

Edgar Filing: RARE MEDIUM GROUP INC - Form 10-Q

RARE MEDIUM GROUP INC  
Form 10-Q  
November 14, 2001

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 FOR THE PERIOD ENDED SEPTEMBER 30, 2001, OR  
  
 /  TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

Commission file number 0-13865

RARE MEDIUM GROUP, INC.  
(Exact name of registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of incorporation or organization)

23-2368845  
(I.R.S. Employer I  
dentification Number)

28 WEST 23RD STREET, 5TH FLOOR  
NEW YORK, NEW YORK  
(Address of principal executive offices)

10010  
(Zip Code)

Registrant's telephone number, including area code: (646) 638-9700

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No  / /

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Number of shares outstanding of the issuer's common stock, as of November 9, 2001

Common Stock, par value \$0.01 per share	64,086,076
Class	Number of shares outstanding

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Part I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

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Consolidated Balance Sheets as of December 31, 2000 and September 30, 2001 (Unaudited)

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Unaudited Consolidated Statements of Cash Flows - Nine months ended September 30, 2000 and 2001

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SIGNATURES

RARE MEDIUM GROUP, INC.  
CONSOLIDATED BALANCE SHEETS  
(In thousands except share data)

	ASSETS	DECEMBER 31, 2001
Current assets:		
Cash and cash equivalents		\$
Short-term investments		
Total cash, cash equivalents and short-term investments		
Accounts receivable, net		
Work in process		
Notes receivable		
Prepaid expenses and other current assets		
Total current assets		
Property and equipment, net		
Investments in affiliates		
Goodwill and intangibles, net		
Other assets		

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Total assets	\$
=====	
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	\$
Accrued liabilities	
Deferred revenue	
Other current liabilities	
	-----
Total current liabilities	
Other noncurrent liabilities	
	-----
Total liabilities	
	-----
Series A Convertible Preferred Stock, \$.01 par value, net of unamortized discount of \$50,162 and \$46,867, respectively	
	-----
Stockholders' equity:	
Preferred stock, \$.01 par value. Authorized 10,000,000 shares; issued 977,838 shares as Series A Convertible Preferred Stock at December 31, 2000 and 1,033,875 shares at September 30, 2001	
Common stock, \$.01 par value. Authorized 200,000,000 shares; issued and outstanding 63,676,074 shares at December 31, 2000 and 63,666,505 shares at September 30, 2001	
Additional paid-in capital	
Accumulated other comprehensive loss	
Accumulated deficit	
Treasury stock, at cost, 66,227 shares	
	-----
Total stockholders' equity	
	-----
Total liabilities and stockholders' equity	\$
	=====

See accompanying notes to unaudited consolidated financial statements.

RARE MEDIUM GROUP, INC.  
 UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (In thousands except share data)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MON
	2000	2001	2000
	-----	-----	-----
Revenues	\$ 2,311	\$ 25	\$
Cost of revenues	910	2	
	-----	-----	-----
Gross profit	1,401	23	
Expenses:			
Sales and marketing	3,560	28	
General and administrative	13,378	2,737	3
Depreciation and amortization	2,518	398	
Restructuring charges	--	125	

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Total expenses	19,456	3,288	4
Loss from operations	(18,055)	(3,265)	(4)
Interest income, net	3,004	3,010	
Loss on investments in affiliates	(1,860)	(18,212)	
Unrealized loss on derivative instrument	--	(15,311)	
Other (expense) income	(73)	490	
Loss before discontinued operations	(16,984)	(33,288)	(4)
Discontinued operations:			
Loss from discontinued operations	(16,187)	(50,677)	(4)
Loss from wind-down of discontinued operations	--	(3,073)	
Loss from discontinued operations	(16,187)	(53,750)	(4)
Net loss	(33,171)	(87,038)	(8)
Cumulative dividends and accretion of convertible preferred stock to liquidation value	(2,975)	(3,001)	(1)
Net loss attributable to common stockholders	\$ (36,146)	\$ (90,039)	(10)
Basic and diluted loss per share:			
Continuing operations	\$ (0.36)	\$ (0.57)	\$
Discontinued operations	(0.29)	(0.85)	
Net loss per share	\$ (0.65)	\$ (1.42)	\$
Basic weighted average common shares outstanding	55,419,834	63,416,825	50,10

See accompanying notes to unaudited consolidated financial statements.

RARE MEDIUM GROUP, INC.  
 UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (In thousands)

	NINE MONTHS END
	2000
Cash flows from operating activities:	
Net loss	\$ (82,064)
Adjustments to reconcile net loss to net cash used in operating activities:	
Loss from discontinued operations	40,418
Depreciation and amortization	6,246
Loss on investments in affiliates	4,424
Unrealized loss on derivative instrument	--
Non-cash restructuring charges	--
Non-cash interest, net	--
Changes in assets and liabilities, net of acquisitions and sale of businesses:	
Accounts receivable	(1,377)

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Work in process	62
Prepaid expenses and other assets	(1,420)
Deferred revenue	575
Accounts payable, accrued and other liabilities	(2,334)
	-----
Net cash used in continuing operations	(35,470)
Net cash used in discontinued operations	(21,332)
	-----
Net cash used in operating activities	(56,802)
Cash flows from investing activities:	
Cash paid for investments in affiliates	(26,592)
Purchases of property and equipment	(2,513)
Purchase of notes receivable	--
Cash paid for acquisitions, net of cash acquired and acquisition costs	(76)
Cash received for sale of investment in affiliates	--
Purchases of short-term investments	--
Sales of short-term investments	--
	-----
Net cash used in continuing operations	(29,181)
Net cash used in discontinued operations	(15,519)
	-----
Net cash used in investing activities	(44,700)
Cash flows from financing activities:	
Proceeds from issuance of common stock, net of costs	241,355
Proceeds from issuance of common stock in connection with the exercise of warrants and options	5,468
Repayments of borrowings, net	(832)
	-----
Net cash provided by financing activities	245,991
	-----
Net increase (decrease) in cash and cash equivalents	144,489
Cash and cash equivalents, beginning of period	28,540
	-----
Cash and cash equivalents, end of period	\$ 173,029
	=====

See accompanying notes to unaudited consolidated financial statements.

RARE MEDIUM GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(1) DESCRIPTION OF THE BUSINESS

Rare Medium Group, Inc. (the "Company") conducts its business primarily through its subsidiaries. Since 1998, its principal business was conducted through Rare Medium, Inc., which developed Internet e-commerce strategies, business processes, marketing communications, branding strategies and interactive content using Internet-based technologies and solutions. A decision to discontinue Rare Medium, Inc.'s operations was made at the end of the quarter.

Through its investment business, the Company has historically made venture investments by taking strategic minority equity positions in other independently managed companies. Additionally, in the past, the Company has developed, managed and operated companies in selected Internet-focused market segments ("Incubator Companies"). During the first quarter of 2001, the Company reduced its focus on

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the investment business and substantially ceased providing funding to its Incubator Companies. Additionally, in April 2001, the Company sold a majority of its equity interest in ChangeMusic Network ("CMJ") and ePrize, two of its Incubator Companies (see Note 5).

Currently, the Company, through its newly formed subsidiary, MSV Investors Holdings, Inc., expects to be an active participant in the Mobile Satellite Ventures ("MSV") joint venture, which includes TMI Communications, Inc., Motient Corporation ("Motient"), Telcom Ventures LLC, Columbia Capital and Spectrum Equity Investors. MSV is a provider of mobile satellite services in North America, providing its customers with digital voice and data services, including circuit switched voice, nationwide voice and data dispatch, and packet data services.

In addition to its joint venture interest in MSV, subject to closing (see Note 11), the Company's principal assets consist of its venture portfolio, 5,000,000 shares of XM Satellite Radio Holdings, Inc. ("XM Radio") common stock, a promissory note from Motient with a \$26.2 million face value and cash.

The Company is headquartered in New York, New York. Its Rare Medium, Inc. subsidiary continues to have an office in Dallas, Texas as well.

### (2) BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared by the Company in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting only of those of a normal recurring nature, necessary for a fair presentation of the Company's financial position, results of operations and cash flows at the dates and for the periods indicated. While the Company believes that disclosures presented are adequate to make the information not misleading, these unaudited consolidated financial statements should be read in conjunction with the audited financial statements and related notes for the year ended December 31, 2000 which are contained in the Company's second amended Annual Report on Form 10-K/A filed with the Securities and Exchange Commission (the "SEC"). The results of the three and nine month periods ended September 30, 2001 are not necessarily indicative of the results to be expected for the full year. Certain prior year amounts in the consolidated financial statements have been reclassified to conform to the current year's presentation.

## RARE MEDIUM GROUP, INC.

### NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

### (3) INVESTMENTS IN AFFILIATES

The following is a summary of the carrying value of investments held by the Company (in thousands):

DECEMBER 31, 2000 -----	SEPTEMBER 30, 2001 -----
-------------------------------	--------------------------------

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(UNAUDITED)

Cost investments	\$37,501	\$15,155
Marketable securities	7,791	172
Equity investments	2,724	--
	-----	-----
	\$48,016	\$15,327
	=====	=====

The Company recognized losses of approximately \$0.5 million for the nine months ended September 30, 2001 representing its proportionate share of the losses of investee companies, for those investments carried under the equity method. The Company also recognized losses of approximately \$2.2 million for the nine months ended September 30, 2001 representing the amortization of the net excess of investment over its proportionate share of the affiliates' net assets. Amortization is generally recorded on a straight-line basis over three years. Also, the Company recorded a loss of approximately \$35.9 million during the nine months ended September 30, 2001 for the impairment of investments in affiliates, including approximately \$4.1 million relating to its Incubator Companies. Additionally, the Company recognized a loss of approximately \$3.2 million for realized losses on the sale of publicly traded securities. During the nine months ended September 30, 2001, Rare Medium, Inc. recognized revenue of approximately \$4.5 million for services provided to affiliates which is included in the loss from discontinued operations.

(4) DISCONTINUED OPERATIONS

At the end of the third quarter, a decision to discontinue the operations of Rare Medium, Inc. and the LiveMarket subsidiary was made in light of their performance and prospects. The wind-down of these businesses is expected to be completed by the first quarter 2002. In connection with the discontinuance of these businesses, the Company recorded a charge in the third quarter of 2001 of \$35.9 million related to severance and benefits resulting from headcount reductions, an accrual for estimated losses of \$3.1 million during the wind-down period and the write-off of unamortized goodwill and property and equipment, net of expected proceeds. As of September 30, 2001, the remaining assets, including cash, accounts receivables, work in process, property and equipment and other assets, and liabilities, including accounts payable, restructuring and other accrued expenses and advances payable, amounted to approximately \$8.2 million and \$27.6 million, respectively.

The discontinuance of these businesses represents the disposal of a business segment under Accounting Principles Board Opinion No. 30. Accordingly, the results of these operations have been classified as discontinued, and prior period results have been restated. For segment reporting purposes, Rare Medium, Inc.'s results are classified as "Internet Services," and LiveMarket's results are included in "Investment."

(5) SALE OF BUSINESSES

In April 2001, the Company sold a majority of its equity interest in two of its Incubator Companies: CMJ and ePrize. The Company received total aggregate consideration of \$1.4 million, consisting of cash and a promissory note with a principal amount of approximately \$0.5 million. The Company retained a 15% equity interest in CMJ and a 5% equity interest in ePrize. During the first quarter of 2001, the Company recognized a loss of approximately \$2.5 million relating to the sale of CMJ. During the second quarter of 2001, the Company recognized a gain of approximately \$1.5 million relating to the sale of ePrize.

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RARE MEDIUM GROUP, INC.  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(6) SUPPLEMENTAL INFORMATION

The Company's operations have historically been classified into two primary segments: the investment business and the Internet services business, the operations of which were discontinued at the end of the third quarter (see Note 4). Subsequent to September 30, 2001, the Company will operate solely within the investment business. Presented below is summarized financial information of the Company's operations for each segment (in thousands):

	THREE MONTHS ENDED SEPTEMBER 30,		
	2000	2001	
	-----	-----	
Revenues:			
Internet services	\$ 33,215	\$ 3,885	\$
Investment	2,410	297	
Internet services provided to consolidated investments	(6,749)	--	
	-----	-----	
	\$ 28,876	\$ 4,182	\$
	=====	=====	=
Loss before interest, taxes, depreciation, amortization and other items:			
Internet services	\$ (318)	\$ (6,703)	\$
Investment and corporate	(20,360)	(4,193)	
	-----	-----	
	(20,678)	(10,896)	
Depreciation and amortization	(2,518)	(398)	
Interest income, net	3,004	3,010	
Loss on investments in affiliates	(1,860)	(18,212)	
Restructuring charges	--	(125)	
Unrealized loss on derivative instrument	--	(15,311)	
Other (expense) income	(73)	490	
Other items included in discontinued operations	(11,046)	(45,596)	
	-----	-----	
Net loss	\$ (33,171)	\$ (87,038)	\$
	=====	=====	=
		DECEMBER 31, 2000	SEPTEMBER 30, 2001
		-----	-----
Total assets:			
Internet services		\$ 61,339	\$
Investment and corporate		256,152	
		-----	-----
		\$ 317,491	\$
		=====	=====

For the nine months ended September 30, 2001, two Internet services customers, each representing more than 10% of Internet services revenue,



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aggregated approximately 27% of Internet services revenue.

### (7) NOTES RECEIVABLE AND DERIVATIVE INSTRUMENT

On April 2, 2001, the Company agreed to purchase from Motient 12.5% secured promissory notes (the "Notes"), issuable in two tranches, each in the principal amount of \$25.0 million. The Notes were collateralized by 5,000,000 shares of XM Radio common stock owned by Motient. The first tranche was purchased on April 4, 2001, and the second tranche was purchased on July 16, 2001. The principal of and accrued interest on the Notes were payable on October 1, 2001 in either cash, shares of XM Radio, or any combination thereof at Motient's option, as set forth in the agreement. At the option of the Company, the Notes may have been exchanged for a number of XM Radio shares based on a formula, as set forth in the agreement (the "Exchange Feature"). The Company ascribed separate values to each of the outstanding Notes and the Exchange Feature. As such, \$48.5 million was allocated to Notes and the remaining \$1.5 million was allocated to the Exchange Feature. Additional interest income was recognized representing the accretion of the \$48.5 million carrying value up to the \$50.0 million face value over the term of the Notes. As of June 30, 2001, the Company had recognized an unrealized gain of approximately \$13.8 million related to the increase in the fair value of the Exchange Feature. As a result of the decrease in the price of XM Radio stock since June 30, 2001 and the \$1.5 million value ascribed to the Exchange Feature at the purchase date of the Notes, the Company recognized an unrealized loss of \$15.3 million for the three months ending September 30, 2001 relating to a decrease in the fair value of the Exchange Feature.

## RARE MEDIUM GROUP, INC.

### NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

### (7) NOTES RECEIVABLE AND DERIVATIVE INSTRUMENT - (CONTINUED)

On October 1, 2001, and again on October 8, 2001, the Company extended the maturity date of the Notes. On October 12, 2001, in accordance with the terms of the Notes, the Company received 5,000,000 shares of XM Radio as payment for \$26.2 million of the Notes and accrued interest. The maturity date for the remaining balance of the Notes in the principal amount of approximately \$26.2 million, and interest thereon, was extended for 60 days. The Company may further extend the maturity date to October 12, 2002 upon satisfaction of certain conditions.

### (8) MERGER WITH MOTIENT CORPORATION

On May 14, 2001, the Company entered into an agreement to merge with a subsidiary of Motient. By a letter agreement dated October 1, 2001, Motient and the Company terminated the planned merger. As a result of the termination, neither the Company nor Motient shall have any obligation to the other party, except for repayment by Motient to the Company of amounts outstanding under the Notes (see Note 7).

### (9) RESTRUCTURING CHARGES

During the first and second quarters of 2001, the Company recognized restructuring charges of approximately \$21.9 million primarily related to its Internet services business, consisting of \$16.7 million for the consolidation of facilities and the disposition of property and equipment, \$2.0 million for the impairment of unamortized goodwill, \$2.0 million for

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severance and benefits related to headcount reductions and \$1.2 million for other office shutdown costs. These restructuring charges were aimed at aligning Rare Medium, Inc.'s cost structure with changing market conditions and decreased demand for its services. An additional \$36.1 million was recognized in the third quarter, consisting of \$15.4 million for the closing of facilities and the disposition of property and equipment, \$17.0 million for the impairment of unamortized goodwill, \$1.1 million for further severance and benefits related to headcount reductions and \$2.6 million for other office shutdown costs. These additional charges were primarily a result of the discontinuance of the operations of the Rare Medium, Inc. and LiveMarket subsidiaries. The plan resulted in head count reductions of approximately 500 employees during the first nine months of 2001, and approximately an additional 100 subsequent to September 30, 2001. Of the \$58.0 million in restructuring charges for the nine months ended September 30, 2001, \$56.9 million are reflected in the loss from discontinued operations.

The total cash outlay and non-cash charges for the restructuring activities will be approximately \$14.5 million and \$43.5 million, respectively. As of September 30, 2001, approximately \$4.9 million of cash was used, \$5.8 million is expected to be used in the remainder of 2001, and the remaining cash outlay of approximately \$3.8 million, primarily related to the present value of the net future minimum lease payments for certain real estate lease obligations, is expected to be used over the next seven years.

Restructuring activities during the nine months ended September 30, 2001 were as follows (in thousands):

	RESTRUCTURING CHARGES	AMOUNT UTILIZED	BALANCE SEPTEMBER 30, 2001
	-----	-----	-----
Facilities and property and equipment	\$ 32,133	\$ 26,185	\$ 5,948
Goodwill	19,001	19,001	--
Severance and benefits	3,107	2,349	758
Other office shutdown costs	3,745	873	2,872
	-----	-----	-----
Total	\$ 57,986	\$ 48,408	\$ 9,578
	=====	=====	=====

### RARE MEDIUM GROUP, INC.

#### NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

#### (10) CONTINGENCIES

The Company is aware of a number of purported class action lawsuits that have been filed by the holders of the Company's common stock in the Court of Chancery of the State of Delaware challenging the then proposed merger with Motient (see Note 8). All of the complaints name the Company and members of the Company's board of directors as defendants. Most of the complaints name the holders of the Company's preferred stock, and certain of their affiliates, as defendants, and some of the complaints name Motient as a defendant. On June 22, 2001, the Delaware court entered an order to consolidate all of the Delaware

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lawsuits for all purposes into a single purported class action, IN RE RARE MEDIUM GROUP, INC. SHAREHOLDERS LITIGATION, C.A. No. 18879-NC. On August 7, 2001, a Consolidated Amended Class Action Complaint was filed in Delaware Chancery Court. The Delaware Chancery Court has not yet certified the consolidated lawsuit as a class action. The lawsuit alleges that the defendants breached duties allegedly owed to the holders of the Company's common stock in connection with the merger agreement and sought to stop the merger and/or obtain monetary damages. The Company has and intends to continue vigorously contesting this lawsuit. On October 19, 2001, the Company filed a motion to dismiss the Consolidated Amended Class Action Complaint on a variety of grounds, including mootness.

A purported class action was filed in New York, titled BRICKELL PARTNERS V. RARE MEDIUM GROUP, INC., ET AL., N.Y.S. Index No. 01602694, in the New York State Supreme Court, making similar allegations to the Consolidated Amended Class Action Complaint in Delaware. A motion to dismiss the complaint is currently pending.

In 2000, Rare Medium, Inc. entered into a strategic alliance agreement, as amended, with a software company (the "Partner") to assist in the training of personnel and development and delivery by Rare Medium, Inc. of solutions built utilizing the Partner's technology. Under the terms of the alliance, the Partner was to provide Rare Medium, Inc. with refundable advances of approximately \$17.1 million, on an interest free basis, to be paid to Rare Medium, Inc. over the term of the two-year agreement, subject to Rare Medium, Inc.'s compliance with certain requirements set forth in the agreement. The amount and timing of the repayment of the advances may be adjusted based on Rare Medium, Inc.'s achievement of certain milestones in accordance with the terms of the agreement. The Partner and Rare Medium, Inc. have a dispute as to whether certain milestones have been achieved. Efforts at renegotiating the payment schedule and milestones were not successful. In July 2001, Rare Medium, Inc. received a notice of arbitration from the Partner seeking the return of the approximately \$8.6 million, plus interest, that had been advanced by the Partner, who has asserted that the agreement has terminated. Rare Medium, Inc. is contesting the Partner's claims. There can be no assurance that Rare Medium, Inc. will be successful in contesting this action and that accelerated repayment, along with attorney's fees and interest, will not be required.

The Company has been in settlement discussions with its former financial public relations firm with respect to the Company's refusal to deliver options covering approximately 124,000 shares of the Company's stock that are allegedly owed relating to past services allegedly rendered. Based on the current state of settlement discussions, the Company believes that it will be able to resolve this contingency without it having a material adverse effect on the Company's results of operations or financial position. However, if no settlement is reached, the claimant has indicated that it will file a claim alleging its entitlement to damages of approximately \$12.8 million. While the Company does not believe such a claim will be filed, until a formal settlement has been executed, there can be no assurance of this outcome or the results of any subsequent litigation.

On May 16, 2001, plaintiffs Jay M. Wolff, David Bliss, Tim Barber and Steve O'Brien filed suit against Rare Medium, Inc., ICC Technologies, Inc., and Rare Medium Texas I, Inc. in the United States District Court for the Southern District of New York, WOLFF, ET AL. V. RARE MEDIUM, INC., ET AL., CV No 01-4279. The plaintiffs asserted claims for breach of contract, tortious interference with contractual relations, tortious interference with prospective advantage, and breach of implied obligation of good faith, arising out of the plaintiffs' alleged attempt to engage in transactions involving some or all of the approximately 1,200,000 shares of the Company's common stock that the plaintiffs obtained in the Company's acquisition of Big Hand, Inc. The plaintiffs seek

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unspecified compensatory and punitive damages, interest, attorneys' fees and costs. On October 31, 2001, the Court dismissed the case without prejudice.

### RARE MEDIUM GROUP, INC.

#### NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

##### (10) CONTINGENCIES - (CONTINUED)

On July 23, 2001, plaintiff Microsoft Corporation filed suit against Rare Medium, Inc. in the United States District Court for the Western District of Washington, CO1-1130P. The plaintiff alleges breach of contract in connection with a consulting agreement and an alliance agreement entered between the parties seeking \$2.3 million in damages, interest and attorney's fees. Rare Medium, Inc. plans to defend the matter vigorously.

Additionally, from time to time, the Company is subject to litigation in the normal course of business. The Company is of the opinion that, based on information presently available, the resolution of any such additional legal matters will not have a material adverse effect on the Company's financial position or results of its operations.

##### (11) SUBSEQUENT EVENTS - COMMITMENT

In October 2001, the Company, through a majority owned subsidiary, committed to invest \$50.0 million in the MSV joint venture, a satellite communications venture that will integrate the satellite operations of Motient with the satellite operations of TMI Communications, Inc., a wholly owned subsidiary of BCE Inc. of Canada. The investment is contingent on customary approvals by both the American and Canadian regulatory agencies. This investment will represent a joint venture interest of approximately 30%.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that involve risks and uncertainties, including statements regarding our capital needs, business strategy, expectations and intentions. We urge you to consider that statements that use the terms "believe," "do not believe," "anticipate," "expect," "plan," "estimate," "intend" and similar expressions are intended to identify forward-looking statements. These statements reflect our current views with respect to future events and because our business is subject to numerous risks, uncertainties and risk factors, our actual results could differ materially from those anticipated in the forward-looking statements, including those set forth below under this "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report. Actual results will most likely differ from those reflected in these statements, and the differences could be substantial. We disclaim any obligation to publicly update these statements, or disclose any difference between our actual results and those reflected in these statements. The information constitutes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

### OVERVIEW

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We conduct our business primarily through our subsidiaries. Since 1998, our principal business was conducted through Rare Medium, Inc., which developed Internet e-commerce strategies, business processes, marketing communications, branding strategies and interactive content using Internet-based technologies and solutions. A decision to discontinue Rare Medium, Inc.'s operations was made at the end of the quarter.

Through our investment business, we have historically made venture investments by taking strategic minority equity positions in other independently managed companies. Additionally, in the past, we have developed, managed and operated companies in selected Internet-focused market segments ("Incubator Companies"). During the first quarter of 2001, we reduced our focus on the investment business and substantially ceased providing funding to our Incubator Companies. Additionally, in April 2001, we sold a majority of our equity interest in ChangeMusic Network ("CMJ") and ePrize, two of our Incubator Companies.

Currently, through our newly formed subsidiary, MSV Investors Holdings, Inc., we expect to be an active participant in the Mobile Satellite Ventures ("MSV") joint venture, which includes TMI Communications, Inc., Motient Corporation, Telcom Ventures, LLC, Columbia Capital and Spectrum Equity Investors. MSV is a provider of mobile satellite services in North America, providing its customers with digital voice and data services, including circuit switched voice, nationwide voice and data dispatch, and packet data services.

In addition to our joint venture interest in MSV, subject to closing, our principal assets consist of our venture portfolio, 5,000,000 shares of XM Radio common stock, a promissory note from Motient with a face value of \$26.2 million and cash.

As a result of the decision to discontinue the operations of Rare Medium, Inc. and LiveMarket, the reported operating results include the operations of our Incubator Companies and our investment activities and not those of Rare Medium, Inc. and LiveMarket.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2000

### REVENUES

Revenues for the three months ended September 30, 2001 decreased to approximately \$25,000 from \$2.3 million for the three months ended September 30, 2000, a decrease of approximately \$2.3 million. Current period revenues are driven by our remaining Incubator Companies. The decrease from the same period of the prior year is due primarily to the sale of our majority interest in two Incubator Companies in April 2001.

### COST OF REVENUES

Cost of revenues includes salaries, payroll taxes and related benefits and other direct costs associated with the generation of revenues. Cost of revenues for the three months ended September 30, 2001 decreased to approximately \$2,000 from \$0.9 million for the three months ended September 30, 2000, a decrease of approximately \$0.9 million. This decrease is due primarily to the sale of our majority interest in two Incubator Companies in April 2001.

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### SALES AND MARKETING EXPENSE

Sales and marketing expense represents the actual costs associated with our sales force, marketing and advertising. Sales and marketing expense for the three months ended September 30, 2001 decreased to approximately \$28,000 from \$3.6 million for the three months ended September 30, 2000, a decrease of approximately \$3.5 million. The decrease is primarily the result of the sale of our majority interest in two Incubator Companies in April 2001.

### GENERAL AND ADMINISTRATIVE EXPENSE

General and administrative expense includes facilities costs, recruiting, training, finance, legal and other corporate costs, as well as the salaries and related employee benefits for those employees that support such functions. General and administrative expense for the three months ending September 30, 2001 decreased to \$2.7 million from \$13.4 million for the three months ended September 30, 2000, a decrease of \$10.7 million. This decrease was primarily related to the reduced infrastructure needed to manage our continuing operations and the sale of our majority interest in two Incubator Companies in April 2001, partially offset by the legal and advisory costs associated with our terminated merger with Motient Corporation. We expect these costs to continue to decrease as we reduce our overhead.

### DEPRECIATION AND AMORTIZATION EXPENSE

Depreciation and amortization expense substantially consists of the depreciation of property and equipment. Depreciation and amortization expense for the three months ended September 30, 2001 decreased to \$0.4 million from \$2.5 million for the three months ended September 30, 2000, a decrease of \$2.1 million. This decrease resulted primarily from the sale of two Incubator Companies in April 2001, as well as the disposal of property and equipment associated with our restructuring activities. As we have reduced our capital expenditures and have written off all remaining goodwill, we expect depreciation and amortization expense to decrease in future periods.

### RESTRUCTURING CHARGES

During the three months ended September 30, 2001, we recorded restructuring charges of approximately \$0.1 million primarily relating to the disposition of property and equipment. These restructuring charges were the result of the reduction of our infrastructure needed to manage our continuing operations.

### INTEREST INCOME, NET

Interest income, net for the three months ended September 30, 2001 is mainly comprised of the interest earned on our cash, cash equivalents, and short-term investments, interest on our Motient promissory note, as well as the accretion of the \$48.5 million carrying value of the Motient promissory notes up to the face value of \$50.0 million over the terms of the notes.

### LOSS ON INVESTMENT IN AFFILIATES

Loss on investments in affiliates consists primarily of \$16.2 million for the impairment to the carrying value of certain affiliates accounted for under the cost method, \$0.1 million for the realized loss on the sale of publicly traded securities, \$0.5 million for our proportionate share of affiliates' operating losses and amortization of our net excess investment over our equity in each affiliate's net assets for those affiliates accounted for under the equity method and \$1.4 million for the impairment of the goodwill and net assets related to one of our Incubator Companies. We will continue to monitor the

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carrying value our investments in affiliates for further impairment.

### UNREALIZED LOSS ON DERIVATIVE INSTRUMENT

At the purchase dates of the promissory notes from Motient, we ascribed \$1.5 million to the fair value of the exchange feature allowing us to convert the notes to shares of XM Radio common stock held by Motient. We recognized an unrealized gain of approximately \$13.8 million as of June 30, 2001 related to the increase in the fair value of the exchange feature. As a result of the decrease in the price of XM Radio stock since June 30, 2001, we recognized an unrealized loss of \$15.3 million for the three months ending September 30, 2001 relating to a decrease in the fair value of the exchange feature.

### LOSS FROM DISCONTINUED OPERATIONS

At the end of the quarter, a decision to discontinue the operations of Rare Medium, Inc. and the LiveMarket subsidiary was made in light of their performance and prospects. The wind-down of these businesses is expected to be completed by the first quarter 2002. In connection with the discontinuance of these businesses, we recorded a charge in the third quarter of 2001 of \$35.9 million related to severance and benefits resulting from headcount reductions, an accrual for estimated losses of \$3.1 million during the wind-down period and the write-off of unamortized goodwill and property and equipment, net of expected proceeds. The remaining loss of \$17.9 million resulted from operations prior to the decision to discontinue the businesses.

### NET LOSS

For the three months ended September 30, 2001, we recorded a net loss of \$87.0 million. The loss was primarily due to the factors described in "Cost of Revenues," "General and Administrative Expense," "Sales and Marketing Expense," "Restructuring Charges," "Loss on Investments in Affiliates," "Unrealized Loss on Derivative Instrument" and "Loss from Discontinued Operations."

Included in net loss attributable to common shareholders of \$90.0 million was \$3.0 million of non-cash deemed dividends and accretion related to the issuance of our Series A convertible preferred stock. Dividends were accrued related to the pay-in-kind dividends payable quarterly on Series A convertible preferred stock and to the accretion of the carrying amount of the Series A convertible preferred stock up to its \$100 per share face redemption amount over 13 years.

### RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2000

#### REVENUES

Revenues for the nine months ended September 30, 2001 decreased to \$1.9 million from \$5.6 million for the nine months ended September 30, 2000, a decrease of \$3.7 million. Current period revenues are driven by our remaining Incubator Companies. The decrease from the prior year is due primarily to the sale of our majority interest in two Incubator Companies in April 2001.

#### COST OF REVENUES

Cost of revenues includes salaries, payroll taxes and related benefits and

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other direct costs associated with the generation of revenues. Cost of revenues for the nine months ended September 30, 2001 decreased to \$1.3 million from \$4.0 million for the nine months ended September 30, 2000, a decrease of \$2.7 million. This decrease is due primarily to the sale of our majority interest in two Incubator Companies in April 2001.

### SALES AND MARKETING EXPENSE

Sales and marketing expense represents the actual costs associated with our sales force, marketing and advertising. Sales and marketing expense for the nine months ended September 30, 2001 decreased to \$1.3 million from \$8.3 million for the nine months ended September 30, 2000, a decrease of \$7.0 million. The decrease is primarily the result of the sale of our majority interest in two Incubator Companies in April 2001.

### GENERAL AND ADMINISTRATIVE EXPENSE

General and administrative expense includes facilities costs, recruiting, training, finance, legal and other corporate costs, as well as the salaries and related employee benefits for those employees that support such functions. General and administrative expense for the nine months ending September 30, 2001 decreased to \$14.2 million from \$31.8 million for the nine months ended September 30, 2000, a decrease of \$17.6 million. This decrease was primarily related to the reduced infrastructure needed to manage our continuing operations and the sale of our majority interest in two Incubator Companies in April 2001, partially offset by the legal and advisory costs associated with our terminated merger with Motient Corporation. We expect these costs to continue to decrease as we reduce our overhead.

### DEPRECIATION AND AMORTIZATION EXPENSE

Depreciation and amortization expense substantially consists of the depreciation of property and equipment. Depreciation and amortization expense for the nine months ended September 30, 2001 decreased to \$3.0 million from \$6.2 million for the nine months ended September 30, 2000, a decrease of \$3.2 million. This decrease resulted primarily from the sale of two Incubator Companies in April 2001, as well as the disposal of property and equipment associated with our restructuring activities. As we have reduced our capital expenditures and have written off all remaining goodwill, we expect depreciation and amortization expense to decrease in future periods.

### RESTRUCTURING CHARGES

During the nine months ended September 30, 2001, we recorded restructuring charges of approximately \$1.1 million primarily relating to the disposition of property and equipment. These restructuring charges were the result of the reduction of our infrastructure needed to manage our continuing operations.

### INTEREST INCOME, NET

Interest income, net for the nine months ended September 30, 2001 is mainly comprised of the interest earned on our cash, cash equivalents, and short-term investments, interest on our Motient promissory note, as well as the accretion of the \$48.5 million carrying value of the Motient promissory notes up to the face value of \$50.0 million over the terms of the notes.



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### LOSS ON INVESTMENT IN AFFILIATES

Loss on investments in affiliates consists primarily of \$31.8 million for the impairment to the carrying value of certain affiliates accounted for under the cost method, \$3.2 million for the realized loss on the sale of publicly traded securities, \$2.7 million for our proportionate share of affiliates' operating losses and amortization of our net excess investment over its equity in each affiliate's net assets for those affiliates accounted for under the equity method, and \$4.1 million related to our incubator companies. We will continue to monitor the carrying value our investments in affiliates for further impairment.

### UNREALIZED LOSS ON DERIVATIVE INSTRUMENT

At the purchase date of the promissory notes from Motient, we ascribed \$1.5 million to the fair value of the exchange feature allowing us to convert the notes to shares of XM Radio common stock held by Motient. As a result of the decrease in the price of XM Radio stock since the purchase of the notes, we recognized an unrealized loss of \$1.5 million for the nine months ended September 30, 2001 relating to the decrease in the fair value of the exchange feature.

### LOSS FROM DISCONTINUED OPERATIONS

At the end of the third quarter, a decision to discontinue the operations of Rare Medium, Inc. and the LiveMarket subsidiary was made in light of their performance and prospects. The wind-down of these businesses is expected to be completed by the first quarter 2002. In connection with the discontinuance of these businesses, we recorded a charge in the third quarter of 2001 of \$35.9 million related to severance and benefits resulting from headcount reductions, an accrual for estimated losses of \$3.1 million during the wind-down period and the write-off of unamortized goodwill and property and equipment, net of expected proceeds. The remaining loss of \$84.8 million resulted from operations prior to the decision to discontinue the businesses.

### NET LOSS

For the nine months ended September 30, 2001, we recorded a net loss of \$174.8 million. The loss was primarily due to the factors described in "Cost of Revenues," "General and Administrative Expense," "Sales and Marketing Expense," "Restructuring Charges," "Loss on Investments in Affiliates," "Unrealized Loss on Derivative Instrument" and "Loss from Discontinued Operations."

Included in net loss attributable to common shareholders of \$183.7 million was \$8.9 million of non-cash deemed dividends and accretion related to the issuance of our Series A convertible preferred stock. Dividends were accrued related to the pay-in-kind dividends payable quarterly on Series A convertible preferred stock and to the accretion of the carrying amount of the Series A convertible preferred stock up to its \$100 per share face redemption amount over 13 years.

### LIQUIDITY AND CAPITAL RESOURCES

We had \$65.8 million in cash, cash equivalents, and short-term investments as of September 30, 2001. Cash used in operating activities from continuing operations was \$8.4 million for the nine months ended September 30, 2001 and resulted primarily from the loss before discontinued

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operations of \$54.0 million, partially offset by non-cash items of \$45.5 million (which consists of depreciation, amortization, loss on investments in affiliates, unrealized loss on derivative instrument, investments in affiliates received for services rendered, non-cash restructuring charges and non-cash interest) and changes in working capital. Cash used in operating activities from discontinued operations was \$27.0 for the nine months ended September 30, 2001. We expect cash used in continuing operations to decrease in future periods as we have reduced our infrastructure needed to manage our remaining business activities and sold our majority interest in two Incubator Companies in April 2001.

Cash used in investing activities was \$56.3 million, net of \$10.7 million resulting from the net sale of short-term investments, for the nine months ended September 30, 2001, which primarily consists of the \$50.0 million used to purchase the promissory notes from Motient, cash paid for venture investments of \$6.2 million and capital expenditures of \$3.7 million (including discontinued operations), partially offset by \$3.6 million of cash received from the sale of investments in affiliates. Capital expenditures have generally been comprised of purchases of computer hardware and software, as well as leasehold improvements related to leased facilities, and are not expected to increase at the same level in future periods.

In April 2001, we agreed to purchase from Motient 12.5% secured promissory notes (the "Notes"), issuable in two tranches, each in the principal amount of \$25.0 million. The Notes were collateralized by 5,000,000 shares of XM Radio common stock owned by Motient. The first tranche was purchased on April 4, 2001, and the second tranche was purchased on July 16, 2001. The principal of and accrued interest on the Notes were payable on October 1, 2001 in either cash, shares of XM Radio, or any combination thereof at Motient's option, as set forth in the agreement. At our option, the Notes may have been exchanged for a number of XM Radio shares equivalent to the principal of the Notes and any accrued interest thereon, as set forth in the agreement. As of June 30, 2001, we recognized an unrealized gain of approximately \$13.8 million related to the increase in the fair value of the exchange feature allowing us to convert the first tranche of the Notes to XM Radio shares. As a result of the decrease in the price of XM Radio stock since June 30, 2001 and the \$1.5 million value ascribed to the exchange feature at the purchase date of the Notes, we recognized an unrealized loss of \$15.3 million for the three months ending September 30, 2001 relating to a decrease in the fair value of the exchange feature.

On October 1, 2001, and again on October 8, 2001, we extended the maturity date of the Notes. On October 12, 2001, in accordance with the terms of the Notes, we received 5,000,000 shares of XM Radio as payment for \$26.2 million of the Notes and related interest. The maturity date for the remaining Notes in the principal amount of approximately \$26.2 million, and interest thereon, was extended for 60 days. We may further extend the maturity date to October 12, 2002 upon satisfaction of certain conditions.

In 2000, Rare Medium, Inc. entered into a strategic alliance agreement, as amended, with the Partner to assist in the training of personnel and development and delivery by Rare Medium, Inc. of solutions built utilizing the Partner's technology. Under the terms of the alliance, the Partner was to provide Rare Medium, Inc. with refundable advances of approximately \$17.1 million, on an interest free basis, to be paid to Rare Medium, Inc., over the term of the two-year agreement, subject to Rare Medium, Inc.'s compliance with certain requirements set forth in the agreement. The amount and timing of the repayment of the advances may be adjusted based on Rare Medium, Inc.'s achievement of certain milestones in accordance with the terms of the agreement. The Partner and Rare Medium, Inc. have a dispute as to whether certain milestones have been achieved.

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Efforts at renegotiating the payment schedule and milestones were not successful. In July 2001, Rare Medium, Inc. received a notice of arbitration demand from the Partner seeking the return of the approximately \$8.6 million, plus interest, that had been advanced by the Partner, who has asserted that the agreement has terminated. Rare Medium, Inc. intends to contest the Partner's claims. There can be no assurance that Rare Medium, Inc. will be successful in contesting this action and that accelerated repayment, along with attorney's fees and interest, will not be required.

Through our newly formed subsidiary, MSV Investors Holdings, Inc., we expect to be an active participant in the MSV joint venture, which includes TMI Communications, Inc., Motient Corporation, Telcom Ventures, LLC, Columbia Capital and Spectrum Equity Investors. MSV is a provider of mobile satellite services in North America, providing its customers with digital voice and data services, including circuit switched voice, nationwide voice and data dispatch, and packet data services. In October 2001, we committed to invest \$50.0 million in the MSV joint venture. The investment is contingent on customary approvals by both the American and Canadian regulatory agencies. We will own approximately 30% of the joint venture interest in MSV.

On June 29, 2001, we received a notice from the Nasdaq National Market that our common stock had failed to maintain the required minimum closing bid price of \$1.00 for a period of 30 consecutive trading days. As a result, Nasdaq has provided us 90 calendar days, or until September 27, 2001, to regain compliance with this requirement or be delisted from trading on the Nasdaq National Market. In order to regain compliance, the closing bid price of our common stock must stay above \$1.00 for 10 consecutive trading days. We were unable to gain compliance with this requirement during this time period; however, on September 27, 2001, the Nasdaq suspended this requirement for all companies traded on the Nasdaq until January 2, 2002. If we are unable to gain compliance with this requirement during this time period, and any appeal to Nasdaq for relief from this requirement is unsuccessful, our common stock will be delisted from trading on the Nasdaq National Market. If this were to happen, trading in our common stock would decrease substantially or cease altogether.

### RECENTLY ISSUED ACCOUNTING STANDARDS

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS No. 141"). SFAS No. 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interests method. The adoption of SFAS No. 141 did not have a significant impact on our results of operations.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," ("SFAS No. 142") which is effective January 1, 2002. SFAS No. 142 eliminates the current requirement to amortize goodwill and indefinite-lived intangible assets and replaces the amortization with an impairment test which must be performed at least annually. For intangible assets with definite useful lives, SFAS 142 requires amortization over their respective expected useful lives to their estimated residual values and review for impairment in accordance with Statement of Financial Accounting 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." Additionally, SFAS No. 142 requires that a transitional goodwill impairment test be completed six months from the date of adoption. The adoption of SFAS No. 142 is not expected to have a significant impact on our results of operations.

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 143 ("SFAS No. 143"), "Accounting for Asset Retirement Obligations," which is effective January 1, 2003. SFAS No. 143 addresses the financial accounting and reporting for obligations and retirement costs related to the retirement of tangible long-lived assets. The Company does

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not expect that the adoption of SFAS No. 143 will have a significant impact on its financial statements.

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144 ("SFAS No. 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets," which is effective January 1, 2002. SFAS No. 144 supersedes FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of," and the accounting and reporting provisions relating to the disposal of a segment of a business of Accounting Principles Board Opinion No. 30. The Company does not expect that the adoption of SFAS No. 144 will have a significant impact on its financial statements.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to certain market risks from changes in the price of the XM Radio publicly traded stock which was collateralizing our promissory notes from Motient until October 12, 2001. As of September 30, 2001, we have purchased \$50.0 million of 12.5% promissory notes from Motient. Embedded within these notes is an exchange feature that allows us to convert the notes to shares of XM Radio owned by Motient at a ratio set forth in the purchase agreement. As of June 30, 2001, we recognized an unrealized gain of approximately \$13.8 million related to the increase in the fair value of the exchange feature. As a result of the decrease in the price of XM Radio stock since June 30, 2001 and the \$1.5 million value ascribed to the exchange feature at the purchase date of the notes, we recognized an unrealized loss of \$15.3 million for the three months ending September 30, 2001 relating to a decrease in the fair value of the exchange feature.

On October 12, 2001, in accordance with the terms of the notes, we received 5,000,000 shares of XM Radio as payment for \$26.2 million of the notes and related interest. The maturity date for the remaining balance of the notes in the principal amount of approximately \$26.2 million, and interest thereon, was extended for 60 days. We may further extend the maturity date to October 12, 2002 upon satisfaction of certain conditions. Any change in the market price of XM Radio stock could cause fluctuations in our earnings.

## PART II OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The Company is aware of a number of purported class action lawsuits that have been filed by the holders of the Company's common stock in the Court of Chancery of the State of Delaware challenging the proposed merger with Motient Corporation. All of the complaints name the Company and members of the Company's board of directors as defendants. Most of the complaints name the holders of the Company's preferred stock, and certain of their affiliates, as defendants, and some of the complaints name Motient as a defendant. On June 22, 2001, the Delaware court entered an order to consolidate all of the Delaware lawsuits for all purposes into a single purported class action, IN RE RARE MEDIUM GROUP, INC. SHAREHOLDERS LITIGATION, C.A. No. 18879-NC. On August 7, 2001, a Consolidated Amended Class Action Complaint was filed in Delaware Chancery Court. The Delaware Chancery Court has not yet certified the consolidated lawsuit as a class action. The lawsuit alleges that the defendants breached duties allegedly

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owed to the holders of the Company's common stock in connection with the merger agreement and sought to stop the merger and/or obtain monetary damages.

The Company has and intends to continue vigorously contesting this lawsuit. On October 19, 2001, the Company filed a motion to dismiss the Consolidated Amended Class Action Complaint on a variety of grounds, including mootness.

A purported class action was filed in New York, titled BRICKELL PARTNERS V. RARE MEDIUM GROUP, INC., ET AL., N.Y.S. Index No. 01602694, in the New York State Supreme Court, making similar allegations to the Consolidated Amended Class Action Complaint in Delaware. A motion to dismiss the complaint is currently pending.

On May 16, 2001, plaintiffs Jay M. Wolff, David Bliss, Tim Barber and Steve O'Brien filed suit against Rare Medium, Inc., ICC Technologies, Inc., and Rare Medium Texas I, Inc. in the United States District Court for the Southern District of New York, WOLFF, ET AL. V. RARE MEDIUM, INC., ET AL., CV No 01-4279. The plaintiffs asserted claims for breach of contract, tortuous interference with contractual relations, tortuous interference with prospective advantage, and breach of implied obligation of good faith, arising out of the plaintiffs' alleged attempt to engage in transactions involving some or all of the approximately 1.2 million shares of the Company's common stock that the plaintiffs obtained in the Company's acquisition of Big Hand, Inc. The plaintiffs seek unspecified compensatory and punitive damages, interest, attorneys' fees and costs. On October 31, 2001, the Court dismissed the case without prejudice.

In July 2001, Rare Medium, Inc. received a notice of arbitration the Partner with whom it had entered a strategic alliance agreement, as amended (the "Agreement"), to assist in the training of personnel and development and delivery by Rare Medium, Inc. of solutions built utilizing the Partner's technology. Under the terms of the Agreement, the Partner was to provide Rare Medium, Inc. with refundable advances of approximately \$17.1 million, on an interest free basis, to be paid to Rare Medium, Inc. over the term of the two-year Agreement, subject to Rare Medium, Inc.'s compliance with certain requirements set forth in the agreement. The amount and timing of the repayment of the advances was subject to adjustment based on Rare Medium, Inc.'s achievement of certain milestones in accordance with the terms of the Agreement. A dispute arose with respect to Rare Medium, Inc.'s achievement of the milestones. As a result, the Partner has asserted that the Agreement has terminated and commenced an arbitration seeking the return of all of the approximately \$8.6 million that had been advanced under the Agreement. Rare Medium, Inc. intends to contest the Partner's claims. There can be no assurance that Rare Medium, Inc. will be successful in contesting this action and that accelerated repayment, along with attorney's fees and interest, will not be required.

On July 23, 2001, plaintiff Microsoft Corporation filed suit against Rare Medium, Inc. in the United States District Court for the Western District of Washington, CO1-1130P. The plaintiff alleges breach of contract in connection with a consulting agreement and an alliance agreement entered between the parties seeking \$2.3 million in damages, interest and attorney's fees. Rare Medium, Inc. plans to defend the matter vigorously.

### ITEM 2. CHANGES IN SECURITIES

- (a) Not applicable
- (b) Not applicable

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- (c) Not applicable
- (d) Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4. SUBMISSIONS OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- (a) The following sets forth those exhibits filed pursuant to Item 601 of Regulation S-K:

None

- (b) The following sets forth the Company's reports on Form 8-K that have been filed during the quarter for which this report is filed:

None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, this Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 14, 2001

By: /s/ GLENN S MEYERS

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Glenn S. Meyers  
Chief Executive Officer

Date: November 14, 2001

By: /s/ CRAIG C. CHESSER

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Craig C. Chesser  
Vice President Finance and Treasurer  
(Principal Financial Officer)

Date: November 14, 2001

By: /s/ MICHAEL A. HULTBERG

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Michael A. Hultberg  
Vice President and Controller  
(Principal Accounting Officer)