networking, and internetworking products for voice, data, and video networks. Anixter supplies the Company with certain of its requirements for fiber optic cable and other materials

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

used in the installation of the ARC Network. For the period from inception (December 19, 1996) to December 31, 1997 and the year ended December 31, 1998, the Company paid Anixter approximately \$195,000 and \$2,319,000, respectively, for such supplies.

In addition, the Company purchases its commercial general liability and other insurance policies through EGI Risk Services, Inc., an insurance brokerage affiliated with Samuel Zell. For the year ended December 31, 1998, the Company remitted approximately \$64,000 to EGI Risk Services, Inc. Moreover, the Company has engaged Rosenberg & Liebenritt, P.C. for certain legal services. Rosenberg & Liebenritt, P.C. is a captive law firm that provides legal services to Samuel Zell and his affiliates. For the year ended December 31, 1998, the Company paid approximately \$323,000 for such legal services.

In April 1997, Mrs. O.W. Koberg, a related party of William Koberg, a shareholder, lent the Company \$100,000, at 10% annual interest, for the purpose of funding continuing operations. This loan was paid shortly after the Company received the funding from SZI in June 1997 (see Note 6).

In December 1996, Todd Doshier, the CFO and shareholder, and Steve Polizzi, a shareholder, lent the Company \$60,000, for the purpose of funding continuing operations. The loan was repaid on February 20, 1997.

12. Subsequent Events

In March 1999, the Company entered into a credit facility under which the Company can borrow up to \$45,000,000, subject to certain conditions. The facility will accrue interest at one of the following or a combination of the following, at the Company's option: the bank's prime rate plus 3.5%, a base CD rate plus 4.5%, Federal funds rate plus 4.0%, or an Eurodollar rate plus 4.5%. The credit facility is secured by all of the Company's assets, except for the assets pledged in connection with the Company's capital lease obligations. The Company paid an origination fee of \$1,350,000 in conjunction with the agreement. This amount is being amortized to interest expense over the term of the agreement. The Company pays a commitment fee of 1.5% on the unused portion of the credit facility once the facility is initially borrowed against. The facility, which extends through October 2000, contains various restrictive covenants, including the maintenance of certain financial ratios, the achievement of certain operation targets and restrictions on certain activities.

On April 29, 1999, the Company successfully deployed a significant product and emerged from the development stage.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEET — JUNE 30, 1999

ASSETS

CURRENT ASSETS:

Cash and cash equivalents	\$ 24,307,103
Accounts receivable, net of reserve of \$6,378	113,666
Stock subscription receivable	762
Prepaid expenses and other current assets	269,110
Total current assets	24,690,641
PROPERTY AND EQUIPMENT, net	20,764,738
OTHER ASSETS	1,764,889
Total assets	<u>\$ 47,220,268</u>

LIABILITIES AND STOCKHOLDERS' DEFICIT

CURRENT LIABILITIES:

Accounts payable	\$ 789,905
Accrued liabilities	5,145,063
Current maturities of capital lease obligations	1,882,444
Total current liabilities	7,817,412
CAPITAL LEASE OBLIGATIONS, net of current maturities	3,493,405
Total liabilities	11,310,817

COMMITMENTS AND CONTINGENCIES

CONVERTIBLE REDEEMABLE PREFERRED STOCK, \$.0001 par value, 1,000 shares authorized, Series A, 66 shares issued and outstanding (aggregate redemption of \$69,751,781)	69,751,781
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STOCKHOLDERS DEFICIT:

Common Stock, \$.0001 par value, 1,000,000,000 shares authorized, 401,814,487 shares issued and outstanding	40,181
Additional paid-in capital	(2,961,248)
Accumulated deficit	(30,921,263)
Total stockholders' deficit	(33,842,330)
Total liabilities and stockholders' deficit	<u>\$ 47,220,268</u>

The accompanying notes are an integral part of this
condensed consolidated balance sheet.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
For the Three Months Ended June 30, 1998, and 1999

	<u>1998</u>	<u>1999</u>
NETWORK SERVICES REVENUE	\$ 22,325	\$ 401,466
OPERATING EXPENSES:		
Network operations	497,913	1,651,634
Selling expense	394,007	1,800,590
General and administrative expenses	1,764,938	5,598,985
Depreciation and amortization	45,172	504,292
Total operating expenses	<u>2,702,030</u>	<u>9,555,501</u>
OPERATING INCOME (LOSS)	(2,679,705)	(9,154,035)
OTHER INCOME (EXPENSE):		
Interest expense	(151,994)	(390,806)
Interest income	8,061	349,092
Other income (expense), net	1,000	(4,926)
Total other income (expense)	<u>(142,933)</u>	<u>(46,640)</u>
NET INCOME (LOSS) BEFORE INCOME TAXES	<u>(2,822,638)</u>	<u>(9,200,675)</u>
PROVISION FOR INCOME TAXES	—	—
NET INCOME (LOSS)	(2,822,638)	(9,200,675)
ACCRUED DIVIDENDS ON PREFERRED STOCK	—	(1,650,000)
NET INCOME (LOSS) APPLICABLE TO COMMON STOCK	<u>\$(2,822,638)</u>	<u>\$(10,850,675)</u>
NET INCOME (LOSS) PER COMMON SHARE	<u>\$ (.78)</u>	<u>\$ (.03)</u>
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	<u>3,621,498</u>	<u>390,776,383</u>

The accompanying notes are an integral part of these
condensed consolidated financial statements.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the Six Months Ended June 30, 1998, and 1999

	1998	1999
NETWORK SERVICES REVENUE:	\$ 26,992	\$ 547,463
OPERATING EXPENSES:		
Network operations	717,686	2,819,162
Selling expense	599,501	2,406,302
General and administrative expenses	2,821,605	9,207,479
Depreciation and amortization	65,741	889,650
Total operating expenses	4,204,533	15,322,593
OPERATING INCOME (LOSS)	(4,177,541)	(14,775,130)
OTHER INCOME (EXPENSE):		
Interest expense	(220,407)	(461,627)
Interest income	15,057	834,993
Other income (expense), net	1,000	(4,926)
Total other income (expense)	(204,350)	368,440
NET INCOME (LOSS) BEFORE INCOME TAXES	(4,381,891)	(14,406,690)
PROVISION FOR INCOME TAXES	—	—
NET INCOME (LOSS)	(4,381,891)	(14,406,690)
ACCRUED DIVIDENDS ON PREFERRED STOCK	—	(3,300,000)
NET INCOME (LOSS) APPLICABLE TO COMMON STOCK	\$ (4,381,891)	\$(17,706,690)
NET INCOME (LOSS) PER COMMON SHARE	\$ (1.21)	\$ (.05)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING ...	3,621,498	388,471,017

The accompanying notes are an integral part of these
condensed consolidated financial statements.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
For the Six Months Ended June 30, 1998, and 1999

	1998	1999
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$(4,381,891)	\$(14,406,690)
Adjustments to reconcile net loss to net cash used in operating activities —		
Depreciation and amortization	65,741	889,650
Changes in assets and liabilities —		
Increase in accounts receivable, net	(9,379)	(87,078)
Increase in prepaid expenses	(52,345)	(138,087)
(Increase) decrease in other assets	(37,583)	622,176
Increase in accounts payable and accrued liabilities	800,032	2,740,460
Net cash used in operating activities	<u>(3,615,425)</u>	<u>(10,379,569)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	<u>(1,930,650)</u>	<u>(4,527,800)</u>
Net cash used in investing activities	<u>(1,930,650)</u>	<u>(4,527,800)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from debt	6,585,252	—
Payments on capital lease obligations	(47,533)	(808,587)
Proceeds from issuance of common stock	—	1,606
Credit facility origination fee	—	(1,350,000)
Net cash provided by (used in) financing activities	<u>6,537,719</u>	<u>(2,156,981)</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS ...	991,644	(17,064,350)
CASH AND CASH EQUIVALENTS, beginning of period	187,919	41,371,453
CASH AND CASH EQUIVALENTS, end of period	<u>\$ 1,179,563</u>	<u>\$ 24,307,103</u>
SUPPLEMENTAL CASH FLOW DISCLOSURES:		
Cash paid for interest	\$ 1,495	\$ 236,627
Noncash investing and financing activities —		
Equipment acquired under capital leases	213,109	4,041,713
Accrued property and equipment additions	900,000	80,249
Accrued dividends on preferred stock	—	3,300,000

The accompanying notes are an integral part of these condensed consolidated financial statements.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 1998 and 1999

1. Organization:

The Company is a facilities-based provider of broadband data, video and voice communications services to small-and-medium-sized businesses in major metropolitan areas in the United States. The Company's services, which today include ultra high-speed Internet access, business-oriented television for display on the computer desktop, and Internet-enhanced voice conferencing calling services, among other things, are typically delivered to the Company's customers over its own fiber optic network built inside multi-tenant commercial office buildings. In addition to selling services to the commercial tenants of buildings in which the Company owns and operates these advanced communications networks, the Company leverages its market presence and brand by offering end-to-end connectivity on a resold basis to businesses located outside these buildings.

On April 29, 1999, the Company successfully deployed a significant product and emerged from the development stage. Since its inception on December 19, 1996, the Company's principal activities have included developing its business plans, procuring governmental authorizations, raising capital, hiring management, and other key personnel, working on the design and development of its high capacity fiber-optic networks, acquiring equipment and facilities, and negotiating interconnection agreements. Accordingly, the Company has incurred operating losses and operating cash flow deficits.

2. Presentation:

In the opinion of the Company's management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the Company's consolidated financial position as of June 30, 1999 (see Note 7). The results of operations for the three and six months ended June 30, 1999 and cash flows for the six months ended June 30, 1998 and 1999, are not necessarily indicative of the results of operations or cash flows to be expected for the full year. The accompanying unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and disclosures normally included in notes to consolidated financial statements have been condensed or omitted pursuant to such rules and regulations, but resultant disclosures are in accordance with generally accepted accounting principles as they apply to interim reporting. The unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto.

3. Net Income (Loss) Per Common Share

Net income (loss) per common share is presented in accordance with the provisions of Statement of Financial Accounting Standards No. 128, "Earnings Per Share." Convertible redeemable preferred stock was outstanding at June 30, 1999. These securities were not considered in a computation of diluted EPS for the periods ended June 30, 1999 as the conversion is dependent upon a qualifying public offering or qualifying recapitalization, as defined in the articles of incorporation and due to the net loss incurred for both the three and six month period ended June 30, 1999, as the impact would be antidilutive.

Options to purchase 5,211,632 shares of common stock at \$.0001 per share were outstanding at June 30, 1999. In management's opinion, the exercise price was equal to the fair value of the common stock at the date of grant. These securities were not considered in a

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

computation of diluted EPS due to the net loss incurred for both the three and six month period ended June 30, 1999, as the impact would be antidilutive.

4. Property and Equipment:

Property and equipment as of June 30, 1999, consist of the following:

	Average Estimated Useful Lives (Years)	
Office equipment	4	\$ 4,272,137
Furniture and fixtures	7	198,160
Leasehold improvements	5	712,649
System infrastructure	10	3,434,929
System equipment	5	3,288,823
Construction-in-progress		<u>10,256,321</u>
		22,163,019
Less — Accumulated depreciation and amortization	—	<u>(1,398,281)</u>
Property and equipment, net		<u>\$20,764,738</u>

No interest was capitalized for the six months ended June 30, 1999.

5. Credit Facility:

In March 1999, the Company entered into a credit facility under which the Company can borrow up to \$45,000,000, subject to certain conditions. The Company has not borrowed against the facility as of June 30, 1999. The facility will accrue interest at one of the following or a combination of the following, at the Company's option: the bank's prime rate plus 3.5%, a base CD rate plus 4.5%, Federal funds rate plus 4.0%, or an Eurodollar base rate plus 4.5%. The credit facility is secured by all of the Company's assets, except for the assets pledged in connection with the Company's capital lease obligations. The Company pays a commitment fee of 1.5% on the unused portion of the credit facility once the facility is initially borrowed against. The facility, which extends through October 2000, contains various restrictive covenants, including the maintenance of certain financial ratios, the achievement of certain operation targets and restrictions on certain activities.

The Company paid an origination fee of \$1,350,000 in conjunction with the facility. This amount has been included in other assets and is being amortized to interest expense over the term of the facility.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS — (Continued)**

6. Commitments and Contingencies:

Operating Leases

The Company has entered into various operating lease agreements, with expirations through 2005, for lease space and equipment. Future minimum lease obligations as of June 30, 1999, related to the Company's operating leases are as follows:

2000	\$2,018,766
2001	2,021,051
2002	2,004,498
2003	2,000,463
2004	1,134,285
Thereafter	<u>8,507</u>
Total minimum lease obligations	<u>\$9,187,570</u>

Total rent expense for the three months ended June 30, 1998 and 1999, was approximately \$64,597 and \$495,995, respectively. Total rent expense for the six months ended June 30, 1998 and 1999, was approximately \$100,303 and \$851,389, respectively.

Capital Leases

The Company has entered into various capital leases for equipment. Future minimum lease obligations as of June 30, 1999, related to the Company's capital leases are as follows:

2000	\$ 2,351,772
2001	2,478,865
2002	1,348,714
Thereafter	<u>—</u>
Total minimum lease obligations	6,179,351
Less — Amounts representing interest	<u>(803,502)</u>
Present value of minimum lease obligations	5,375,849
Current maturities	<u>(1,882,444)</u>
Capital lease obligations, net of current maturities	<u>\$ 3,493,405</u>

Connectivity Contracts

In order to provide its services, the Company must connect each intra-building network to a local network and each metropolitan point of presence to a national fiber optic backbone. The Company has secured contracts that range from monthly to five years for local transport and up to three years for national inter-city transport. The Company incurs fixed monthly charges for local connectivity. For national backbone connectivity, the Company incurs fixed monthly charges plus incremental charges for customer usage above a certain volume. In addition, in the event the Company fails to meet its minimum volume commitments for national backbone connectivity, it may be obligated to pay underutilization charges.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Future minimum obligations as of June 30, 1999, related to the Company's connectivity contracts are as follows:

2000	\$1,323,506
2001	279,855
2002	152,624
2003	75,019
2004	42,511
Total minimum lease obligations	<u>\$1,873,515</u>

7. Equity Transactions:

Effective June 1, 1999, the Company adopted the 1999 Stock Option and Equity Incentive Plan (the "Plan") under which 40,546,734 shares of common stock, subject to adjustment, are available for award to employees, officers, directors, or consultants. Pursuant to the Plan, the Company's board of directors may grant stock options, stock appreciation rights, restricted shares, deferred shares and certain tax offset payments. The terms of any particular grant, including any performance-based requirements, vesting terms and other restrictions are determined by the Board or by the Compensation Committee of the Board.

The exercise price of nonstatutory options may be above, at or below fair market value of the common stock on the grant date. The exercise price of incentive stock options must not be less than the fair market value. The exercise period of options may be set by the Board or the Committee but may not exceed ten years for incentive stock options.

The Company accounts for stock options and other employee awards under the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." For the six month period ended June 30, 1999, the Company granted approximately 5,212,000 stock options to employees. Each of the options granted has an exercise price of \$.0001 per share and a term of 10 years. Options granted during the six month period ended June 30, 1999 vest over a four year period and include a provision for exercise through July 26, 1999. Any options which are not exercised by July 26, 1999 will vest ratably over four years based upon the employee's anniversary date. Shares issued upon the exercise of the stock options are restricted. Restricted shares vest on a monthly basis over a four year period.

Also during the six month period ended June 30, 1999, the Company issued, net of repurchases, 14,187,453 shares of restricted stock to certain employees. These issuances were pursuant to subscription agreements and vest on a monthly basis over four years. The restricted stock was issued at \$.0001 per share. Unvested shares will be subject to repurchase by the Company at the price paid by the employee. The Company believes the exercise price of the stock options issued and the restricted stock issuances during the six month period ended June 30, 1999 reflects fair value. Management determined the exercise and issuance price based on a valuation of the Company's common stock and stock transactions with independent third parties in late 1998 and considering business activities through mid June 1999.

In April 1999, the Company issued 1,881,098 shares of common stock to Advest at \$.0001 per share as settlement of certain rights held by Advest and for consulting and investment banking services.

ALLIED RISER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS — (Continued)**

8. Subsequent Events

Stock Options

In late June 1999, the Company engaged an independent third party to perform another valuation of the Company. The valuation, received in late July, indicated a stock valuation of \$.0224 per share as of June 29, 1999. Management believes that the increase in the value of the Company from mid June is the result of the Company executing a letter of intent on June 22, 1999 with an investor to purchase an interest in the Company. Accordingly, the Company has not recorded compensation expense or deferred compensation for option grants or issuances of restricted stock prior to June 22, 1999 as management believes such grants and issuances were at fair value.

On July 27, 1999 the Company granted approximately 1,100,000 stock options to employees. Each of the options granted has an exercise price of \$.0224 per share.

The Company is in the process of filing for an initial public offering of its securities. Depending on the ultimate valuation of the Company determined by this offering and business activities and transactions which have occurred or may occur prior to the completion of the offering, the Company may be required to record compensation expense and/or deferred compensation to the extent the Company cannot reconcile the value determined in the offering to the exercise prices of options granted and issuance prices of restricted stock issued.

Common and Preferred Stock

In August 1999, we issued shares of Series B Preferred Stock and shares of common stock to a group of financial sponsors, including GS Capital Partners III, L.P., an affiliate of Goldman, Sachs & Co.

Also in August 1999, we issued shares of Series B Preferred Stock, shares of common stock and warrants to purchase additional shares of our common stock to real estate partners and their affiliates, including Whitehall Street Real Estate Limited Partnership XI. The warrants were issued as part of the compensation for the right to install and operate our fiber-optic networks inside buildings owned or managed by these partners. The warrants are exercisable upon the occurrence of certain events, as defined in the warrant acquisition agreement.