

October 4, 2010

VIA OVERNIGHT DELIVERY

Ms. Sharla Dillon, Docket Manager
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

10-00193

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EXPEDITED PROCESSING REQUESTED

Re: *Joint Application for Approval to Transfer Indirect Control of DeltaCom, Inc. and
Business Telecom, Inc.*

Dear Ms. Dillon:

Enclosed for filing are an original and thirteen (13) copies of the above referenced application, which seeks Commission approval of the proposed transfer of control of DeltaCom, Inc. ("DeltaCom") and Business Telecom, Inc. ("BTI") from ITC^DeltaCom, Inc. to Earthlink, Inc. Also enclosed is a check in the amount of \$50.00 to cover the requisite filing fee for two certificated applicants.

Please date-stamp the extra copy of this filing, and return it to us in the enclosed self-addressed stamped envelope. Should you have any questions with respect to this matter, please do not hesitate to contact us.

Respectfully submitted,



Robert L. Hart
Tony S. Lee
Counsel to ITC^DeltaCom, Inc.

Enclosures

cc: D. Anthony Mastando (ITC^DeltaCom, Inc.)
Mark J. O'Connor (Counsel to EarthLink, Inc.)

**BEFORE THE
TENNESSEE REGULATORY AUTHORITY**

Joint Application of)	
)	
)	
ITC^DELTACom, INC., AND)	
EARTHLINK, INC.,)	Docket No. _____
)	
for Approval of the Indirect Transfer of)	
Control of DeltaCom, Inc. and Business)	
Telecom, Inc.)	
)	

JOINT APPLICATION

I. INTRODUCTION

1. ITC^DeltaCom, Inc. ("ITCD") and EarthLink, Inc. ("EarthLink" and, together with ITCD, "Applicants"), by and through their undersigned counsel and pursuant to Sections 65-4-112, 65-4-113 of the Tennessee Code Annotated (TCA), TENN. CODE ANN. § 65-4-112, 65-4-113, hereby request the approval of the Tennessee Regulatory Authority ("Authority") to transfer control of DeltaCom, Inc. ("DeltaCom") and Business Telecom, Inc. ("BTI") (collectively, the "DeltaCom Subsidiaries") from ITCD to EarthLink (the "Transfer of Control").

2. As described more fully below, the proposed Transfer of Control will result from the merger of newly formed subsidiary with and into ITCD, with ITCD surviving as a wholly-owned subsidiary of EarthLink. Corporate organization charts depicting the respective corporate structure of EarthLink and ITCD prior to and following the acquisition are attached hereto as Exhibit A.

Although EarthLink's acquisition of ITCD will result in a change in the ultimate ownership and control of the DeltaCom Subsidiaries, no transfer of certificate, assets or customers will occur as a result of the Transfer of Control. Immediately following consummation of the merger, the DeltaCom Subsidiaries will continue to provide service to their Tennessee customers pursuant to

their existing authorization with no change in the rates or terms and conditions of service as currently provided. The Transfer of Control will be transparent to the customers of the DeltaCom Subsidiaries.

3. In support of this Application, the parties state as follows:

II. DESCRIPTION OF THE PARTIES

A. ITC^DeltaCom, Inc.

4. ITCD is a publicly-traded Delaware holding company headquartered at 7037 Old Madison Pike, Huntsville, Alabama 35806 and is the ultimate parent of the Applicants. Through its certificated subsidiaries – DeltaCom and BTI – ITCD provides voice and data telecommunications services on a retail basis to primarily business customers in the southern United States and regional communications transmission services over its network on a wholesale basis to other communications companies.

B. DeltaCom, Inc.

5. DeltaCom is a wholly-owned subsidiary of Interstate FiberNet Inc. (“IFN”) which, in turn, is wholly-owned by ITCD. DeltaCom is incorporated under the laws of the state of Alabama and is qualified to transact business in this State as a foreign corporation. DeltaCom is authorized to provide local exchange telecommunications services in this state pursuant to certification issued in Docket No. 96-01431 on January 2, 1997, and resold telecommunications services pursuant to certification issued in Docket No. 95-02826 on September 8, 1995. Additionally, DeltaCom is authorized by the various state public service commissions to provide facilities-based and/or resold interexchange telecommunications services in the other 49 states and the District of Columbia, pursuant to certification, registration or tariff requirements, or on a

deregulated basis and is authorized to provide competitive local exchange services in more than 10 states.

C. Business Telecom, Inc.

6. BTI is a wholly owned subsidiary of BTI Telecom Corp. which is a wholly owned subsidiary of ITCD. BTI is a corporation organized pursuant to the laws of the State of North Carolina and is qualified to transact business in this State as a foreign corporation. BTI provides integrated telecommunications services primarily in the southeastern United States and is authorized to provide resold and facilities-based local exchange telecommunications services in this state pursuant to certification issued in Docket Nos. 98-00126 (March 12, 1998) and 98-00334 (October 7, 1998), respectively, and resold, operator service and facilities-based interexchange telecommunications services pursuant to certification issued in Docket Nos. 95-02947 (September 12, 1995; resold and operator services) and 98-00334 (October 7, 1998; facilities-based services), respectively. Additionally, BTI is authorized by the various state public service commissions to provide facilities-based and/or resold interexchange telecommunications services in the other 49 states and the District of Columbia, pursuant to certification, registration or tariff requirements, or on a deregulated basis and is authorized to provide competitive local exchange services in over 20 states.

D. EarthLink, Inc.

7. EarthLink is a publicly traded Delaware corporation. It is primarily an Internet service provider, providing nationwide Internet access and related value-added services to individual and small business customers. Its service offerings are narrowband and broadband (high speed) Internet access; web hosting; advertising and related services; and VoIP services. EarthLink provides its portfolio of services to approximately 1.9 million customers through a

nationwide network of dial-up points of presence and a nationwide broadband footprint. EarthLink also provides, through its wholly-owned subsidiary New Edge Network, Inc. ("New Edge"), competitive local exchange and interexchange services in 46 states. In Tennessee, New Edge is authorized to provide resold and facilities-based local exchange telecommunications services, as well as resold and facilities-based interexchange telecommunications services, pursuant to certification issued in Docket No. 99-00714 on May 22, 2000.

8. EarthLink is operated by a highly qualified management team. A list of EarthLink's officers and directors is attached hereto as Exhibit B. Additional information regarding EarthLink's management team is available at www.earthlink.net. EarthLink's financial qualifications are demonstrated by its financial and operating information for second quarter 2010. Attached hereto as Exhibit C is a copy of EarthLink's most recent consolidated balance sheets from its most recent 10-Q filed with the Securities and Exchange Commission on June 30, 2010. Highlights of second quarter 2010 include: revenues of \$153.0 million; net income of \$28.0 million; adjusted EBITDA of \$56.7 million; free cash flow of \$54.0 million; and ending cash and marketable securities balance of \$740.1 million.

9. Additional information concerning EarthLink's legal, technical, managerial and financial qualifications to acquire control of the DeltaCom Subsidiaries can be found on EarthLink's web site at <http://www.earthlink.net/about/leaders/>. Applicants request that the Commission take official notice of those descriptions of EarthLink's qualifications and incorporate them by reference herein.

E. Designated Contacts

10. Questions, correspondence, or other communications concerning this Application should be directed to the following:

For ITCD:

Tony S. Lee
Robert L. Hart
Venable LLP
575 7th Street, N.W.
Washington, D.C. 20036
Tel: (202) 344-4000
Fax: (202) 344-8300
Email: tslee@venable.com
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VP – Regulatory Affairs/Senior Reg Attorney
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Huntsville, AL 35806
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For EarthLink

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Washington, DC 20006
Tel: (202) 887-6230
Fax: (202) 877-6231
Email: oconnor@lojlaw.com

Samuel R. DeSimone, Jr.
General Counsel and Secretary
1375 Peachtree Street, Level A
Atlanta, GA 30309
Tel: (404) 748-6634
Fax: (404) 287-4905

III. DESCRIPTION OF PROPOSED TRANSACTION

11. EarthLink and ITCD recently entered into an Agreement and Plan of Merger (“Agreement”), pursuant to which ITCD will become a direct, wholly-owned subsidiary of EarthLink. As a result of the merger, the DeltaCom Subsidiaries will become indirect, wholly owned subsidiaries of EarthLink. The proposed Transfer of Control will result from the merger of a newly formed subsidiary with and into ITCD, with ITCD surviving as a wholly-owned subsidiary of EarthLink. Under the terms of the Agreement, which was unanimously approved by the boards of directors of both companies, EarthLink will acquire the stock of ITCD in an all cash

transaction. Corporate organization charts depicting the respective corporate structures of the parties prior to and immediately following the merger, as well as a diagram illustrating the merger, are attached hereto as Exhibit A.

IV. PUBLIC INTEREST CONSIDERATIONS

12. The proposed acquisition of the DeltaCom Subsidiaries by EarthLink will serve the public interest by creating one of the largest nationwide competitive communications service providers serving Internet/business customers. The combined company will offer customers a compelling alternative to legacy carriers through the combined footprint of the two companies, a comprehensive suite of Internet/business services, and an extensive switching and fiber network.

13. The complementary strengths, product sets, and geographic footprints of the two companies should position EarthLink to realize cost savings and achieve synergies that are expected to strengthen its ability to enhance service offerings and provide more advanced communications services to a broader customer base. Among the additional synergies and benefits that are expected include the following: the transaction will provide both companies with significant new customer relationships and create opportunities for both companies to offer additional products and services to each other's customers; both companies will be afforded greater capabilities to market and offer solutions to businesses and to differentiate themselves significantly in the marketplace; and the merged company will be able to bring new services and products to the marketplace more quickly than either could do separately. Moreover, the strategic combination will bring together two companies that share a commitment to building and maintaining solid relationships with their customers. Both EarthLink and ITCD believe that success is built by providing excellent service to every customer.

14. Although EarthLink's acquisition of ITCD will result in a change in the ultimate ownership and control of the DeltaCom Subsidiaries, no transfer of certificate, assets or customers will occur as a result of the Transfer of Control. Immediately following consummation of the merger, the DeltaCom Subsidiaries will continue to provide service to Tennessee customers pursuant to their existing authorization with no change in the rates or terms and conditions of service as currently provided. The Transfer of Control will be transparent to the DeltaCom Subsidiaries' Tennessee customers in terms of the services they currently receive.

15. In sum, the combination of EarthLink and ITCD is expected to create substantial opportunities for customers of both companies and provide shareholders with significant value, which will ultimately enhance the quality and variety of telecommunications products and services offered to Tennessee consumers. Grant of this Application will therefore serve the public interest of the State of Tennessee.

V. CONCLUSION

16. For foregoing reasons, Applicants submit that the public interest, convenience, and necessity would be furthered by grant of this Application for Commission approval to transfer of control of the DeltaCom Subsidiaries as described herein. Applicants respectfully request expedited consideration and grant of this Application no later than December 15, 2010 as the parties expect to close the transaction at the end of the year. To the extent that approval cannot be granted before the transaction closing date, the parties request that approval be granted, to the extent necessary, *nunc pro tunc*.

Mark J. O'Connor / TSC

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Counsel for EarthLink, Inc.

Respectfully submitted,

Tony S. Lee

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Counsel for ITC^DeltaCom, Inc.

Dated: October 4, 2010

LIST OF EXHIBITS

- Exhibit A Corporate Structure of EarthLink, Inc., and ITC^DeltaCom, Inc.
Prior to and Following the Merger
- Exhibit B Officers and Directors of EarthLink, Inc.
- Exhibit C Financial Qualifications of EarthLink, Inc.
- Verifications

EXHIBIT A

**Corporate Structure of EarthLink, Inc.
and ITC^DeltaCom, Inc.
Prior to and Following the Merger**

**Pre-Transaction Corporate Structure of the
Regulated Subsidiaries of ITC^DeltaCom, Inc. and EarthLink, Inc.**

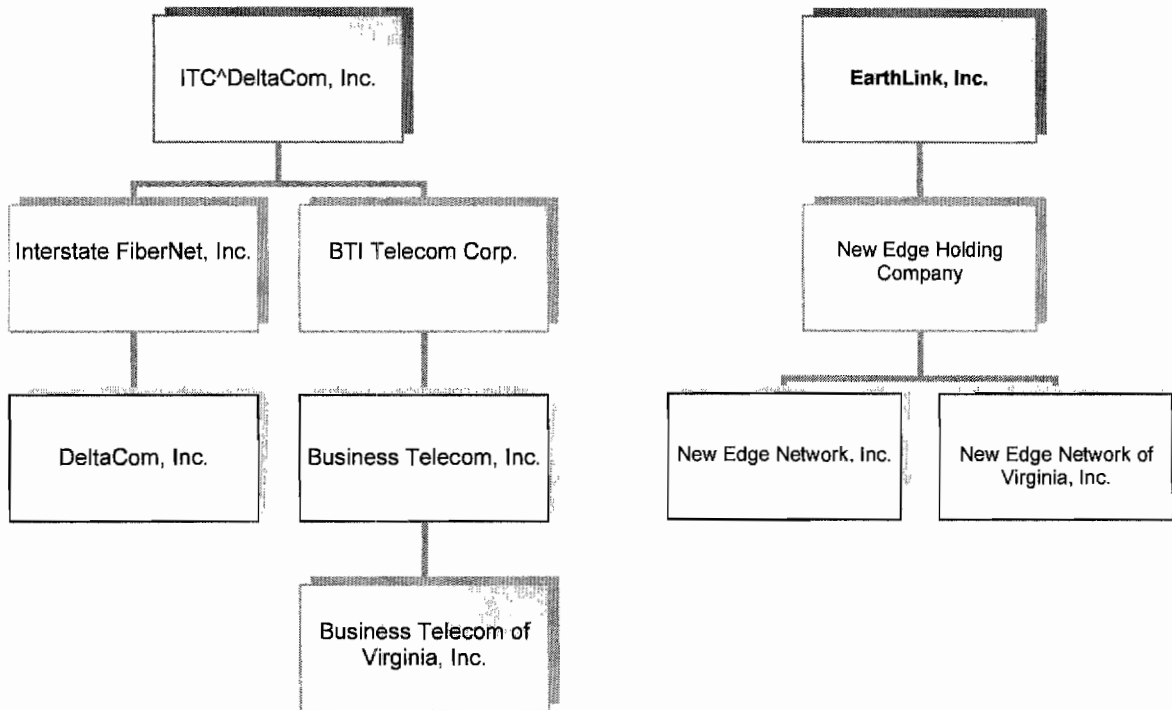
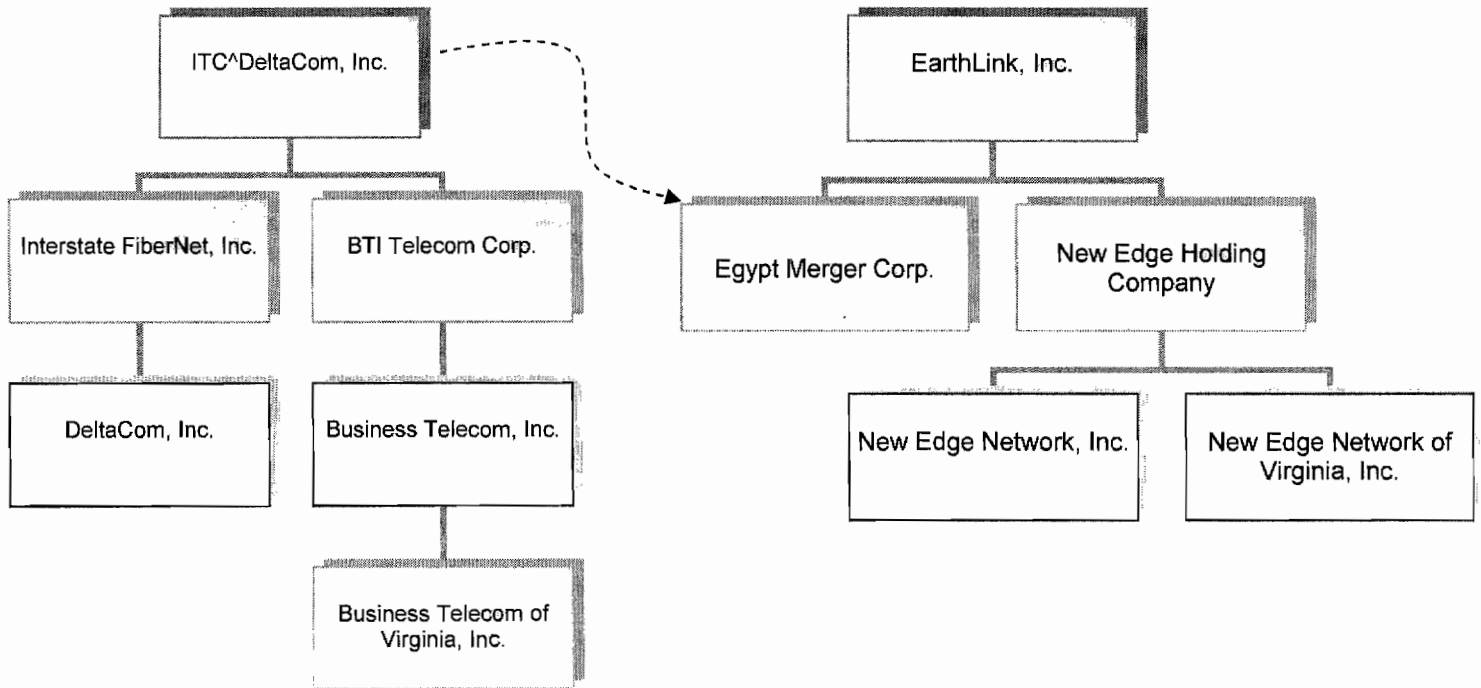


Illustration of the Merger



**Post-Transaction Corporate Structure of the
Regulated Subsidiaries of ITC^DeltaCom, Inc. and EarthLink, Inc.**

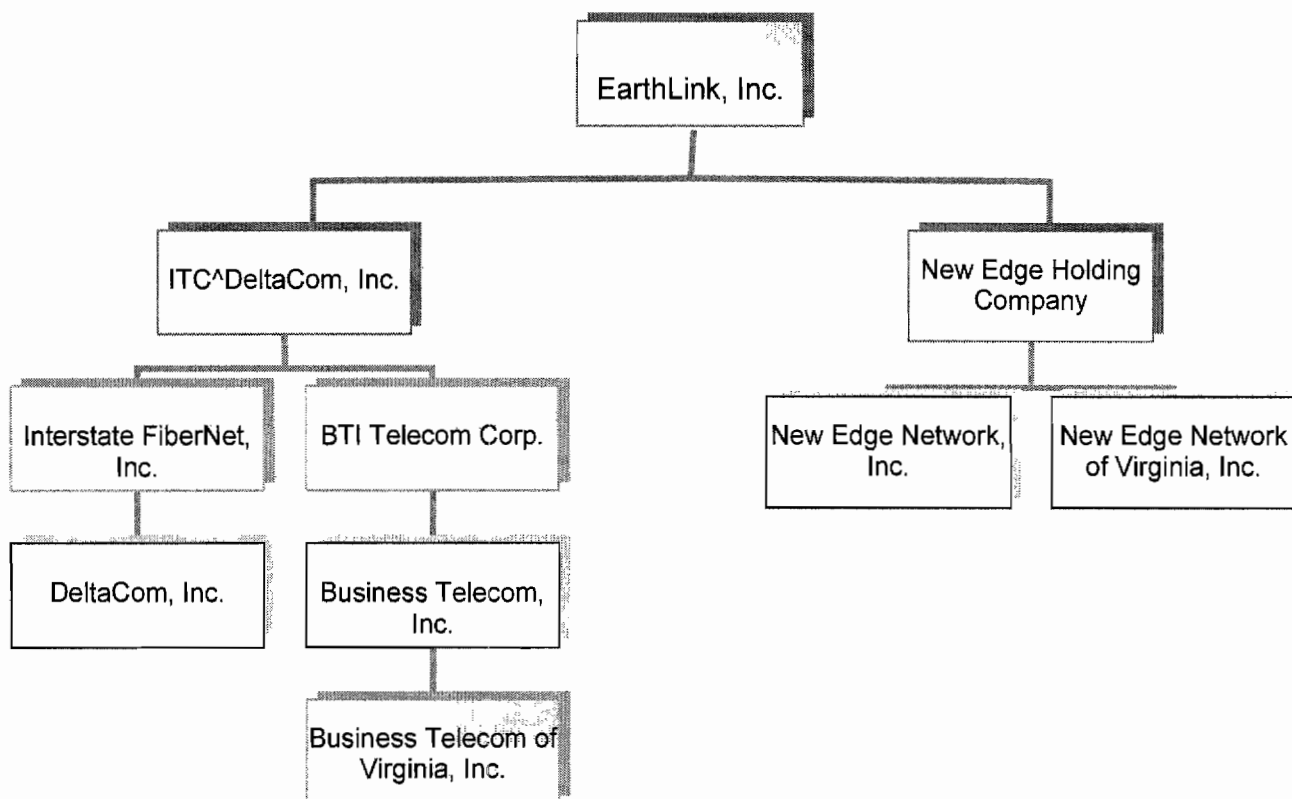


EXHIBIT B

**Officers and Directors
of EarthLink, Inc.**

EarthLink Officers and Directors

Key Officers:

Rolla P. Huff: Chairman and Chief Executive Officer
Joseph M. Wetzel: President and Chief Operating Officer
Bradley A. Ferguson: Chief Financial Officer
Samuel R. DeSimone, Jr.: General Counsel and Secretary
Stacie Hagan: Chief People Officer
Cardi Prinzi: President, New Edge Networks
Kevin Brand: Chief of Consumer Products and Support

Board of Directors:

Rolla P. Huff: Chairman and Chief Executive Officer
Marce Fuller: Independent Lead Director
Terrell Jones: Director
Susan D. Bowick: Director
David Koretz: Director
Thomas E. Wheeler: Director
M. Wayne Wisheart: Director

All of the above Officers and Directors of EarthLink, Inc. can be contacted at the following address:

EarthLink, Inc.
1375 Peachtree Street
Suite 400
Atlanta, Ga 30309
Tel: (404) 815-0770

EXHIBIT C

**Financial Qualifications
of EarthLink, Inc.**

PART I

Item 1. Financial Statements.

EARTHLINK, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

	December 31, 2009	June 30, 2010 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 610,995	\$ 498,549
Marketable securities	84,966	62,986
Accounts receivable, net of allowance of \$1,736 and \$988 as of December 31, 2009 and June 30, 2010, respectively	20,560	26,137
Prepaid expenses	4,374	4,559
Deferred income taxes, net	46,063	27,218
Other current assets	16,423	11,272
Total current assets	783,381	630,721
Long-term marketable securities	—	178,565
Property and equipment, net	34,267	31,743
Deferred income taxes, net	153,132	140,283
Purchased intangible assets, net	11,550	9,059
Goodwill	88,920	88,920
Other long-term assets	3,368	2,806
Total assets	<u>\$ 1,074,618</u>	<u>\$ 1,082,097</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 6,270	\$ 6,971
Accrued payroll and related expenses	25,093	14,050
Other accrued liabilities	34,659	28,185
Deferred revenue	25,728	24,411
Convertible senior notes, net of discount of \$26,502 and \$19,620 as of December 31, 2009 and June 30, 2010, respectively	232,248	236,171
Total current liabilities	323,998	309,788
Other long-term liabilities	16,596	14,410
Total liabilities	340,594	324,198
Stockholders' equity:		
Convertible preferred stock, \$0.01 par value, 100,000 shares authorized, 0 shares issued and outstanding as of December 31, 2009 and June 30, 2010	—	—
Common stock, \$0.01 par value, 300,000 shares authorized, 190,472 and 191,508 shares issued as of December 31, 2009 and June 30, 2010, respectively, and 107,132 and 108,065 shares outstanding as of December 31, 2009 and June 30, 2010, respectively	1,905	1,915
Additional paid-in capital	2,118,100	2,088,470
Accumulated deficit	(729,715)	(674,928)
Treasury stock, at cost, 83,340 shares and 83,443 shares as of December 31, 2009 and June 30, 2010, respectively	(656,760)	(657,611)
Accumulated other comprehensive income	494	53
Total stockholders' equity	734,024	757,899
Total liabilities and stockholders' equity	<u>\$ 1,074,618</u>	<u>\$ 1,082,097</u>

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

EARTHLINK, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>
	<u>(in thousands, except per share data)</u> <u>(unaudited)</u>			
Revenues	\$ 185,597	\$ 153,007	\$ 384,660	\$ 310,265
Operating costs and expenses:				
Cost of revenues	69,270	58,018	144,835	118,832
Sales and marketing	14,543	11,623	31,565	22,924
Operations and customer support	23,940	18,930	51,686	38,587
General and administrative	16,409	12,742	35,031	27,116
Amortization of intangible assets	2,038	1,232	4,185	2,496
Facility exit and restructuring costs	4,927	(89)	5,415	1,346
Total operating costs and expenses	<u>131,127</u>	<u>102,456</u>	<u>272,717</u>	<u>211,301</u>
Income from operations	54,470	50,551	111,943	98,964
Gain on investments, net	11	154	270	572
Interest expense and other, net	<u>(5,100)</u>	<u>(5,483)</u>	<u>(9,391)</u>	<u>(10,775)</u>
Income before income taxes	49,381	45,222	102,822	88,761
Income tax provision	<u>(17,896)</u>	<u>(17,182)</u>	<u>(38,840)</u>	<u>(33,974)</u>
Net income	<u>\$ 31,485</u>	<u>\$ 28,040</u>	<u>\$ 63,982</u>	<u>\$ 54,787</u>
Net income per share				
Basic	<u>\$ 0.30</u>	<u>\$ 0.26</u>	<u>\$ 0.60</u>	<u>\$ 0.51</u>
Diluted	<u>\$ 0.29</u>	<u>\$ 0.26</u>	<u>\$ 0.59</u>	<u>\$ 0.50</u>
Weighted average common shares outstanding				
Basic	<u>105,908</u>	<u>108,053</u>	<u>106,976</u>	<u>107,840</u>
Diluted	<u>107,080</u>	<u>108,888</u>	<u>108,110</u>	<u>108,685</u>
Dividends declared per share	<u>\$ —</u>	<u>\$ 0.16</u>	<u>\$ —</u>	<u>\$ 0.30</u>

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

EARTHLINK, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30,	
	2009	2010
	(in thousands) (unaudited)	
Cash flows from operating activities:		
Net income	\$ 63,982	\$ 54,787
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	12,578	9,325
Stock-based compensation	7,416	4,374
Non-cash income taxes	33,696	31,375
Accretion of debt discount and amortization of debt issuance costs	6,674	7,160
Loss on disposals and impairments of fixed assets	190	362
Gain on investments, net	(270)	(572)
Gain on debt surrendered for conversion	—	(172)
Decrease (increase) in accounts receivable, net	1,871	(5,577)
Decrease (increase) in prepaid expenses and other assets	5,072	(1,401)
Decrease in accounts payable and accrued and other liabilities	(27,421)	(20,934)
Decrease in deferred revenue	(4,482)	(1,295)
Net cash provided by operating activities	99,306	77,432
Cash flows from investing activities:		
Purchases of property and equipment	(5,060)	(5,783)
Purchases of marketable securities	(52,502)	(214,179)
Sales and maturities of marketable securities	2,950	62,915
Proceeds received from investments in other companies	200	1,618
Net cash used in investing activities	(54,412)	(155,429)
Cash flows from financing activities:		
Principal payments under capital lease obligations	(17)	(17)
Proceeds from exercises of stock options	1,396	1,901
Repurchases of common stock	(22,340)	(851)
Payment of dividends	—	(32,714)
Payment for debt surrendered for conversion	—	(2,768)
Net cash used in financing activities	(20,961)	(34,449)
Net increase (decrease) in cash and cash equivalents	23,933	(112,446)
Cash and cash equivalents, beginning of period	486,564	610,995
Cash and cash equivalents, end of period	\$ 510,497	\$ 498,549

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

EARTHLINK, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED

1. Organization

EarthLink, Inc. ("EarthLink" or the "Company") is an Internet service provider ("ISP"), providing nationwide Internet access and related value-added services to individual and business customers. The Company's primary service offerings are dial-up and high-speed Internet access services and related value-added services, such as ancillary services sold as add-on features to the Company's Internet access services, search and advertising. In addition, through the Company's wholly-owned subsidiary, New Edge Networks ("New Edge"), the Company builds and manages IP-based wide area networks for businesses and communications carriers.

The Company operates two reportable segments, Consumer Services and Business Services. The Company's Consumer Services segment provides Internet access and related value-added services to individual customers. These services include dial-up and high-speed Internet access and voice-over-Internet protocol ("VoIP") services, among others. The Company's Business Services segment provides integrated communications services and related value-added services to businesses and communications carriers. These services include managed IP-based wide area networks, dedicated Internet access and web hosting, among others. For further information concerning the Company's business segments, see Note 12, "Segment Information."

2. Summary of Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements of EarthLink, which include the accounts of its wholly-owned subsidiaries, for the three and six months ended June 30, 2009 and 2010 and the related footnote information are unaudited and have been prepared on a basis consistent with the Company's audited consolidated financial statements as of December 31, 2009 contained in the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission (the "Annual Report"). All significant intercompany transactions have been eliminated.

These financial statements should be read in conjunction with the audited consolidated financial statements and the related notes thereto contained in the Company's Annual Report. In the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting of normal recurring adjustments), which management considers necessary to present fairly the Company's financial position, results of operations and cash flows for the interim periods presented. The results of operations for the three and six months ended June 30, 2010 are not necessarily indicative of the results anticipated for the entire year ending December 31, 2010.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results may differ from those estimates.

Fair Value of Financial Instruments

The carrying amounts of the Company's cash, cash equivalents, trade receivables and trade payables approximate their fair values because of their nature and respective durations. The Company's short- and long-term marketable securities consist of available-for-sale and trading securities that are carried at fair value. The Company's equity investments in publicly-held companies are stated at fair value, which is based on quoted market prices, with unrealized gains and losses included in stockholders' equity. The Company's investments in privately-held companies are stated at cost, net of other-than-temporary impairments, because it is impracticable to estimate fair value.

EARTHLINK, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED - (Continued)

Recently Issued Accounting Pronouncement

In September 2009, the Financial Accounting Standards Board issued new guidance on revenue recognition. The new guidance addresses the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit and to modify the manner in which the transaction consideration is allocated across the separately identifiable deliverables and how revenue is recognized. The new guidance also significantly expands the disclosure requirements for multiple-element arrangements. The new guidance is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company does not expect the adoption of the new guidance to have a material impact on its financial statements.

3. Earnings per Share

The Company presents a dual presentation of basic and diluted earnings per share. Basic earnings per share represents net income divided by the weighted average number of common shares outstanding during the reported period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, including stock options, restricted stock units, phantom share units and convertible debt (collectively "Common Stock Equivalents"), were exercised or converted into common stock. The dilutive effect of outstanding stock options, restricted stock units and convertible debt is reflected in diluted earnings per share by application of the treasury stock method. Phantom share units are reflected on an if-converted basis. In applying the treasury stock method for stock-based compensation arrangements, the assumed proceeds are computed as the sum of the amount the employee must pay upon exercise, the amount of compensation cost attributed to future services and not yet recognized and the amount of excess tax benefits, if any, that would be credited to additional paid-in capital assuming exercise of the awards.

The following table sets forth the computation for basic and diluted net income per share for the three and six months ended June 30, 2009 and 2010:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2010	2009	2010
	(in thousands, except per share data)			
Numerator				
Net income	\$ 31,485	\$ 28,040	\$ 63,982	\$ 54,787
Denominator				
Basic weighted average common shares outstanding	105,908	108,053	106,976	107,840
Dilutive effect of Common Stock Equivalents	1,172	835	1,134	845
Diluted weighted average common shares outstanding	107,080	108,888	108,110	108,685
Basic net income per share	\$ 0.30	\$ 0.26	\$ 0.60	\$ 0.51
Diluted net income per share	\$ 0.29	\$ 0.26	\$ 0.59	\$ 0.50

EARTHLINK, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED - (Continued)

During the three months ended June 30, 2009 and 2010, approximately 5.1 million and 2.7 million, respectively, stock options and restricted stock units were excluded from the calculation of diluted earnings per share because the exercise prices plus the amount of unrecognized compensation cost attributed to future services and the amount of excess tax benefits exceeded the Company's average stock price during the respective periods. During the six months ended June 30, 2009 and 2010, approximately 5.9 million and 3.0 million, respectively, stock options and restricted stock units were excluded from the calculation of diluted EPS. Approximately 28.4 million shares that underlie the Company's convertible debt instruments were also excluded from the calculation of diluted earnings per share during the three and six months ended June 30, 2009 because the conversion price exceeded the Company's average stock price during the periods.

4. Facility Exit and Restructuring Costs

In August 2007, EarthLink adopted a restructuring plan (the "2007 Plan") to reduce costs and improve the efficiency of the Company's operations. The 2007 Plan was the result of a comprehensive review of operations within and across the Company's functions and businesses. Under the 2007 Plan, the Company reduced its workforce by approximately 900 employees, closed office facilities in Orlando, Florida; Knoxville, Tennessee; Harrisburg, Pennsylvania and San Francisco, California and consolidated its office facilities in Atlanta, Georgia and Pasadena, California. The 2007 Plan was primarily implemented during the latter half of 2007 and during the year ended December 31, 2008. However, since management continues to evaluate EarthLink's businesses, there have been and may continue to be supplemental provisions for new cost savings initiatives as well as changes in estimates to amounts previously recorded.

The following table summarizes facility exit and restructuring costs during the six months ended June 30, 2009 and 2010 and the cumulative costs incurred to date as a result of the 2007 Plan. Facility exit and restructuring costs during the six months ended June 30, 2009 and 2010 were primarily the result of changes to sublease estimates in the Company's exited facilities and further consolidation in its Atlanta, Georgia facility. Such costs have been classified as facility exit and restructuring costs in the Condensed Consolidated Statements of Operations.

	Six Months Ended June 30,		Cumulative Costs Incurred To Date
	2009	2010	
	(in thousands)		
Severance and personnel-related costs	\$ —	\$ —	\$ 30,764
Lease termination and facilities-related costs	5,369	1,237	23,958
Non-cash asset impairments	46	109	24,901
Other associated costs	—	—	1,131
	<u>\$ 5,415</u>	<u>\$ 1,346</u>	<u>\$ 80,754</u>

The following table reconciles the beginning and ending liability balances associated with the 2007 Plan as of June 30, 2010, including changes during the period attributable to costs incurred and charged to expense and costs paid or otherwise settled:

	Facilities	Asset Impairments (in thousands)	Total
Balance as of December 31, 2009	\$ 17,438	\$ —	\$ 17,438
Accruals	1,237	109	1,346
Payments	(2,265)	—	(2,265)
Non-cash charges	368	(109)	259
Balance as of June 30, 2010	<u>\$ 16,778</u>	<u>\$ —</u>	<u>\$ 16,778</u>

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Facility exit and restructuring liabilities due within one year of the balance sheet date are classified as other accrued liabilities and facility exit and restructuring liabilities due after one year are classified as other long-term liabilities in the Condensed Consolidated Balance Sheets. Of the unpaid balance as of December 31, 2009 and June 30, 2010, approximately \$5.1 million and \$5.6 million, respectively, was classified as other accrued liabilities and approximately \$12.3 million and \$11.2 million, respectively, was classified as other long-term liabilities.

5. Investments

Marketable Securities

The Company's marketable securities consisted of the following as of December 31, 2009 and June 30, 2010:

	As of December 31, 2009	As of June 30, 2010
	(in thousands)	
Auction rate securities	\$ 42,906	\$ 16,850
Government and agency securities	42,060	224,701
Total marketable securities	84,966	241,551
Less: classified as current	(84,966)	(62,986)
Total long-term marketable securities	<u>\$ —</u>	<u>\$ 178,565</u>

The Company's auction rate securities are variable-rate debt instruments whose underlying agreements have contractual maturities of up to 40 years, but have interest rate reset periods at pre-determined intervals, usually every 28 days. These securities are predominantly secured by student loans guaranteed by state related higher education agencies and reinsured by the U.S. Department of Education. Beginning in February 2008, auctions for these securities failed to attract sufficient buyers, resulting in the Company continuing to hold such securities. In October 2008, EarthLink entered into an agreement with the broker that sold the Company its auction rate securities that gave the Company the right to sell its existing auction rate securities back to the broker at par plus accrued interest, beginning on June 30, 2010 until July 2, 2012 (herein referred to as the "put right"). As a result of the put right, these securities were classified as short-term marketable securities in the Condensed Consolidated Balance Sheets as of December 31, 2009 and June 30, 2010. The Company's auction rate securities are classified as trading securities and are carried at fair value, with any unrealized gains and losses included in gain on investments, net, in the Condensed Consolidated Statement of Operations.

During the six months ended June 30, 2010, the Company sold \$31.3 million of its auction rate securities to the selling broker at par, plus accrued interest. The Company's remaining \$16.9 million of auction rate securities were redeemed at par on June 30, 2010, pursuant to the put right, with a trade settlement date of July 1, 2010. Accordingly, the auction rate securities were recorded at par and classified as short-term marketable securities as of June 30, 2010. The Company recognized a \$5.3 million gain as a result of the increase in fair value of the auction rate securities and recognized a \$5.3 million loss as a result of the decrease in fair value of the put right, which is discussed in more detail below. The nominal net impact is included in gain on investments, net, in the Condensed Consolidated Statement of Operations. See Note 11, "Fair Value Measurements," for a table that reconciles the beginning and ending balances of the auction rate securities.

As of December 31, 2009, the Company's government and agency notes consisted of government-sponsored debt securities. As of June 30, 2010, the Company's government and agency notes consisted of U.S. treasury securities and government-sponsored debt securities. The Company classifies its government and agency notes as available for sale. Available-for-sale securities are carried at fair value, with any unrealized gains and losses, net of tax, included in accumulated other comprehensive income as a separate component of stockholders' equity and in total comprehensive income. Amounts reclassified out of accumulated other comprehensive income into earnings are determined on a specific identification basis. Realized gains and losses

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on marketable securities are included in gain on investments, net, in the Condensed Consolidated Statements of Operations and are determined on a specific identification basis. As of December 31, 2009, the amortized cost and aggregate fair value of the government and agency notes was \$42.1 million. Gross unrealized gains and gross unrealized losses as of December 31, 2009 were nominal. As of June 30, 2010, the amortized cost of the government and agency notes was \$224.6 million and the aggregate fair value was \$224.7 million. Gross unrealized gains as of June 30, 2010 were \$0.1 million and gross unrealized losses were nominal. In the Condensed Consolidated Balance Sheet as of June 30, 2010, \$46.1 million of the government and agency notes were classified as short-term marketable securities and \$178.6 million were classified as long-term marketable securities. All of the Company's government and agency notes were classified as short-term marketable securities in the Condensed Consolidated Balance Sheet as of December 31, 2009.

The following table summarizes the estimated fair value of the Company's marketable securities designated as available-for-sale classified by the maturity of the security:

	As of June 30, 2010 (in thousands)
Due within one year	\$ 46,136
Due after one year through two years	178,565
	<u>\$ 224,701</u>

Investments

The Company's investments as of December 31, 2009 consisted of equity investments in other companies and the Company's put right. The Company's equity investments in other companies had a carrying value and fair value of \$1.5 million as of December 31, 2009 and were classified as other current assets in the Condensed Consolidated Balance Sheet. The Company's put right had a carrying value and fair value of \$5.2 million as of December 31, 2009 and was classified as other current assets in the Condensed Consolidated Balance Sheet.

Equity investments in other companies are accounted for under the cost method of accounting because the Company does not have the ability to exercise significant influence over the companies' operations. Under the cost method of accounting, investments in private companies are carried at cost and are only adjusted for other-than-temporary declines in fair value and distributions of earnings. For cost method investments in public companies that have readily determinable fair values, the Company classifies its investments as available-for-sale and, accordingly, records these investments at their fair values with unrealized gains and losses, net of tax, included as a separate component of stockholders' equity and in total comprehensive income. Upon sale or liquidation, realized gains and losses are included in the Condensed Consolidated Statement of Operations. Amounts reclassified out of accumulated other comprehensive income into earnings are determined on a specific identification basis. As of December 31, 2009, gross unrealized losses were nominal and gross unrealized gains were \$0.5 million.

The Company had a put right to sell its existing auction rate securities back to the broker beginning on June 30, 2010. The Company elected the fair value option for the put right to offset changes in fair value of its auction rate securities. The fair value of the put right was estimated using a discounted cash flow analysis. Changes in fair value were recognized in gain on investments, net, in the Condensed Consolidated Statement of Operations. During the six months ended June 30, 2010, the Company exercised its put right and sold its auction rate securities back to the selling broker at par. The Company recognized a \$5.3 million loss as a result of the decrease in fair value of the put right, which is included in gain on investments, net, in the Condensed Consolidated Statement of Operations. See Note 11, "Fair Value Measurements," for a table that reconciles the beginning and ending balances of the put right.

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Gain on investments, net

The Company's gain on investments, net, in the Condensed Consolidated Statement of Operations consisted of the following during the three and six months ended June 30, 2009 and 2010:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2010	2009	2010
	(in thousands)			
Cash distributions from investments	\$ —	\$ —	\$ 200	\$ —
Gain from sale of investments	—	152	—	568
Net change in fair value of auction rate securities and put right	11	2	70	4
	<u>\$ 11</u>	<u>\$ 154</u>	<u>\$ 270</u>	<u>\$ 572</u>

During the six months ended June 30, 2009, the Company received \$0.2 million in cash distributions from eCompanies Venture Group, L.P., a limited partnership that invested in domestic emerging Internet-related companies, and recorded a net gain of \$0.1 million related to changes in fair value of its auction rate securities and put right. During the six months ended June 30, 2010, the Company sold certain of its investments in other companies that were classified as available for sale for proceeds of \$1.6 million and recognized a realized gain on investments of \$0.6 million.

6. Purchased Intangible Assets and Goodwill*Goodwill*

There were no changes in the carrying amount of goodwill during the six months ended June 30, 2010.

Purchased Intangible Assets

The following table presents the components of the Company's acquired identifiable intangible assets included in the accompanying Condensed Consolidated Balance Sheets as of December 31, 2009 and June 30, 2010:

	As of December 31, 2009			As of June 30, 2010		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
	(in thousands)					
Intangible assets subject to amortization:						
Subscriber bases and customer relationships	\$ 79,413	\$ (70,487)	\$ 8,926	\$ 79,413	\$ (72,826)	\$ 6,587
Software and technology	711	(711)	—	711	(711)	—
Trade names	1,521	(608)	913	1,521	(760)	761
	<u>81,645</u>	<u>(71,806)</u>	<u>9,839</u>	<u>81,645</u>	<u>(74,297)</u>	<u>7,348</u>
Intangible assets not subject to amortization:						
Trade names	1,711	—	1,711	1,711	—	1,711
	<u>\$ 83,356</u>	<u>\$ (71,806)</u>	<u>\$ 11,550</u>	<u>\$ 83,356</u>	<u>\$ (74,297)</u>	<u>\$ 9,059</u>

Amortization of intangible assets in the Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2009 and 2010 represents the amortization of definite-lived intangible assets. The Company's definite-lived intangible assets primarily consist of subscriber bases and customer relationships, acquired software and technology and trade names acquired in conjunction with the purchases of businesses and

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subscriber bases from other companies that are not deemed to have indefinite lives. The Company's identifiable indefinite-lived intangible assets consist of certain trade names. Definite-lived intangible assets are amortized on a straight-line basis over their estimated useful lives, which are generally three to six years for subscriber bases and customer relationships and three years for acquired software and technology. As of June 30, 2010, the weighted average amortization periods were 4.4 years for subscriber base assets and customer relationships, 3.0 years for software and technology and 5.0 years for trade names. Based on the current amount of definite-lived intangible assets, the Company expects to record amortization expense of approximately \$1.6 million during the remaining six months in the year ending December 31, 2010 and \$2.9 million, \$1.5 million, \$0.8 million and \$0.5 million during the years ending December 31, 2011, 2012, 2013 and 2014, respectively. Actual amortization expense to be reported in future periods could differ materially from these estimates as a result of asset acquisitions, changes in useful lives and other relevant factors.

7. Convertible Senior Notes

General

In November 2006, the Company issued \$258.8 million aggregate principal amount of Convertible Senior Notes due November 15, 2026 in a registered offering. The Company received net proceeds of \$251.6 million after transaction fees of \$7.2 million. The Notes bear interest at 3.25% per year on the principal amount of the Notes until November 15, 2011, and 3.50% interest per year on the principal amount of the Notes thereafter, payable semi-annually in May and November of each year. The Notes rank as senior unsecured obligations of the Company.

The Notes are payable with cash and, if applicable, are convertible into shares of the Company's common stock. The initial conversion rate was 109.6491 shares per \$1,000 principal amount of Notes (which represented an initial conversion price of approximately \$9.12 per share). As a result of the Company's cash dividend payments, the conversion rate has been adjusted and was 117.5691 shares per \$1,000 principal amount of Notes as of June 30, 2010 (which represents a conversion price of approximately \$8.51 per share), subject to further adjustment. Upon conversion, a holder will receive cash up to the principal amount of the Notes and, at the Company's option, cash, or shares of the Company's common stock or a combination of cash and shares of common stock for the remainder, if any, of the conversion obligation. The conversion obligation is based on the sum of the "daily settlement amounts" for the 20 consecutive trading days that begin on, and include, the second trading day after the day the notes are surrendered for conversion. The Notes will be convertible only in the following circumstances: (1) during any calendar quarter after the calendar quarter ending December 31, 2006 (and only during such calendar quarter), if the closing sale price of the Company's common stock for each of 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the conversion price in effect on the last trading day of the immediately preceding calendar quarter; (2) during the five consecutive business days immediately after any five consecutive trading day period in which the average trading price per \$1,000 principal amount of Notes was equal to or less than 98% of the average conversion value of the Notes during the note measurement period; (3) upon the occurrence of specified corporate transactions, including the payment of dividends in certain circumstances; (4) if the Company has called the Notes for redemption; and (5) at any time from, and including, October 15, 2011 to, and including, November 15, 2011 and at any time on or after November 15, 2024. The Company has the option to redeem the Notes, in whole or in part, for cash, on or after November 15, 2011, provided that the Company has made at least ten semi-annual interest payments. In addition, the holders may require the Company to purchase all or a portion of their Notes on each of November 15, 2011, November 15, 2016 and November 15, 2021.

As of December 31, 2009 and June 30, 2010, the fair value of the Notes was approximately \$279.8 million and \$276.5 million, respectively, based on quoted market prices.

Under the terms of the indenture governing the Notes, the Company's payment of cash dividends requires an adjustment to the conversion rate for the Notes. In addition, as a result of the adjustment, the Notes may be surrendered for conversion for a period of time between the declaration date and the record date, as defined in the indenture, for the consideration provided for in the indenture. During the six months ended June

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30, 2010, \$3.0 million principal amount of Notes were surrendered for conversion for cash payment of \$2.8 million, resulting in a gain on conversion of debt of \$0.2 million. Such gain is included in interest expense and other, net, in the Condensed Consolidated Statement of Operations.

The Company accounts for the liability and equity components of the Notes separately. The Company is accreting the debt discount related to the equity component to non-cash interest expense over the estimated five-year life of the Notes, which represents the first redemption date of November 2011. The principal amount, unamortized discount and net carrying amount of the debt and equity components as of December 31, 2009 and June 30, 2010 are presented below:

	As of December 31, 2009	As of June 30, 2010
	(in thousands)	
Principal amount	\$ 258,750	\$ 255,791
Unamortized discount	(26,502)	(19,620)
Net carrying amount	<u>\$ 232,248</u>	<u>\$ 236,171</u>
Carrying amount of the equity component	<u>\$ 62,095</u>	<u>\$ 61,847</u>

As of June 30, 2010, the remaining amortization period for the discount was 16 months. As of June 30, 2010, the conversion price was approximately \$8.51 per share, resulting in 30.1 million shares issuable upon conversion.

The following table presents the associated interest cost related to the Notes during the three and six months ended June 30, 2009 and 2010, which consists of both the contractual interest coupon and amortization of the discount on the equity component:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2010	2009	2010
	(in thousands)			
Contractual interest recognized	\$ 2,223	\$ 2,200	\$ 4,447	\$ 4,426
Discount amortization	3,091	3,328	6,110	6,579
Effective interest rate	9.5%	9.5%	9.5%	9.5%

Classification

In 2009, the Company began paying quarterly cash dividends on its common stock. The Company currently intends to pay regular quarterly dividends on its common stock. Under the terms of the indenture governing the Notes, the Company's payment of cash dividends requires an adjustment to the conversion rate for the Notes. In addition, as a result of the adjustment, the Notes may be surrendered for conversion for a period of time between the declaration date and the record date, as defined in the indenture, for the consideration provided for in the indenture. As a result, the Company classified the Notes as a current liability in the Condensed Consolidated Balance Sheets as of December 31, 2009 and June 30, 2010.

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8. Stockholders' Equity*Comprehensive Income*

Comprehensive income includes unrealized gains and losses on certain investments classified as available-for-sale, net of tax, which are excluded from the Condensed Consolidated Statements of Operations. Comprehensive income for the three and six months ended June 30, 2009 and 2010 was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2010	2009	2010
	(in thousands)			
Net income	\$ 31,485	\$ 28,040	\$ 63,982	\$ 54,787
Unrealized holding gains on certain investments, net of tax	5,185	54	6,416	72
Total comprehensive income	<u>\$ 36,670</u>	<u>\$ 28,094</u>	<u>\$ 70,398</u>	<u>\$ 54,859</u>

Share Repurchases

Since the inception of the Company's share repurchase program, the Board of Directors has authorized a total of \$750.0 million for the repurchase of EarthLink's common stock. As of June 30, 2010, the Company had \$145.9 million available under the current authorizations. The Company may repurchase its common stock from time to time in compliance with the Securities and Exchange Commission's regulations and other legal requirements, including through the use of derivative transactions, and subject to market conditions and other factors. The share repurchase program does not require the Company to acquire any specific number of shares and may be terminated by the Board of Directors at any time.

The Company repurchased 3.6 million shares of its common stock for \$22.3 million during the six months ended June 30, 2009. The Company repurchased 0.1 million shares of its common stock for \$0.9 million during the six months ended June 30, 2010.

Dividends

During the three months ended June 30, 2010, cash dividends declared were \$0.16 per common share and total dividend payments were \$17.3 million. During the six months ended June 30, 2010, cash dividends declared were \$0.30 per common share and total dividend payments were \$32.7 million. The Company currently intends to pay regular quarterly dividends on its common stock. Any decision to declare future dividends will be made at the discretion of the Board of Directors and will depend on, among other things, the Company's results of operations, financial condition, cash requirements, investment opportunities and other factors the Board of Directors may deem relevant.

9. Stock-Based Compensation

The Company measures compensation cost for all stock awards at fair value on the date of grant and recognizes compensation expense over the requisite service period for awards expected to vest. The Company estimates the fair value of stock options using the Black-Scholes valuation model, and determines the fair value of restricted stock units based on the number of shares granted and the quoted price of EarthLink's common stock on the date of grant. Such value is recognized as expense over the requisite service period, net of estimated forfeitures, using the straight-line attribution method. For performance-based awards, the Company recognizes expense over the requisite service period, net of estimated forfeitures, using the accelerated attribution method when it is probable that the performance measure will be achieved. The estimate of awards that will ultimately vest requires significant judgment, and to the extent actual results or updated estimates differ from the Company's current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. The Company considers many factors when estimating expected forfeitures, including types of

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awards, employee class and historical employee attrition rates. Actual results, and future changes in estimates, may differ substantially from the Company's current estimates.

Stock-based compensation expense was \$3.0 million and \$1.7 million during the three months ended June 30, 2009 and 2010, respectively, and \$7.4 million and \$4.4 million during the six months ended June 30, 2009 and 2010, respectively. The Company classifies stock-based compensation expense within the same operating expense line items as cash compensation paid to employees.

Stock Incentive Plans

The Company has granted options to employees and non-employee directors to purchase the Company's common stock under various stock incentive plans. The Company has also granted restricted stock units to employees and non-employee directors under various stock incentive plans. Under the plans, employees and non-employee directors are eligible to receive awards of various forms of equity-based incentive compensation, including stock options, restricted stock, restricted stock units and performance awards, among others. The plans are administered by the Board of Directors or the Leadership and Compensation Committee of the Board of Directors, which determine the terms of the awards granted. Stock options are generally granted with an exercise price equal to the market value of EarthLink, Inc. common stock on the date of grant, have a term of ten years or less, and vest over terms of four years from the date of grant. Restricted stock units are granted with various vesting terms that range from one to six years from the date of grant.

Options Outstanding

The following table summarizes stock option activity as of and for the six months ended June 30, 2010:

	Stock Options	Weighted Average Exercise Price (shares and dollars in thousands)	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2009	3,916	\$ 9.61		
Granted	—	—		
Exercised	(428)	7.05		
Forfeited and expired	(391)	14.25		
Outstanding as of June 30, 2010	<u>3,097</u>	<u>9.38</u>	<u>4.0</u>	<u>\$ 801</u>
Vested and expected to vest as of June 30, 2010	<u>3,050</u>	<u>\$ 9.41</u>	<u>3.9</u>	<u>\$ 767</u>
Exercisable as of June 30, 2010	<u>2,582</u>	<u>\$ 9.69</u>	<u>3.5</u>	<u>\$ 516</u>

The aggregate intrinsic value amounts in the table above represent the closing price of the Company's common stock on June 30, 2010 in excess of the exercise price, multiplied by the number of stock options outstanding or exercisable, when the closing price is greater than the exercise price. This represents the amount that would have been received by the stock option holders if they had all exercised their stock options on June 30, 2010. The total intrinsic value of options exercised during the six months ended June 30, 2009 and 2010 was \$0.3 million and \$0.7 million, respectively. The intrinsic value of stock options exercised represents the difference between the market value of Company's common stock at the time of exercise and the exercise price, multiplied by the number of stock options exercised. To the extent the forfeiture rate is different than what the Company has anticipated, stock-based compensation related to these awards will be different from the Company's expectations. As of June 30, 2010, there was \$1.1 million of total unrecognized compensation cost related to stock options. That cost is expected to be recognized over a weighted-average period of 1.0 years.

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The following table summarizes the status of the Company's stock options as of June 30, 2010:

Stock Options Outstanding				Stock Options Exercisable	
Range of Exercise Prices	Number Outstanding (in thousands)	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable (in thousands)	Weighted Average Exercise Price
\$ 5.10 to \$ 6.86	179	3.8	\$ 6.00	132	\$ 5.70
6.90 to 7.25	256	6.7	7.00	161	6.99
7.31 to 7.31	250	7.0	7.31	50	7.31
7.32 to 8.96	237	4.6	8.14	203	8.23
9.01 to 9.01	314	4.1	9.01	314	9.01
9.23 to 9.51	375	5.5	9.47	236	9.45
9.64 to 10.06	652	0.8	9.89	652	9.89
10.36 to 16.82	834	3.8	11.51	834	11.51
\$ 5.10 to \$ 16.82	<u>3,097</u>	4.0	\$ 9.38	<u>2,582</u>	\$ 9.69

Restricted Stock Units

The following table summarizes restricted stock unit activity as of and for the six months ended June 30, 2010:

	Restricted Stock Units (in thousands)	Weighted Average Grant Date Fair Value
Nonvested as of December 31, 2009	2,166	\$ 7.25
Granted	248	8.21
Vested	(1,059)	7.20
Forfeited	(39)	7.14
Nonvested as of June 30, 2010	<u>1,316</u>	\$ 7.47

The fair value of restricted stock units is determined based on the closing trading price of EarthLink's common stock on the grant date. The weighted-average grant date fair value of restricted stock units granted during the six months ended June 30, 2009 and 2010 was \$6.74 and \$8.21, respectively. As of June 30, 2010, there was \$4.3 million of total unrecognized compensation cost related to nonvested restricted stock units. That cost is expected to be recognized over a weighted-average period of 1.6 years. The total fair value of shares vested during the six months ended June 30, 2009 and 2010 was \$10.3 million and \$8.8 million, respectively, which represents the closing price of the Company's common stock on the vesting date multiplied by the number of restricted stock units that vested.

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10. Income Taxes

The Company recorded an income tax provision of \$17.9 million and \$17.2 million during the three months ended June 30, 2009 and 2010, respectively, and \$38.8 million and \$34.0 million during the six months ended June 30, 2009 and 2010, respectively. The major components of the income tax provision for the three and six months ended June 30, 2009 and 2010 are as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2009	2010	2009	2010
	(in thousands)			
Federal alternative minimum tax	\$ 816	\$ 796	\$ 1,849	\$ 1,603
State income tax	1,941	615	3,295	996
Current provision	<u>2,757</u>	<u>1,411</u>	<u>5,144</u>	<u>2,599</u>
Deferred provision	<u>15,139</u>	<u>15,771</u>	<u>33,696</u>	<u>31,375</u>
Total	<u>\$ 17,896</u>	<u>\$ 17,182</u>	<u>\$ 38,840</u>	<u>\$ 33,974</u>

The income tax provision of \$34.0 million for the six months ended June 30, 2010 represents an annual effective rate of 38.3%, including a benefit of discrete items of 0.1% to the annual effective rate.

The current federal and state tax provisions recorded during the three and six months ended June 30, 2009 and 2010 were the result of limitations on net operating loss utilization associated with the alternative minimum tax calculation and state laws. The non-cash deferred tax provision recorded during the three and six months ended June 30, 2009 and 2010 was primarily a result of the utilization of net operating loss tax carryforwards.

The Company has a remaining valuation allowance of \$34.1 million against certain deferred tax assets. Of this amount, \$31.7 million relates to net operating losses generated by the tax benefits of stock-based compensation. The valuation allowance will be removed upon utilization of these net operating losses by the Company through an adjustment to additional paid-in-capital. The remaining \$2.4 million relates to net operating losses in certain jurisdictions where the Company believes it is not more likely than not to be realized in future periods.

To the extent the Company reports income in future periods, the Company intends to use its net operating loss carryforwards to the extent available to offset taxable income and reduce cash outflows for income taxes. The Company's ability to use its federal and state net operating loss carryforwards and federal and state tax credit carryforwards may be subject to restrictions attributable to equity transactions in the future resulting from changes in ownership as defined under the Internal Revenue Code.

The Company has identified its federal tax return and its state tax returns in California, Florida, Georgia and Illinois as "major" tax jurisdictions, for purposes of calculating its uncertain tax positions. Periods extending back to 1994 are still subject to examination for all "major" jurisdictions. The Company believes that its income tax filing positions and deductions through the period ended June 30, 2010 will not result in a material adverse effect on the Company's financial position, results of operations or cash flow. The Company's policy for recording interest and penalties associated with audits is to record such items as a component of income tax expense.

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A reconciliation of changes in the amount of unrecognized tax benefits for the six months ended June 30, 2010 is as follows:

	Six Months Ended June 30, 2010 (in thousands)
Balance as of December 31, 2009	\$ 1,315
Increases for tax positions of prior years	158
Increases for tax positions of current years	27
Decreases for tax positions of prior years	(583)
Balance as of June 30, 2010	<u>\$ 917</u>

11. Fair Value Measurements

As of December 31, 2009 and June 30, 2010, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included the Company's cash equivalents, marketable securities, auction rate securities, equity investments in other companies and the Company's put right.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). A three-tier fair value hierarchy is used to prioritize the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

The following tables present the Company's assets that are measured at fair value on a recurring basis as of December 31, 2009 and June 30, 2010:

Description	Carrying Value	Fair Value	Fair Value Measurements as of December 31, 2009 Using		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(in thousands)		
Cash equivalents	\$ 588,666	\$ 588,666	\$ 588,666	\$ —	\$ —
Marketable securities	42,060	42,060	42,060	—	—
Auction rate securities	42,906	42,906	—	—	42,906
Equity investments in other companies	1,529	1,529	1,529	—	—
Put right	5,239	5,239	—	—	5,239
Total	<u>\$ 680,400</u>	<u>\$ 680,400</u>	<u>\$ 632,255</u>	<u>\$ —</u>	<u>\$ 48,145</u>

EARTHLINK, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED - (Continued)

Description	Carrying Value	Fair Value	Fair Value Measurements as of June 30, 2010 Using		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(in thousands)		
Cash equivalents	\$ 480,728	\$ 480,728	\$ 480,728	\$ —	\$ —
Marketable securities	224,701	224,701	224,701	—	—
Auction rate securities	16,850	16,850	—	16,850	—
Total	<u>\$ 722,279</u>	<u>\$ 722,279</u>	<u>\$ 705,429</u>	<u>\$ 16,850</u>	<u>\$ —</u>

Cash equivalents, marketable securities and equity investments in other companies were valued using quoted market prices and are classified within Level 1. Investments in auction rate securities and the Company's put right were classified within Level 3 as of December 31, 2009 because they were valued using a discounted cash flow model. Some of the inputs to this model are unobservable in the market and are significant. During the six months ended June 30, 2010, the Company sold \$31.3 million of its auction rate securities to the selling broker at par, plus accrued interest. The Company's remaining \$16.9 million of auction rate securities were redeemed at par on June 30, 2010, pursuant to the put right, with a trade settlement date of July 1, 2010. As a result, the remaining auction rate securities were transferred from Level 3 to Level 2 as of June 30, 2010 and the put right was reduced to zero.

The Company has invested in auction rate securities, which are more fully described in Note 5, "Investments." Beginning in February 2008, these instruments held by the Company failed to attract sufficient buyers. As a result, these securities do not have a readily determinable market value and are not liquid. In October 2008, EarthLink entered into an agreement with the broker that sold the Company its auction rate securities that gave the Company the right to sell its existing auction rate securities back to the broker at par plus accrued interest, beginning on June 30, 2010 until July 2, 2012. As a result, the Company classified its auction rate securities as trading, with changes in fair value included in gain on investments, net, in the Condensed Consolidated Statement of Operations. The Company elected the fair value option for the put right to offset the fair value changes of the auction rate securities. The fair values of the Company's auction rate securities and put right as of December 31, 2009 were estimated utilizing a discounted cash flow analysis. These analyses consider, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, and the timing and value of expected future cash flows. These securities were also compared, when possible, to other observable market data with similar characteristics to the securities held by the Company.

The following table presents a reconciliation of the beginning and ending balances of the Company's assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of June 30, 2010:

	Auction Rate Securities	Put Right (in thousands)	Total
Balance as of December 31, 2009	\$ 42,906	\$ 5,239	\$ 48,145
Total realized losses	(91)	—	(91)
Total realized gains	5,335	93	5,428
Settlements	(31,300)	(5,332)	(36,632)
Transfers into Level 2	(16,850)	—	(16,850)
Balance as of June 30, 2010	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

The Company's realized gains and losses for its auction rate securities and put right are included in gain on investments, net, in the Condensed Consolidated Statement of Operations.

EARTHLINK, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED - (Continued)

12. Segment Information

The Company reports segment information along the same lines that its chief operating decision maker reviews its operating results in assessing performance and allocating resources. The Company operates two reportable segments, Consumer Services and Business Services. The Company's Consumer Services segment provides Internet access services and related value-added services to individual customers. These services include dial-up and high-speed Internet access and VoIP services, among others. The Company's Business Services segment provides integrated communications services and related value-added services to businesses and communications carriers. These services include managed IP-based wide area networks, dedicated Internet access and web hosting, among others.

The Company evaluates performance of its segments based on segment income from operations. Segment income from operations includes revenues from external customers, related cost of revenues and operating expenses directly attributable to the segment, which include costs over which segment managers have direct discretionary control, such as advertising and marketing programs, customer support expenses, operations expenses, product development expenses, certain technology and facilities expenses, billing operations and provisions for doubtful accounts. Segment income from operations excludes other income and expense items and certain expenses over which segment managers do not have discretionary control. Costs excluded from segment income from operations include various corporate expenses (consisting of certain costs such as corporate management, human resources, finance and legal), amortization of intangible assets, impairment of goodwill and intangible assets, facility exit and restructuring costs, and stock-based compensation expense, as they are not considered in the measurement of segment performance.

Information on reportable segments and a reconciliation to consolidated income from operations for the three and six months ended June 30, 2009 and 2010 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2010	2009	2010
	(in thousands)			
Consumer Services				
Revenues	\$ 147,606	\$ 120,305	\$ 307,168	\$ 243,869
Cost of revenues	47,345	37,507	99,679	77,968
Gross margin	100,261	82,798	207,489	165,901
Direct segment operating expenses	33,372	23,248	70,578	47,213
Segment operating income	<u>\$ 66,889</u>	<u>\$ 59,550</u>	<u>\$ 136,911</u>	<u>\$ 118,688</u>
Business Services				
Revenues	\$ 37,991	\$ 32,702	\$ 77,492	\$ 66,396
Cost of revenues	21,925	20,511	45,156	40,864
Gross margin	16,066	12,191	32,336	25,532
Direct segment operating expenses	9,823	10,449	21,082	20,390
Segment operating income	<u>\$ 6,243</u>	<u>\$ 1,742</u>	<u>\$ 11,254</u>	<u>\$ 5,142</u>
Consolidated				
Revenues	\$ 185,597	\$ 153,007	\$ 384,660	\$ 310,265
Cost of revenues	69,270	58,018	144,835	118,832
Gross margin	116,327	94,989	239,825	191,433
Direct segment operating expenses	43,195	33,697	91,660	67,603
Segment operating income	73,132	61,292	148,165	123,830
Stock-based compensation expense	3,026	1,707	7,416	4,374
Amortization of intangible assets	2,038	1,232	4,185	2,496
Facility exit and restructuring costs	4,927	(89)	5,415	1,346
Other operating expenses	8,671	7,891	19,206	16,650
Income from operations	<u>\$ 54,470</u>	<u>\$ 50,551</u>	<u>\$ 111,943</u>	<u>\$ 98,964</u>

EARTHLINK, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED - (Continued)

The primary component of the Company's revenues is access and service revenues, which consist of narrowband access services (including traditional, fully-featured narrowband access and value-priced narrowband access); broadband access services (including high-speed access via DSL and cable, VoIP and managed IP-based wide area networks); and web hosting services. The Company also earns revenues from value-added services, which include ancillary services sold as add-on features to the Company's access services, search and advertising revenues.

Consumer access and service revenues consist of narrowband access and broadband access services. These revenues are derived from fees charged to customers for dial-up Internet access; fees charged for high-speed access services; fees charged for VoIP services; usage fees; shipping and handling fees; and termination fees. Consumer value-added services revenues consist of revenues from ancillary services sold as add-on features to the Company's Internet services, such as security products, premium email, home networking, email storage and Internet call waiting; search revenues; and advertising revenues.

Business access and service revenues consist of fees charged for managed IP-based wide area networks; fees charged for Internet access services; installation fees; termination fees; fees for equipment; usage fees; cost recovery fees billed to customers; and fees charged for leasing server space and providing web services that enable customers to build and maintain an effective online presence.

Information on revenues by groups of similar services and by segment for the three and six months ended June 30, 2009 and 2010 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2010	2009	2010
	(in thousands)			
Consumer Services				
Access and service	\$ 129,479	\$ 105,552	\$ 269,269	\$ 213,750
Value-added services	18,127	14,753	37,899	30,119
Total revenues	<u>147,606</u>	<u>120,305</u>	<u>307,168</u>	<u>243,869</u>
Business Services				
Access and service	37,439	32,196	76,347	65,335
Value-added services	552	506	1,145	1,061
Total revenues	<u>37,991</u>	<u>32,702</u>	<u>77,492</u>	<u>66,396</u>
Consolidated				
Access and service	166,918	137,748	345,616	279,085
Value-added services	18,679	15,259	39,044	31,180
Total revenues	<u>\$ 185,597</u>	<u>\$ 153,007</u>	<u>\$ 384,660</u>	<u>\$ 310,265</u>

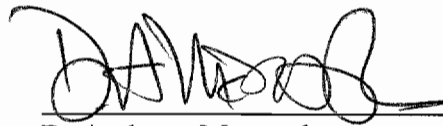
The Company manages its working capital on a consolidated basis and does not allocate long-lived assets to segments. In addition, segment assets are not reported to, or used by, the chief operating decision maker and therefore, total segment assets have not been disclosed.

The Company has not provided information about geographic segments because substantially all of the Company's revenues, results of operations and identifiable assets are in the United States.

VERIFICATION

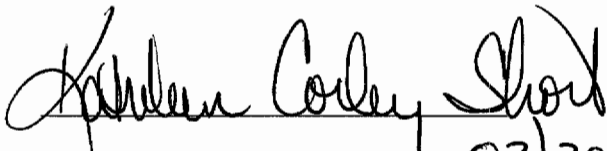
STATE OF ALABAMA §
 §
COUNTY OF MADISON §

I, D. Anthony Mastando, hereby verify under penalty of perjury that I am the Vice President - Regulatory Affairs / Senior Regulatory Attorney of ITC^DeltaCom, Inc.; that I am authorized to make this verification on behalf of the company; that I have read the foregoing document and know the contents thereof; and that the same are true of my own knowledge, except to those matters therein stated upon information and belief, and as to those matters I believe them to be true.



D. Anthony Mastando
VP - Regulatory Affairs / Senior Reg Attorney
ITC^DeltaCom, Inc.

Subscribed and sworn to before me on this 1st day of October, 2010.



My commission expires: 03/20/13

VERIFICATION

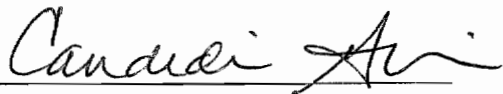
STATE OF GEORGIA §
 §
COUNTY OF FULTON §

I, Erin Shea, hereby verify under penalty of perjury that I am the Vice President and Assistant General Counsel of EarthLink, Inc.; that I am authorized to make this verification on behalf of the company; that I have read the foregoing document and know the contents thereof; and that the same are true of my own knowledge, except to those matters therein stated upon information and belief, and as to those matters I believe them to be true.

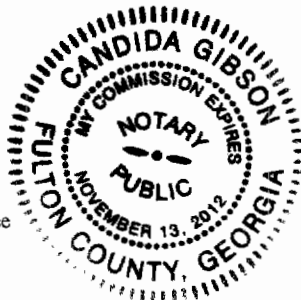


Erin Shea
Vice President and Assistant General Counsel
EarthLink, Inc.

Subscribed and sworn to before me on this 1 day of October, 2010.



My commission expires: 11/13/12



Tennessee