UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

/X/ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2000

OR

/ / TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM ________ TO ________

COMMISSION FILE NUMBER: 000-27265

INTERNAP NETWORK SERVICES CORPORATION
(Exact name of registrant as specified in its charter)

WASHINGTON	91-1896926
(State or other jurisdiction of incorporation or organization)	(IRS Employer identification No.)

601 UNION STREET, SUITE 1000,
SEATTLE, WASHINGTON 98101
(Address of principal executive offices)

(206) 441-8800
(Registrant's telephone number, including area code)

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 PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS.

Yes X No

INDICATE THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE REGISTRANT'S CLASSES OF COMMON STOCK AS OF THE LATEST PRACTICABLE DATE: 148,191,001 SHARES OF COMMON STOCK, $.001 PAR VALUE, OUTSTANDING AS OF SEPTEMBER 30, 2000.

INTERNAP NETWORK SERVICES CORPORATION
FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2000
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INTERNAP NETWORK SERVICES CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands)

	SEPTEMBER 30, 2000	DECEMBER 31, 1999
ASSETS		
Current assets:		
Cash and cash equivalents	$ 79,904	$ 155,184
Short-term investments	102,355	50,168
Investment income receivable	2,316	591
Accounts receivable, net of allowance of $764 and $206, respectively	14,668	4,084
Prepaid expenses and other assets	2,950	553
Total current assets	202,193	210,580
Property and equipment, net	118,172	28,811
Patents and trademarks, net	193	142
Restricted cash	10,355	---
Investments	62,001	5,050
Goodwill and other intangible assets, net	298,900	---
Deposits and other assets, net	5,414	963
Total assets	$ 697,228	$ 245,546
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 17,853	$ 7,278
Accrued liabilities	7,215	4,209
Accrued acquisition costs	8,441	---
Deferred revenue	3,675	22
Notes payable, current portion	2,212	1,021
Line of credit	1,525	1,525
Capital lease obligations, current portion	14,635	6,613
Total current liabilities	55,556	20,668
Deferred revenue	11,231	---
Notes payable, less current portion	3,629	2,861
Capital lease obligations, less current portion	20,988	11,517
Total liabilities	91,404	35,046
Commitments and contingencies		
Shareholders' equity:		
Common stock, $0.001 par value, 500,000 shares authorized; 148,191 and 132,089 shares issued and outstanding, respectively	148	132
Additional paid-in capital	784,885	287,054
Deferred stock compensation	(14,117)	(17,228)
Accumulated deficit	(177,690)	(59,458)
Accumulated other comprehensive income	12,598	---
Total shareholders' equity	605,824	210,500
Total liabilities and shareholders' equity	$ 697,228	$ 245,546

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

INTERNAP NETWORK SERVICES CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(Unaudited, in thousands, except per share amounts)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2000	1999	2000	1999
Revenues	$ 20,220	$ 3,613	$ 42,758	$ 7,022
Costs and expenses:				
Cost of network and customer support	26,935	8,428	62,736	16,335
Product development	4,107	1,053	7,548	2,448
Sales and marketing	8,889	4,691	24,578	10,560
General and administrative	11,168	2,216	20,862	5,121
Amortization of goodwill and other intangible assets	26,183	---	28,340	---
Amortization of deferred stock compensation	2,625	2,505	8,249	4,292
Acquired in-process research and development	18,000	---	18,000	---
Total operating costs and expenses	97,907	18,893	170,313	38,756
Loss from operations	(77,687)	(15,280)	(127,555)	(31,734)
Other income (expense):				
Interest income	3,900	93	11,238	543
Interest and financing expense	(1,025)	(640)	(1,915)	(787)
Net loss	$ (74,812)	$ (15,827)	$(118,232)	$ (31,978)
Basic and diluted net loss per share	$ (0.51)	$ (1.92)	$ (0.85)	$ (4.39)
Weighted average shares used in computing basic and diluted net loss per share	146,794	8,246	139,315	7,291

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

INTERNAP NETWORK SERVICES CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited, in thousands)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2000	1999
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(118,232)	$ (31,978)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	39,370	2,854
Non-cash interest and financing expense	---	549
Provision for doubtful accounts	627	88
Non-cash compensation and warrant expense	8,534	4,292
Acquired in-process research and development	18,000	---
Changes in operating assets and liabilities:		
Accounts receivable	(10,655)	(1,931)
Investment income receivable	(1,724)	---
Prepaid expenses, deposits and other assets	(4,186)	(705)
Accounts payable	(2,819)	3,014
Deferred revenue	4,140	(275)
Accrued liabilities	(958)	565
Net cash used in operating activities	(67,903)	(23,527)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(37,547)	(7,030)
Proceeds from disposal of property and equipment	167	---
Investment in CO Space, net of cash acquired	(9,984)	---
Investment in VPNX.com, net of cash acquired	2,655	---
Collection of full recourse notes receivable for outstanding common stock	642	---
Purchase of investments	(160,377)	(9,995)
Redemption of investments	63,838	9,995
Payments for patents and trademarks	(42)	(86)
Net cash used in investing activities	(140,648)	(7,116)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from shareholder loan	---	1,100
Repayment of shareholder loan	---	(1,100)

Proceeds from notes payable	---	1,766
Principal payments on notes payable	(909)	(15)
Net increase (decrease) in line of credit	---	875
Payments on capital lease obligations	(6,561)	(1,642)
Proceeds from equipment leaseback financing	717	428
Restriction of cash	(10,355)	(1,677)
Proceeds from issuance of and exercise of warrants to purchase capital stock, net of issuance costs	444	121
Proceeds from exercise of stock options	4,728	71
Proceeds from issuance of common stock	145,207	31,268
Net cash provided by financing activities	133,271	31,195
Net increase (decrease) in cash and cash equivalents	(75,280)	552
Cash and cash equivalents at beginning of period	155,184	275
Cash and cash equivalents at end of period	$ 79,904	$ 827
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest, net of amounts capitalized	$ 1,840	$ 238
Purchase of property and equipment financed with capital leases	$ 23,444	$ 10,105
Purchase of property and equipment included in accounts payable	$ 2,074	$ 1,153
Subscription receivable on sale of equity	$ ---	$ 176,700
Cost of equity proceeds included in accounts payable	$ ---	$ 442
Value ascribed to warrants	$ ---	$ 536

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

INTERNAP NETWORK SERVICES CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE LOSS
NINE MONTHS ENDED SEPTEMBER 30, 2000
(Unaudited, in thousands)

	COMMON STOCK							
	SHARES	PAR VALUE	ADDITIONAL PAID-IN CAPITAL	DEFERRED STOCK COMPENSATION	ACCUMULATED DEFICIT	ACCUMULATED ITEMS OF OTHER COMPREHENSIVE INCOME	TOTAL	COMPREHENSIVE LOSS
Balances, December 31, 1999	132,089	$ 132	$287,054	$(17,228)	$ (59,458)		$210,500	
Issuance of common stock, net of costs of proceeds	3,450	3	141,967				141,970	
Amortization of deferred stock compensation				8,249			8,249	
Exercise of employee stock options	3,098	3	4,725				4,728	
Issuance of employee stock purchase plan shares	350		3,236				3,236	
Exercise of warrants to purchase common stock	296	1	443				444	
Common stock issued for the acquisition of CO Space	6,881	7	254,944				254,951	
Common stock issued and deferred stock compensation recorded for the acquisition of VPNX.com	2,027	2	92,230	(5,138)			87,094	
Issuance of warrants to purchase common stock			286				286	
Net loss					(118,232)		(118,232)	$(118,232)
Unrealized gain on investments						$ 12,598	12,598	12,598
Balances, September 30, 2000	148,191	$ 148	$784,885	$(14,117)	$(177,690)	$ 12,598	$605,824	$(105,634)

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

INTERNAP NETWORK SERVICES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION:

The unaudited condensed consolidated financial statements have been prepared by InterNAP Network Services Corporation (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission and include all the accounts of the Company and its wholly owned subsidiaries. Certain information and footnote disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles, have been

condensed or omitted pursuant to such rules and regulations. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the Company's financial position at September 30, 2000, its operating results for the three and nine months ended September 30, 2000 and 1999, its cash flows for the nine months ended September 30, 2000 and 1999 and changes in its shareholders' equity for the nine months ended September 30, 2000. The balance sheet at December 31, 1999 has been derived from audited financial statements as of that date. These financial statements and the related notes should be read in conjunction with the Company's financial statements and notes thereto contained in the Company's annual report on Form 10-K and the Company's registration statement on Form S-1 (File No. 333-95503) filed with the Securities and Exchange Commission.

In December 1999, the Company incorporated a wholly owned subsidiary in the United Kingdom, InterNAP Network Services U.K. Limited and in June 2000, the Company incorporated a wholly owned subsidiary in the Netherlands, InterNAP Network Services B.V. The condensed consolidated financial statements of the Company include all activity of these subsidiaries. Foreign exchange gains and losses have not been material to date.

On January 7, 2000, the Company paid a 100% share dividend to shareholders of record as of December 27, 1999. Accordingly, the number of shares disclosed in the financial statements and related notes have been adjusted to reflect the stock dividend for all periods presented.

The results of operations for the three and nine months ended September 30, 2000 are not necessarily indicative of the results that may be expected for the future quarters.

2. BUSINESS COMBINATIONS:

On June 20, 2000, the Company completed its acquisition of CO Space, Inc. ("CO Space"). The acquisition was recorded using the purchase method of accounting under Accounting Principle Board Opinion No. 16 ("APB 16"). The aggregate purchase price of the acquired company, plus related charges, was approximately $275,307,000 and was comprised of the Company's common stock, cash, acquisition costs and assumed options to purchase common stock. The Company issued approximately 6,881,000 shares of common stock and assumed options to purchase CO Space common stock that were subsequently converted into options to purchase approximately 323,000 shares of the Company's common stock to effect the transaction. Results of operations of CO Space have been included in the financial results of the Company from the closing date of the transaction forward.

Supplemental disclosure of cash flow information for CO Space is as follows (in thousands):

Cash acquired	$ 3,488
Accounts receivable	546
Property and equipment	39,105
Full recourse notes receivable for outstanding common stock	642
Other tangible assets	1,887

Tangible assets acquired	45,668
Customer relationships	1,800
Completed real estate leases	19,300
Trade name and trademarks	2,800
Workforce in place	2,000
Goodwill	232,948
Intangible assets acquired	258,848
Total assets acquired	$ 304,516
Cash paid	$ 7,200
Acquisition expenses incurred	16,658
Accounts payable assumed	11,305
Accrued liabilities assumed	3,434
Deferred revenue assumed	8,992
Notes and capital leases assumed	1,990
Value of stock and options issued	254,937
Total cash paid, liabilities assumed, common stock issued and options	

assumed	$ 304,516

On July 31, 2000, the Company completed its acquisition of VPNX.com, Inc., formerly Switchsoft Systems, Inc. ("VPNX"). The acquisition was recorded using the purchase method of accounting under APB 16. The aggregate purchase price of the acquired company, plus related charges, was approximately $87,947,000 and was comprised of the Company's common stock, cash, acquisition costs and assumed options to purchase common stock. The Company issued approximately 2,027,000 shares of common stock and assumed options to purchase VPNX common stock that were subsequently converted into options to purchase approximately 268,000 shares of the Company's common stock to effect the transaction. Results of operations of VPNX have been included in the financial results of the Company from the closing date of the transaction forward.

Supplemental disclosure of cash flow information for VPNX is as follows (in thousands):

Cash acquired	$ 3,070
Property and equipment	834
Other tangible assets	798
Tangible assets acquired	4,702
Developed technology	3,400
Acquired in-process research and development	18,000
Covenants not to compete	14,100
Workforce in place	1,000
Goodwill	49,920
Intangible assets acquired	86,420
Total assets acquired	$ 91,122
Acquisition expenses incurred	850
Accrued liabilities assumed	655
Deferred revenue assumed	1,751
Notes and capital leases assumed	772
Value of stock and options issued	92,232
Deferred stock compensation	(5,138)
Total cash paid, liabilities assumed, common stock issued, and options assumed	$ 91,122

In accordance with APB 16, all identifiable assets were assigned a portion of the purchase price of the acquired companies on the basis of their respective fair values. Identifiable intangible assets and goodwill are included in "Goodwill and other intangible assets, net" on the accompanying consolidated balance sheets and are amortized over their average useful lives of three years. Intangible assets were identified and valued by considering the Company's intended use of acquired assets, and analysis of data concerning products, technologies, markets, historical financial performance and underlying assumptions of future performance. The economic and competitive environments in which the Company and the acquired companies operate were also considered in the valuation analysis. The amount allocated to acquired in-process research and development is related to technology acquired from VPNX that was written off immediately subsequent to the acquisition because the in-process technology had not reached technological feasibility and had no probable alternative future use. Expected future cash flows associated with in-process technology were discounted considering risks and uncertainties related to the viability of and potential changes in future target markets and to the completion of the products that will ultimately be marketed by the Company. This analysis resulted in an allocation of $18 million to acquired in-process research and development expense.

The pro forma consolidated financial information for the nine months ended September 30, 2000 and 1999, determined as if the acquisitions of CO Space and VPNX had occurred on January 1 of each year, would have resulted in revenues of approximately $45,042,000 and $10,644,000, net loss of approximately $203,053,000 and $149,502,000 and basic and diluted loss per share of approximately $(1.40) and $(9.23), respectively. This unaudited pro forma information is presented for illustrative purposes only and is not necessarily indicative of the results of operations in future periods or results that would have been achieved had the Company, CO Space and VPNX been combined during the specified periods.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates that affect the reported amounts of assets and liabilities in the financial statements and

disclosure of contingent assets and liabilities at the date of the financial statements. Examples of estimates subject to possible revision

based upon the outcome of future events include depreciation of property and equipment, income tax liabilities, the valuation allowance against the deferred tax assets, the allowance for doubtful accounts, the identification of intangible assets and the related amortization periods and the estimate of acquired in-process research and development expense. Actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS

The Company generally considers any highly liquid investments purchased with an original or remaining maturity of three months or less at the date of purchase to be cash equivalents.

The Company invests its cash and cash equivalents in deposits with three financial institutions that may, at times, exceed federally insured limits. Management believes that the risk of loss is minimal. To date, the Company has not experienced any losses related to temporary cash investments. At September 30, 2000, the Company had placed approximately $10,355,000 in a restricted cash account to collateralize letters of credit with financial institutions.

INVESTMENTS

The Company classifies its marketable securities at the date of acquisition into categories in accordance with the provisions of Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Currently, the Company classifies its marketable securities as available-for-sale, which are reported at fair market value with the related unrealized gains and losses included in shareholders' equity. Realized gains and losses and declines in value of securities judged to be other than temporary are included in other income (expense). Interest and dividends on all securities are included in interest income. The fair value of the Company's marketable securities is based on quoted market prices. At September 30, 2000, marketable securities consisted of commercial paper and government securities.

The Company accounts for investments in equity securities without readily determinable fair values at cost. The Company did not own 20% of the voting stock or exert significant influence over any of its cost basis investments as of September 30, 2000. Realized gains and losses and declines in value of securities judged to be other than temporary are included in other income (expense).

NET LOSS PER SHARE

Basic and diluted net loss per share has been computed using the weighted average number of shares of common stock outstanding during the period, less the weighted average number of unvested shares of common stock issued that are subject to repurchase. The Company has excluded all convertible preferred stock, warrants, outstanding options to purchase common stock and shares subject to repurchase from the calculation of diluted net loss per share, as such securities are antidilutive for all periods presented. Basic and diluted net loss per share for the three and nine months ended September 30, 2000 and 1999 are calculated as follows (in thousands, except per share amounts):

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2000	1999	2000	1999
	(unaudited)		(unaudited)	
Net loss	$ (74,812)	$ (15,827)	$ (118,232)	$ (31,978)
Basic and diluted:				
Weighted-average shares of common stock outstanding used in computing basic and diluted net loss per share	146,794	8,246	139,315	7,291
Basic and diluted net loss per share	$ (0.51)	$ (1.92)	$ (0.85)	$ (4.39)
Antidilutive securities not included in diluted net loss per share calculation:				
Convertible preferred stock	---	98,954	---	98,954
Options to purchase common stock	23,657	15,200	23,657	15,200
Warrants to purchase common and Series B preferred stock	1,626	1,386	1,626	1,386
Unvested shares of common stock subject to repurchase	125	226	125	226
	25,408	115,766	25,408	115,766

INTERNAP NETWORK SERVICES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

4. PROPERTY AND EQUIPMENT:

Property and equipment consists of the following (in thousands):

	SEPTEMBER 30, 2000	DECEMBER 31, 1999
	(unaudited)	
Network equipment	$ 28,798	$ 4,665
Network equipment under capital lease	43,111	20,095
Furniture, equipment and software	21,346	6,717
Furniture, equipment and software under capital lease	1,592	1,164
Leasehold improvements	40,490	2,009
	135,337	34,650
Less: Accumulated depreciation and amortization	(17,165)	(5,839)
Property and equipment, net	$ 118,172	$ 28,811

5. INVESTMENTS:

On February 22, 2000, pursuant to an investment agreement, the Company purchased 588,236 shares of Aventail Corporation ("Aventail") Series D preferred stock at $10.20 per share for a total cash investment of $6,000,007. The Series D preferred stock is convertible to common stock at a ratio of one share of preferred stock to one share of common stock, subject to adjustment for certain equity transactions. Additionally, the Company and Aventail entered into a joint marketing agreement which, among other things, granted the Company certain limited exclusive rights to sell Aventail's managed extranet service and granted Aventail certain rights to sell the Company's services. In return, the Company committed to either sell Aventail services or pay Aventail, or a combination of both, which would result in Aventail's recognition of $3,000,000 of revenue over a two-year period. The Company's investment in Aventail is recorded at cost.

Pursuant to an investment agreement among the Company, Ledcor Limited Partnership, Worldwide Fiber Holdings Ltd. and 360networks, Inc. ("360networks"), on April 17, 2000, the Company purchased 374,182 shares of 360networks Class A Non-Voting Stock at $5.00 per share and, on April 26, 2000, the Company purchased 1,122,545 shares of 360networks Class A Subordinate Voting Stock at $13.23 per share. The total cash investment was $16,722,180. Additionally, the Company and 360networks entered into a letter of intent to negotiate a strategic agreement that would provide the Company with long-haul fiber-optic bandwidth capacity and provide 360networks with the Company's Internet connectivity services. The Company's investment in 360networks is recorded at fair market value.

On August 20, 2000, the Company entered into a credit facility with Speedera Networks ("Speedera") which allows Speedera to borrow up to $6,000,000 from the Company. The credit facility bears interest at the prime rate plus 3% on the date of each draw and matures on December 31, 2000. Upon maturity, Speedera has the option of repaying all principal and accrued interest or converting the amount due into Speedera preferred stock. As of September 30, 2000, the Company has included $3,000,000 in non-current investments related to Speedera's borrowings under the credit facility. Subsequent to September 30, 2000, Speedera borrowed the remaining $3,000,000 under the credit facility.

6. ACCRUED LIABILITIES:

Accrued liabilities consist of the following (in thousands):

	SEPTEMBER 30, 2000	DECEMBER 31, 1999
	(unaudited)	
Compensation payable	$ 4,178	$ 2,729
Private placement fee	---	1,000
Other	3,037	480
	$ 7,215	$ 4,209

7. FINANCING ARRANGEMENTS:

During 1999, the Company entered into an equipment financing arrangement with a financial institution allowing the Company to borrow up to $5,000,000 for the purchase of property and equipment. The equipment financing arrangement includes sublimits of $3,500,000 for equipment costs and $1,500,000 for the acquisition of software, service point and other equipment costs. Loans under the $3,500,000 sublimit require monthly principal and interest payments over a term of 48 months. This facility bears interest at 7.5% plus an index rate based on the yield of 4-year U.S. Treasury Notes. This rate was 13.89% at September 30, 2000. Loans under the $1,500,000 sublimit require monthly principal and interest payments over a term of 36 months. This facility bears interest at 7.9% plus an index rate based on the yield of 3-year U.S. Treasury Notes. This rate was 13.98% at September 30, 2000. Borrowings under each sublimit must be made prior to May 1, 2000. During March 2000, the Company borrowed an additional $594,000 for equipment purchases. As of September 30, 2000, the Company's remaining obligation related to this arrangement totaled approximately $3,665,000.

On April 10, 2000, the Company entered into an agreement with a financial institution (the "Financing Agreement"), which will provide the Company up to $7,500,000 in funding for the purpose of financing capital expenditures. The Financing Agreement has a 36 month term and calls for equal payments of accrued interest plus 2.1% of the original principal balance over the term of the agreement with a balloon payment for the residual 27% of principal upon maturity. Interest is at the London Inter Bank Offered Rate plus 3.70% (10.32% at September 30, 2000) and is adjusted monthly. In the event the Company's cash and cash equivalent balance is equal to or less than $60,000,000 at the end of any quarter, the Company will be required to provide an irrevocable renewable letter of credit in an amount equal to the balance of the loan. There were no amounts outstanding under the Financing Agreement at September 30, 2000.

As part of the acquisition of CO Space on June 20, 2000, the Company assumed an equipment financing agreement (the "Equipment Financing Agreement") with a financial institution, which provides up to $2,000,000 for the purchase of equipment. The Equipment Financing Agreement was signed on July 29, 1999 and has a 42 month term, with a commitment termination date of June 30, 2000. The interest rate is 3.25% over the yield of a 42-month U. S. Treasury Note on the day of funding. There are two loan schedules under the Equipment Financing Agreement with interest rates of 8.99% and 9.12%. The Equipment Financing Agreement calls for equal monthly principal and interest payments over the term of the Equipment Financing Agreement with a final payment of 8.5% of the original loan amount. As of September 30, 2000, the Company had outstanding borrowings of $1,500,000 under this Equipment Financing Agreement.

On July 31, 2000, the Company assumed a senior loan and security agreement (the "Security Agreement") in connection with the acquisition of VPNX. The Security Agreement provides up to $2,000,000 for the purchase of equipment and requires 36 equal monthly payments of principal and interest. The interest rates on the existing notes range from 6.59% to 8.03%, and each note has a final payment of 15% of the original balance. This final payment may be extended for an additional 12 months at a monthly rate of 1.5%. The commitment termination date under the Security Agreement was August 31, 2000. Outstanding borrowings at September 30, 2000 were $685,000.

8. COMMITMENTS AND CONTINGENCIES:

The Company has entered into service commitment contracts with Internet backbone service providers to provide interconnection services. Monthly fees are calculated on a usage basis subject to aggregate minimum payments of $37,000,000 through April 2003.

In connection with the acquisition of CO Space, the Company assumed lease commitments with terms of 10 to 20 years which will require payments totaling approximately $167,569,000 through 2020.

9. SHAREHOLDERS' EQUITY:

On April 6, 2000, 8,625,000 shares of the Company's common stock were sold in a public offering at a price of $43.50 per share. Of these shares, 3,450,000 were sold by the Company and 5,175,000 shares were sold by selling shareholders. The Company did not receive any of the proceeds from the sale of shares of common stock by the selling shareholders. The proceeds to the Company from the offering were $142,900,000, net of underwriting discounts and commissions of $7,100,000.

On August 2, 2000, the Company issued 20,000 warrants to an executive recruiting firm. The fair value of these warrants was estimated to be approximately $286,000 based upon the Black-Scholes option pricing model and was charged to expense.

10. STOCK BASED COMPENSATION PLANS:

The Company's stock-based compensation plans include the Amended 1999 Equity Incentive Plan (the "1999 Plan"), the 1998 Stock Option/Stock Issuance Plan (the "1998 Plan"), the 1999 Non-Employee Directors' Stock Option Plan (the "Director Plan"), the Employee Stock Purchase Plan (the "ESPP") and the 2000 Non-Officer Equity Incentive Plan (the "2000 Plan"). The 2000 Plan initially authorized the issuance of 1,000,000 shares of the Company's common stock. On July 18, 2000, the board of directors increased the shares reserved under the 2000 Plan to 4,500,000. Under the 2000 Plan, the Company may grant stock options only to employees of the Company who are not officers or directors. Options granted under the 2000 Plan are not intended by the Company to qualify as incentive stock options under the Internal Revenue Code. Otherwise, options granted under the 2000 Plan generally will be subject to the same terms and conditions as options granted under the Company's 1999 Plan. During the nine months ended September 30, 2000, the Company granted 11,522,000 options to purchase common stock pursuant to all stock option plans, and 3,098,000 shares of common stock were issued upon exercise of stock options.

On June 19, 2000, pursuant to the terms of the 1999 Plan, the number of shares reserved for the grant of stock options under the 1999 Plan was increased by 4,831,738 shares. On July 24, 2000, pursuant to the terms of the ESPP, the number of shares reserved for the grant of stock options under the ESPP was increased by 1,500,000 shares.

In connection with the acquisition of CO Space, the Company assumed the CO Space, Inc. 1999 Stock Incentive Plan (the "CO Space Plan"). After applying the acquisition conversion ratio, the CO Space plan authorizes the issuance of up to 1,346,840 options to purchase shares of common stock, of which approximately 323,000 options have been granted to date and approximately 178,000 options were outstanding at September 30, 2000.

In connection with the acquisition of VPNX, the Company assumed the Switchsoft Systems, Inc. Founders 1996 Stock Option Plan and the Switchsoft Systems, Inc. 1997 Stock Option Plan (the "VPNX Plans"). After applying the acquisition conversion ratio, the VPNX Plans authorize the issuance of up to 307,417 options to purchase shares of common stock, of which approximately 268,000 options have been granted to date and approximately 264,000 options were outstanding at September 30, 2000. The Company recorded deferred stock compensation related to the unvested options assumed, totaling $5,135,000, of which $573,000 was amortized to expense during the three and nine months ended September 30, 2000.

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

Certain statements in this Quarterly Report on Form 10-Q, including, without limitation, statements containing the words "believes," "anticipates," "estimates," "expects" and words of similar import, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us described below and elsewhere in this Quarterly Report, and in other documents we file with the Securities and Exchange Commission.

OVERVIEW

The Company is a leading provider of fast, reliable and centrally managed Internet connectivity services targeted at businesses seeking to maximize the performance of mission-critical Internet-based applications. Customers connected to one of the Company's connectivity service points have their data optimally routed to and from destinations on the Internet in a manner that minimizes the use of congested public network access points and private peering points. These service points include P-NAP facilities and other points of presence on the Internet from which we service our customers. The Company's optimal routing of data traffic over the multiplicity of networks that comprise the Internet enables higher transmission speeds, lower instances of data loss and greater quality of service.

After the Company decides to open a new service point, it enters into a deployment phase which typically lasts four to six months, during which time the Company executes the required steps to make the service point commercially ready for service. Among other things, this usually entails obtaining collocation space to locate the Company's equipment, entering into agreements with backbone providers, obtaining local loop connections from local telecommunications providers, building service points and initiating pre-sales and marketing activities. Consequently, the Company usually incurs a significant amount of upfront costs related to making a service point commercially ready for service

prior to generating revenues. Therefore, the Company's results of operations will be negatively affected during times of service point deployment.

As of September 30, 2000, the Company has a total of 23 service points deployed in the Atlanta, Boston (two service points), Chicago, Dallas (two service points), Denver, Fremont, CA, Houston, Los Angeles, Miami, New York (two service points), Orange County, CA, Philadelphia, San Diego, San Francisco, San Jose (two service points), Seattle (three service points) and Washington D.C. metropolitan areas, and expects to have a total of 28 service points operational by the end of 2000. In addition, the Company operates four collocation facilities in Boston, Houston, Jersey City and New York in which it currently does not have connectivity service points. However, the Company is in the process of deploying service points into two of these collocation facilities.

On June 20, 2000, the Company completed its acquisition of CO Space, Inc. ("CO Space"). The acquisition was recorded using the purchase method of accounting under APB Opinion No. 16 ("APB 16"). The aggregate purchase price of the acquired company, plus related charges, was approximately $275.3 million and was comprised of the Company's common stock, cash, acquisiton costs and assumed options to purchase common stock. The Company issued approximately 6.9 million shares of common stock and assumed options to purchase CO Space common stock that were subsequently converted into options to purchase approximately 323,000 shares of the Company's common stock to effect the transaction. Results of operations of CO Space have been included in the financial results of the Company from the closing date of the transaction forward.

As a result of the CO Space acquisition, the Company recorded a total of $258.8 million of intangible assets. The intangible assets are being amortized to expense over their useful lives, which are estimated to be three years, resulting in expense of $24.5 million for the nine months ended September 30, 2000.

On July 31, 2000, the Company completed its acquisition of VPNX.com, Inc. ("VPNX"). The acquisition was recorded using the purchase method of accounting under APB 16. The aggregate purchase price of the acquired company, plus related charges, was approximately $87.9 million and was comprised of the Company's common stock, cash, acquisition costs and assumed options to purchase common stock. The Company issued 2.0 million shares of common stock and assumed options to purchase VPNX common stock that were subsequently converted into options to purchase approximately 268,000 shares of the Company's common stock to effect the transaction. Results of operations of VPNX have been included in the financial results of the Company from the closing date of the transaction forward.

As a result of the VPNX acquisition, the Company recorded a total of $68.4 million of intangible assets. The intangible assets are being amortized to expense over their useful lives, which are estimated to be three years, resulting in an expense of $3.8 million for the nine months ended September 30, 2000. The Company also recorded an expense of $18.0 million related to acquired in-process research and development costs for the three and nine months ended September 30, 2000. The amount allocated to the acquired in-process research and development is related to technology acquired from VPNX that had not yet reached technological feasibility and had no alternative future use. The value was determined by estimating the net cash flows from the sale of products resulting from the completion of such projects, and discounting the net cash flows back to their present value adjusted for the stage of completion of the technologies at the date of acquisition.

During the years ended December 31, 1998 and 1999, in connection with the grant of certain stock options to employees, the Company recorded deferred stock compensation totaling $25.0 million, representing the difference between the deemed fair value of the Company's common stock on the date such options were granted and the exercise price. In connection with the acquisition of VPNX, the Company recorded deferred stock compensation related to the unvested options it assumed, totaling $5.1 million. Such amounts are included as a component of shareholders' equity and are being amortized over the vesting period of the individual options, generally four years, using an accelerated method as described in Financial Accounting Standards Board Interpretation No. 28. The Company recorded amortization of deferred stock compensation in the amount of $8.2 million for the nine months ended September 30, 2000. At September 30, 2000, the Company had a total of $14.1million remaining to be amortized over the corresponding vesting periods of the stock options.

RESULTS OF OPERATIONS

The following table sets forth, as a percentage of total revenues, selected statement of operations data for the periods indicated:

	THREE MONTHS ENDED SEPTEMBER 30,	NINE MONTHS ENDED SEPTEMBER 30,

	2000	1999	2000	1999
Revenues	100%	100%	100%	100%
Costs and expenses:				
Cost of network and customer support	133	233	147	233
Product development	20	29	18	35
Sales and marketing	44	130	57	150
General and administrative	55	61	49	73
Amortization of goodwill and other intangible assets	129	---	66	---
Amortization of deferred stock compensation	13	69	19	61
Acquired in-process research and development	89	---	42	---
Total costs and expenses	483	522	398	552
Loss from operations	(383)	(422)	(298)	(452)
Other income (expense):				
Interest income	19	3	26	8
Interest and financing expense	(5)	(18)	(4)	(11)
Net loss	(369)%	(437)%	(276)%	(455)%

NINE MONTHS ENDED SEPTEMBER 30, 2000 AND 1999

Revenues. Revenues increased 511% from $7.0 million for the nine-month period ended September 30, 1999 to $42.8 million for the nine-month period ended September 30, 2000. This increase of $35.8 million was primarily due to increased Internet connectivity revenues. The increase in Internet connectivity revenues was primarily attributable to the increased sales at the Company's existing service points and the deployment of additional service points during 1999 and 2000.

Costs of Network and Customer Support. Costs of network and customer support increased 285% from $16.3 million for the nine-month period ended September 30, 1999 to $62.7 million for the nine-month period ended September 30, 2000. This increase of $46.4 million was primarily due to increased connectivity costs related to added connections to Internet backbone and competitive local exchange providers at each service point and to a lesser extent, additional compensation costs and depreciation expense related to the equipment at newly deployed service points. Network and customer support costs as a percentage of total revenues are generally greater than 100% for newly deployed service points because the Company purchases Internet connectivity capacity from the backbone providers in advance of securing new customers. The Company expects these costs to increase in absolute dollars as the Company deploys additional service points.

Product Development. Product development costs increased 213% from $2.4 million for the nine-month period ended September 30, 1999 to $7.5 million for the nine-month period ended September 30, 2000. This increase of $5.1 million was primarily due to increased compensation costs. The Company expects product development costs to increase in absolute dollars for the foreseeable future.

Sales and Marketing. Sales and marketing costs increased 132% from $10.6 million for the nine-month period ended September 30, 1999 to $24.6 million for the nine-month period ended September 30, 2000. This increase of $14.0 million was primarily due to increased compensation costs. As part of the Company's expanded sales and marketing activities, the Company

hired additional sales and support personnel during 1999 and 2000. The Company expects sales and marketing costs to increase in absolute dollars for the foreseeable future.

General and Administrative. General and administrative costs increased 310% from $5.1 million for the nine-months ended September 30, 1999 to $20.9 million for the six-months ended September 30, 2000. This increase of $15.8 million was primarily due to compensation costs, professional services costs, facility costs, travel costs and increased depreciation and amortization costs due to the addition of corporate office space during 1999 and 2000. The Company expects general and administrative costs to increase in absolute dollars as the Company deploys additional service points.

Other Income (Expense). Other income (expense), net, increased from $244,000 of other expense for the nine-month period ended September 30, 1999 to $9.3 million of other income for the nine-month period ended September 30, 2000. This increase was primarily due to interest income earned on the proceeds from the Company's initial public and follow-on offerings.

THREE MONTHS ENDED SEPTEMBER 30, 2000 AND 1999

Revenues. Revenues increased 461% from $3.6 million for the three-month period ended September 30, 1999 to $20.2 million for the three-month period ended September 30, 2000. This increase of $16.6 million was primarily due to increased Internet connectivity revenues. The increase in Internet connectivity

revenues was attributable to the increased sales at the Company's existing service points and the deployment of additional service points during 1999 and 2000.

Costs of Network and Customer Support. Costs of network and customer support increased 220% from $8.4 million for the three-month period ended September 30, 1999 to $26.9 million for the three-month period ended September 30, 2000. This increase of $18.5 million was primarily due to increased connectivity costs related to added connections to Internet backbone and competitive local exchange providers at each service point and, to a lesser extent, additional compensation costs and depreciation expense related to the equipment at newly deployed service points. Network and customer support costs as a percentage of total revenues are generally greater than 100% for newly deployed service points because the Company purchases Internet connectivity capacity from the backbone providers in advance of securing new customers. The Company expects these costs to increase in absolute dollars as the Company deploys additional service points.

Product Development. Product development costs increased 273% from $1.1 million for the three-month period ended September 30, 1999 to $4.1 million for the three-month period ended September 30, 2000. This increase of $3.0 million was primarily due to increased compensation costs. The Company expects product development costs to increase in absolute dollars for the foreseeable future.

Sales and Marketing. Sales and marketing costs increased 89% from $4.7 million for the three-month period ended September 30, 1999 to $8.9 million for the three-month period ended September 30, 2000. This increase of $4.2 million was primarily due to increased compensation costs. As part of the Company's expanded sales and marketing activities, the Company hired additional sales and support personnel during 1999 and 2000. The Company expects sales and marketing costs to increase in absolute dollars for the foreseeable future.

General and Administrative. General and administrative costs increased 409% from $2.2 million for the three-months ended September 30, 1999 to $11.2 million for the three-months ended September 30, 2000. This increase of $9.0 million was primarily due to compensation costs, professional services costs and facility costs due to the addition of corporate office space during 1999 and 2000. The Company expects general and administrative costs to increase in absolute dollars as the Company deploys additional service points.

Other Income (Expense). Other income (expense), net, increased from $547,000 of other expense for the three-month period ended September 30, 1999 to $2.9 million of other income for the three-month period ended September 30, 2000. This increase was primarily due to interest income earned on the proceeds from the Company's initial public and secondary offerings.

LIQUIDITY AND CAPITAL RESOURCES

Since its inception, the Company has financed its operations primarily through the issuance of its equity securities, capital leases, equipment financing and bank loans. As of September 30, 2000, the Company has raised an aggregate of approximately $739.7 million, net of offering expenses, through the sale of its equity securities.

On February 22, 2000, pursuant to an investment agreement, the Company purchased 588,236 shares of Aventail Corporation ("Aventail") Series D preferred stock at $10.20 per share for a total cash investment of $6.0 million. The Series D preferred stock is convertible to common stock at a ratio of one share of preferred stock to one share of common stock, subject to adjustment for certain equity transactions. Additionally, the Company and Aventail entered into a joint marketing agreement which, among other things,

granted the Company certain limited exclusive rights to sell Aventail's managed extranet service and granted Aventail certain rights to sell the Company's services. In return, the Company committed to either sell Aventail services or pay Aventail, or a combination of both, which would result in Aventail's recognition of $3.0 million of revenue over a two-year period.

On April 6, 2000, 8,625,000 shares of the Company's common stock were sold in a secondary public offering at a price of $43.50 per share. Of these shares, 3,450,000 were sold by the Company and 5,175,000 shares were sold by selling shareholders. The Company did not receive any of the proceeds from the sale of shares of common stock by the selling shareholders. The proceeds to the Company from the offering were $142.9 million, net of underwriting discounts and commissions of $7.1 million.

On April 10, 2000, the Company entered into an agreement with a financial institution (the "Financing Agreement"), which will provide the Company up to $7.5 million in funding for the purpose of financing capital expenditures. The Financing Agreement has a 36 month term and calls for equal payments of accrued interest plus 2.1% of the original principal balance over the term of the agreement with a balloon payment for the residual 27% of principal upon maturity. Interest is at the 30-day London Inter Bank Offered Rate plus 3.70% (10.32% at September 30, 2000) and is adjusted monthly. In the

event the Company's cash and cash equivalent balance is equal to or less than $60.0 million at the end of any quarter, the Company will be required to provide an irrevocable renewable letter of credit in an amount equal to the balance of the loan. There were no amounts outstanding under the Financing Agreement at September 30, 2000.

Pursuant to an investment agreement among the Company, Ledcor Limited Partnership, Worldwide Fiber Holdings Ltd. and 360networks, Inc. ("360networks"), on April 17, 2000, the Company purchased 374,182 shares of 360networks Class A Non-Voting Stock at $5.00 per share and, on April 26, 2000, the Company purchased 1,122,545 shares of 360networks Class A Subordinate Voting Stock at $13.23 per share. The total cash investment was $16.7 million. Additionally, the Company and 360networks entered into a letter of intent to negotiate a strategic agreement that would provide the Company with long-haul fiber-optic bandwidth capacity and provide 360networks with the Company's Internet connectivity services.

On August 20, 2000, the Company entered into a credit facility with Speedera Networks ("Speedera") which allows Speedera to borrow up to $6.0 million from the Company. The credit facility bears interest at the prime rate plus 3% on the date of each draw and matures on December 31, 2000. Upon maturity, Speedera has the option of repaying all principal and accrued interest or converting the amount due into Speedera preferred stock. As of September 30, 2000, the Company has included $3.0 million in non-current investments related to Speedera borrowings under the credit facility. Subsequent to September 30, 2000, Speedera borrowed the remaining $3.0 million under the credit facility.

At September 30, 2000, the Company had cash, cash equivalents and investments of $244.3 million. The Company has a revolving line of credit with Silicon Valley Bank under which the Company is allowed to borrow up to $3.0 million, as limited by certain borrowing base requirements which include maintaining certain levels of monthly revenues and customer turnover ratios. The line of credit requires monthly payments of interest only at prime, or 9.5% as of September 30, 2000, and matures on June 30, 2001. At September 30, 2000, the Company had outstanding borrowings of $1.5 million on the line of credit.

During 1999, the Company entered into an equipment financing arrangement with a financial institution allowing the Company to borrow up to $5.0 million for the purchase of property and equipment. The equipment financing arrangement includes sublimits of $3.5 million for equipment costs and $1.5 million for the acquisition of software, service point and other equipment costs. Loans under the $3.5 million sublimit require monthly principal and interest payments over a term of 48 months. This facility bears interest at 7.5% plus an index rate based on the yield of 4-year U.S. Treasury Notes. This rate was 13.89% at September 30, 2000. Loans under the $1.5 million sublimit require monthly principal and interest payments over a term of 36 months. This facility bears interest at 7.9% plus an index rate based on the yield of 3-year U.S. Treasury Notes. This rate was 13.98% at September 30, 2000. Borrowings under each sublimit must be made prior to May 1, 2000. During March 2000, the Company borrowed an additional $594,000 for equipment purchases. As of September 30, 2000, the Company's remaining obligation related to this arrangement totaled approximately $3.7 million.

During 2000, the Company amended an existing equipment lease credit facility with a vendor to increase its available credit by $14.5 million to $50.0 million. As of September 30, 2000, the Company had approximately $16.6 million available under this credit facility.

As part of the acquisition of CO Space on June 20, 2000, the Company assumed an equipment financing agreement (the "Equipment Financing Agreement") with a financial institution, which provides up to $2.0 million for the purchase of equipment. The Equipment Financing Agreement was signed on July 29, 1999 and has a 42 month term, with a commitment termination date of June 30, 2000. The interest rate is 3.25% over the yield of a 42-month U. S. Treasury Note on the day of funding. There are two loan schedules under the Equipment Financing Agreement with interest rates of 8.99% and 9.12%. The Equipment Financing Agreement calls for equal monthly principal and interest payments over the term of the Equipment Financing Agreement with a final payment of 8.5% of the original loan amount. As of September 30, 2000, the Company had

outstanding borrowings of $1.5 million under this Equipment Financing Agreement.

On July 31, 2000, the Company assumed a senior loan and security agreement (the "Security Agreement") in connection with the acquisition of VPNX. The Security Agreement provides up to $2.0 million for the purchase of equipment and requires 36 equal monthly payments of principal and interest. The interest rates on the existing notes range from 6.59% to 8.03%, and each note has a final payment of 15% of the original balance. This final payment may be extended for an additional 12 months at a monthly rate of 1.5%. The commitment termination date under the Security Agreement was August 31, 2000. Outstanding borrowings at September 30, 2000 were $685,000.

Net cash used in operations was $67.9 million for the nine-months ended September 30, 2000, and $23.5 million for the nine-months ended September 30, 1999. Net cash used in operations for the nine-months ended September 30, 2000 was primarily due to funding our operating losses and increases in accounts receivable, investment income receivable and prepaid expenses, deposits and other assets and decreases in accounts payable, offset by non-cash charges, depreciation and amortization and increases in deferred revenue.

Net cash used in investing activities was $140.6 million for the nine-months ended September 30, 2000 and $7.1 million for the nine-months ended September 30, 1999. Purchases of property and equipment were partially financed by capital leases (such purchases are excluded from the net cash used in investing activities in the statement of cash flows) and totaled $60.9 million ($23.4 million financed by capital leases) for the nine-months ended September 30, 2000. Additionally, for the nine-month period ended September 30, 2000, $160.4 million was used to purchase investments, offset by $63.8 million of redeemed investments. The Company also used $10.0 million in connection with the acquisition of CO Space during the nine-month period ended September 30, 2000 offset by $3.0 million of net cash received from the acquisition of VPNX.

Net cash provided from financing activities was $133.3 million for the nine-months ended September 30, 2000 and $31.2 million for the nine-months ended September 30, 1999. Net cash from financing activities primarily reflects proceeds from the sales of our equity securities offset by the costs of those proceeds, restrictions of cash related to lines and letters of credit and payments on capital lease obligations and notes payable.

The Company expects to spend significant additional capital to recruit and train its customer installation team and the sales force and to build out the sales facilities related to newly deployed service points. In addition to service point deployment, although to a lesser extent, product development and the development of the Company's internal systems and software will continue to require significant capital expenditures in the foreseeable future, as will the expansion of its marketing efforts. The Company expects to continue to expend significant amounts of capital on property and equipment related to the expansion of facility infrastructure, computer equipment and for research and development laboratory and test equipment to support on-going research and development operations.

The Company believes the net proceeds from its secondary offering together with its cash and cash equivalents, investments and funds available under its revolving and capital lease lines will be sufficient to satisfy its cash requirements for the next 12 months. Depending on its rate of growth and cash requirements, the Company may require additional equity or debt financing to meet future working capital needs, which may have a dilutive effect on its then current shareholders. There can be no assurance that such additional financing will be available or, if available, that such financing can be obtained on satisfactory terms. The Company's management intends to invest cash in excess of current operating requirements in short-term, interest-bearing, investment-grade securities.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company maintains investment portfolio holdings of various issuers, types, and maturities, the majority of which are commercial paper and government securities. These securities are generally classified as available for sale and, consequently, are recorded on the balance sheet at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income. Part of this portfolio includes a $16.7 million minority equity investment in 360networks, a publicly traded company listed on the Nasdaq National Market. The value of the 360networks investment is subject to market price volatility. The Company also has a $6.0 million equity investment in Aventail Corporation, an early stage, privately held company, and a $3.0 million investment in, Speedera, an early stage, privately held company. These strategic investments are inherently risky, in part because the market for the products or services being offered or developed by 360networks, Aventail and Speedera have not been proven and may never materialize. Because of the risk associated with these investments, the Company could lose its entire initial investment in these companies.

The residual portion of the Company's investment portfolio is invested in commercial paper and government securities that could experience a material adverse decline in fair value should a sharp decline in interest rates occur. In addition, declines in interest rates could have a material adverse impact on interest earnings for the Company's investment portfolio. The Company does not currently hedge against these interest rate exposures.

The following sensitivity analysis presents hypothetical changes in the fair values of the Company's investment in 360networks, the Company's only current public equity investment. This modeling technique measures the hypothetical change in fair values arising from selected hypothetical changes in the stock price of 360networks. Stock price fluctuations of plus or minus 15%, 35% and 50% were selected because there has been at least one movement in the

Nasdaq Composite Index of at least 15% in each of the last three years and movements of at least 35% and 50% in at least one of the last three years.

Security	Fair Value at 9/30/2000 (in thousands)	Valuation of Security Given X% Increase in Security's Price (in thousands)		Valuation of Security given X% Decrease in Security's Price (in thousands)	
		35%	50%	(35%)	(50%)
360networks Capital Stock	$ 29,373	$ 39,654	$ 44,060	$ 19,093	$ 14,687

Security	Fair Value at 9/30/2000 (in thousands)	Valuation of Security Given 15% Increase in Security's Price (in thousands)	Valuation of Security Given 15% Decrease in Security's Price (in thousands)
360networks Capital Stock	$ 29,373	$ 33,779	$ 24,967

RISK FACTORS

RISKS RELATED TO THE COMPANY'S BUSINESS

THE COMPANY HAS A HISTORY OF LOSSES, EXPECTS FUTURE LOSSES AND MAY NOT ACHIEVE OR SUSTAIN ANNUAL PROFITABILITY. The Company has incurred net losses in each quarterly and annual period since the Company began operations. The Company incurred net losses of $1.6 million, $7.0 million and $49.9 million for the years ended December 31, 1997, 1998 and 1999, respectively. The Company's net loss for the nine months ended September 30, 2000 was $118.2 million. As of September 30, 2000, the Company's accumulated deficit was $177.7 million. As a result of its expansion plans, the Company expects to incur net losses and negative cash flows from operations on a quarterly and annual basis for at least the next 24 months, and the Company may never become profitable.

THE COMPANY'S LIMITED OPERATING HISTORY MAKES IT DIFFICULT TO EVALUATE ITS PROSPECTS. The revenue and income potential of the Company's business and market is unproven, and its limited operating history makes it difficult to evaluate its prospects. The Company has only been in existence since 1996, and its services are only offered in limited regions. Investors should consider and evaluate the Company's prospects in light of the risks and difficulties frequently encountered by relatively new companies, particularly companies in the rapidly evolving Internet infrastructure and connectivity markets.

NEGATIVE MOVEMENTS IN THE COMPANY'S QUARTERLY OPERATING RESULTS MAY DISAPPOINT ANALYSTS' EXPECTATIONS, WHICH COULD HAVE A NEGATIVE IMPACT ON THE COMPANY'S STOCK PRICE. Should the Company's results of operations from quarter to quarter fail to meet the expectations of public market analysts and investors, its stock price could suffer. Any significant unanticipated shortfall of revenues or increase in expenses could negatively impact its expected quarterly results of operations should the Company be unable to make timely adjustments to compensate for them. Furthermore, a failure on the part of the Company to estimate accurately the timing or magnitude of particular anticipated revenues or expenses could also negatively impact its quarterly results of operations.

Because the Company's quarterly results of operations have fluctuated in the past and will continue to fluctuate in the future, investors should not rely on the results of any past quarter or quarters as an indication of future performance in its business operations or stock price. For example, increases in the Company's quarterly revenues for the quarters ended September 30, 1999 through September 30, 2000 have varied between 48% and 67%, and total operating costs and expenses, as a percentage of revenues, have fluctuated between 296% and 523%. Fluctuations in the Company's quarterly operating results depend on a number of factors. Some of these factors are industry risks over which the Company has no control, including the introduction of new services by its competitors, fluctuations in the demand and sales cycle for its services, fluctuations in the market for qualified sales and other personnel, changes in the prices for Internet connectivity the Company pays backbone providers, its ability to obtain local loop connections to its service points at favorable prices, and integration of people, operations, products and technologies of acquired businesses.

Other factors that may cause fluctuations in the Company's quarterly operating results arise from strategic decisions the Company has made or will make with respect to the timing and magnitude of capital expenditures such as those associated with the deployment of additional service points and the terms of its Internet connectivity purchases. For example, the Company's practice is

to purchase Internet connectivity from backbone providers at new service points before customers are secured. The

Company also has agreed to purchase Internet connectivity from some providers without regard to the amount the Company resells to its customers.

THE COMPANY MAY REQUIRE ADDITIONAL CAPITAL IN THE FUTURE AND MAY NOT BE ABLE TO SECURE ADEQUATE FUNDS ON TERMS ACCEPTABLE TO THE COMPANY. The expansion and development of the Company's business will require significant capital, which the Company may be unable to obtain, to fund its capital expenditures and operations, including working capital needs. The Company's principal capital expenditures and lease payments include deployment of service points, construction of collocation facilities, leasehold improvements and the purchase, lease and installation of network equipment such as routers, telecommunications equipment and other computer equipment. The timing and amount of the Company's future capital requirements may vary significantly depending on numerous factors, including regulatory, technological, competitive and other developments in its industry. During the next 12 months, the Company expects to meet its cash requirements with existing cash, cash equivalents, short-term investments, cash flow from sales of its services and use of credit facilities. However, the Company's capital requirements depend on several factors, including the rate of market acceptance of the Company's services, the ability to expand its customer base, the rate of deployment of additional service points and collocation facilities and other factors. If the Company's capital requirements vary materially from those currently planned, or if the Company fails to generate sufficient cash flow from the sales of its services, the Company may require additional financing sooner than anticipated or the Company may have to delay or abandon some or all of its development and expansion plans or otherwise forego market opportunities.

The Company may not be able to obtain future equity, debt or vendor financing on favorable terms, if at all. In addition, the Company's credit agreement contains covenants restricting its ability to incur further indebtedness. Future borrowing instruments such as credit facilities and lease agreements are likely to contain similar or more restrictive covenants and will likely require the Company to pledge assets as security for borrowings thereunder. The Company's inability to obtain additional capital on satisfactory terms may delay or prevent the expansion of its business.

IF THE COMPANY IS UNABLE TO MANAGE COMPLICATIONS THAT ARISE DURING DEPLOYMENT OF NEW SERVICE POINTS AND COLLOCATION FACILITIES, THE COMPANY MAY NOT SUCCEED IN ITS EXPANSION PLANS. Any delay in the opening of new service points and collocation facilities would significantly harm the Company's plans to expand its business. In its effort to deploy new service points and collocation facilities, the Company faces various risks associated with significant construction projects, including identifying and locating service point or collocation facility sites, construction delays, cost estimation errors or overruns, delays in connecting with local exchanges, equipment and material delays or shortages, the inability to obtain necessary permits on a timely basis, if at all, and other factors, many of which are beyond the Company's control and all of which could delay the deployment of a new service point or collocation facility. The deployment of new service points and collocation facilities, each of which takes approximately four to six months to complete, is a key element of the Company's business strategy. In addition to its 23 existing facilities, the Company is planning to continue to deploy service points and collocation facilities across a wide range of geographic regions, including foreign countries. Although the Company conducts market research in a geographic area before deploying a service point or collocation facility, the Company does not enter into service contracts with customers prior to building a new service point or collocation facility.

THE COMPANY WILL INCUR ADDITIONAL EXPENSE ASSOCIATED WITH THE DEPLOYMENT OF NEW SERVICE POINTS AND COLLOCATION FACILITIES AND MAY BE UNABLE TO EFFECTIVELY INTEGRATE NEW SERVICE POINTS AND COLLOCATION FACILITIES INTO ITS EXISTING NETWORK, WHICH COULD DISRUPT ITS SERVICE. New service points and collocation facilities, if completed, will result in substantial new operating expenses, including expenses associated with hiring, training, retaining and managing new employees, provisioning capacity from backbone providers, purchasing new equipment, implementing new systems, leasing additional real estate and incurring additional depreciation expense. In addition, if the Company does not institute adequate financial and managerial controls, reporting systems, and procedures with which to operate multiple service points and collocation facilities in geographically dispersed locations, its operations will be significantly harmed.

BECAUSE THE COMPANY'S REVENUES DEPEND HEAVILY ON A FEW SIGNIFICANT CUSTOMERS, A LOSS OF ONE OR MORE OF THESE SIGNIFICANT CUSTOMERS COULD REDUCE THE COMPANY'S REVENUES. The Company currently derives a substantial portion of its total revenues from a limited number of customers, and the revenues from these customers may not continue. For the quarter ended September 30, 2000 revenues from the Company's five largest customers represented approximately 16.3% of its total revenues. Typically, the agreements with the Company's customers are based on the Company's standard terms and conditions of service and generally have

terms ranging from one year to three years. Revenues from these customers or from other customers that have accounted for a significant portion of the Company's revenues in past periods, individually or as a group, may not continue. If such revenues do continue, they may not reach or exceed historical levels in any future period. In addition, the Company may not succeed in diversifying its customer base in future periods. Accordingly, the Company may continue to derive a significant portion of its revenues from a relatively small number of customers. Further, the Company has had limited experience with the renewal of contracts by customers whose initial service contract terms have been completed and these customers may not renew their contracts with the Company.

IF THE COMPANY IS UNABLE TO CONTINUE TO RECEIVE COST-EFFECTIVE SERVICE FROM ITS BACKBONE PROVIDERS, THE COMPANY MAY NOT BE ABLE TO PROVIDE ITS INTERNET CONNECTIVITY SERVICES ON PROFITABLE TERMS AND THESE BACKBONE PROVIDERS MAY NOT CONTINUE TO PROVIDE SERVICE TO THE COMPANY. In delivering its services, the Company relies on Internet backbones, which are built and operated by others. In order to be able to provide optimal routing to its customers through its service points, the Company must purchase connections from several Internet backbone providers. There can be no assurance that these Internet backbone providers will continue to provide service to the Company on a cost-effective basis, if at all, or that these providers will provide the Company with additional capacity to adequately meet customer demand. Furthermore, it is very unlikely that the Company could replace its Internet backbone providers on comparable terms.

Currently, in each of its fully operational service points, the Company has connections to some combination of the following 11 backbone providers: AT&T, Cable & Wireless USA, Inc., Earthlink, Inc., Global Crossing Telecommunications, Inc., Genuity, Intermedia Communications Inc., PSINet, Inc., Qwest Communications International, Inc., Sprint Internet Services, UUNET, a MCI WorldCom Company, and Verio, Inc. (which was acquired by NTT Communications Corporation). The Company may be unable to maintain relationships with, or obtain necessary additional capacity from, these backbone providers. Furthermore, the Company may be unable to establish and maintain relationships with other backbone providers that may emerge or that are significant in geographic areas in which the Company locates its service points.

COMPETITION FROM MORE ESTABLISHED COMPETITORS WHO HAVE GREATER REVENUES COULD DECREASE ITS MARKET SHARE. The Internet connectivity services market is extremely competitive, and there are few substantial barriers to entry. The Company expects competition from existing competitors to intensify in the future, and the Company may not have the financial resources, technical expertise, sales and marketing abilities or support capabilities to compete successfully in its market. Many of the Company's existing competitors have greater market presence, engineering and marketing capabilities, and financial, technological and personnel resources than the Company does. As a result, the Company's competitors may have several advantages over the Company as it seeks to develop a greater market presence.

The Company's competitors currently include backbone providers that provide connectivity services to the Company, including AT&T, Cable & Wireless USA, Earthlink, Global Crossing, Genuity, Intermedia, PSINet, Qwest Communications International, Sprint, UUNET and Verio (which was acquired by NTT Communications Corporation), regional Bell operating companies which offer Internet access, and global, national and regional Internet service providers.

In addition, if the Company is successful in implementing the Company's international expansion, the Company expects to encounter additional competition from international Internet service providers as well as international telecommunications companies.

COMPETITION FROM NEW COMPETITORS COULD DECREASE THE COMPANY'S MARKET SHARE. The Company also believes that new competitors will enter its market. Such new competitors could include computer hardware, software, media and other technology and telecommunications companies. A number of telecommunications companies and online service providers have announced plans to offer or expand their network services. For example, Genuity, PSINet and Verio (which was acquired by NTT Communications Corporation) have expanded their Internet access products and services through acquisition. Further, the ability of some of these potential competitors to bundle other services and products with their network services could place the Company at a competitive disadvantage. Various companies are also exploring the possibility of providing, or are currently providing, high-speed data services using alternative delivery methods including the cable television infrastructure, direct broadcast satellites, wireless cable and wireless local loop. In addition, Internet backbone providers may make technological developments, such as improved router technology, that will enhance the quality of their services.

PRICING PRESSURE COULD DECREASE THE COMPANY'S MARKET SHARE. Increased price competition or other competitive pressures could erode the Company's market share. The Company currently charges, and expects to continue to charge, more for its Internet connectivity services than its competitors. For example, the Company's current standard pricing is approximately 5% more than UUNET's current standard pricing and approximately 18% more than Sprint's current

standard pricing. By bundling their services and reducing the overall cost of their solutions, telecommunications companies that compete with the Company may be able to provide customers with reduced communications costs in connection with their Internet connectivity services or private network services, thereby significantly increasing the pressure on the Company to decrease its prices. The Company may not be able to offset the effects of any such price reductions even with an increase in the number of its customers, higher revenues from enhanced services, cost reductions or otherwise. In addition, the Company believes that the Internet connectivity industry is likely to encounter consolidation in the future. Consolidation could result in increased pressure on the Company to decrease its prices.

A FAILURE IN THE COMPANY'S NETWORK OPERATIONS CENTERS, SERVICE POINTS OR COMPUTER SYSTEMS WOULD CAUSE A SIGNIFICANT DISRUPTION IN THE PROVISION OF ITS INTERNET CONNECTIVITY SERVICES. Although the Company has taken precautions against systems failure, interruptions could result from natural disasters as well as power loss, telecommunications failure and similar events. The Company's business depends on the efficient and uninterrupted operation of its network operations centers,

its service points and its computer and communications hardware systems and infrastructure. The Company currently has one network operations center located in Seattle, and it has 23 service points which are located in the Atlanta, Boston (two service points), Chicago, Dallas (two service points), Denver, Fremont, CA, Houston, Los Angeles, Miami, New York (two service points), Orange County, CA, Philadelphia, San Diego, San Francisco, San Jose (two service points), Seattle (three service points), and Washington, D.C. metropolitan areas. If the Company experiences a problem at its network operations centers, the Company may be unable to provide Internet connectivity services to its customers, provide customer service and support or monitor its network infrastructure and service points, any of which would seriously harm its business.

BECAUSE THE COMPANY HAS NO EXPERIENCE OPERATING INTERNATIONALLY, ITS INTERNATIONAL EXPANSION MAY BE LIMITED. Although the Company currently operates in 17 domestic metropolitan markets, a key component of its strategy is to expand into international markets. The Company has no experience operating internationally. The Company may not be able to adapt its services to international markets or market and sell these services to customers abroad. In addition to general risks associated with international business expansion, the Company faces the following specific risks in its international business expansion plans:

- difficulties in establishing and maintaining relationships with foreign backbone providers and local vendors, including co-location and local loop providers; and

- difficulties in locating, building and deploying network operations centers, service points and collocation facilities in foreign countries, including in the United Kingdom and the Netherlands where the Company plans to deploy service points in 2000, and managing service points and network operations centers across disparate geographic areas.

The Company may be unsuccessful in its efforts to address the risks associated with its currently proposed international operations, and its international sales growth may therefore be limited.

THE COMPANY'S BRAND IS RELATIVELY NEW, AND FAILURE TO DEVELOP BRAND RECOGNITION COULD HURT THE COMPANY'S ABILITY TO COMPETE EFFECTIVELY. To successfully execute its strategy, the Company must strengthen its brand awareness. If the Company does not build its brand awareness, its ability to realize its strategic and financial objectives could be hurt. Many of the Company's competitors have well-established brands associated with the provision of Internet connectivity services. To date, the Company's market presence has been limited principally to the Atlanta, Boston, Chicago, Dallas, Denver, Fremont CA, Houston, Los Angeles, Miami, New York, Orange County, CA, Philadelphia, San Diego, San Francisco, San Jose, Seattle and Washington D.C. metropolitan areas. To date, the Company has attracted its existing customers primarily through a relatively small sales force and word of mouth. In order to build its brand awareness, the Company intends to increase its marketing efforts significantly, which may not be successful, and the Company must continue to provide high quality services. As part of its brand building efforts, the Company expects to increase its marketing budget substantially as well as its marketing activities, including advertising, tradeshows, direct response programs and new service point and collocation facility launch events.

THE COMPANY IS DEPENDENT UPON ITS KEY EMPLOYEES AND MAY BE UNABLE TO ATTRACT OR RETAIN SUFFICIENT NUMBERS OF QUALIFIED PERSONNEL. The Company's future performance depends to a significant degree upon the continued contributions of its executive management team and key technical personnel. The loss of any member of the Company's executive management team or a key technical employee, such as its Chief Executive Officer, Anthony Naughtin, its Chief

Operating Officer, Michael Vent, its Chief Technology Officer, Christopher Wheeler or its Chief Financial Officer, Paul McBride, could significantly harm the Company. Any of the Company's officers or employees can terminate his or her relationship with the Company at any time. To the extent the Company is able to expand its operations and deploy additional service points and collocation facilities, its workforce will be required to grow. Accordingly, the Company's future success depends on the Company's ability to attract, hire, train and retain a substantial number of highly skilled management, technical, sales, marketing and customer support personnel. Competition for qualified employees is intense. Consequently, the Company may not be successful in attracting, hiring, training and retaining the people the Company needs, which would seriously impede its ability to implement its business strategy.

IF THE COMPANY IS NOT ABLE TO SUPPORT ITS RAPID GROWTH EFFECTIVELY, ITS EXPANSION PLANS MAY BE FRUSTRATED OR MAY FAIL. The Company's inability to manage growth effectively would seriously harm its plans to expand its Internet connectivity services into new markets. Since the introduction of its Internet connectivity services, the Company has experienced a period of rapid growth and expansion, which has placed, and continues to place, a significant strain on all of its resources. For example, as of December 31, 1996 the Company had one operational service point and nine employees compared to 23 operational service points and 694 full-time employees as of September 30, 2000. In addition, the Company had $3.6 million in revenues for the three months ended September 30, 1999, compared to $20.2 million in revenues for the three months ended September 30, 2000. The Company expects its growth to continue to strain its management, operational and financial resources. For example, the Company may not be able to install adequate financial control systems in an efficient and timely manner, and its current or planned information systems, procedures and controls may be inadequate to support its future operations. The

difficulties associated with installing and implementing new systems, procedures and controls may place a significant burden on the Company's management and its internal resources. The Company's plans to rapidly deploy additional service points and collocation facilities could place a significant strain on its management's time and resources.

IF THE COMPANY FAILS TO ADEQUATELY PROTECT ITS INTELLECTUAL PROPERTY, THE COMPANY MAY LOSE RIGHTS TO SOME OF ITS MOST VALUABLE ASSETS. The Company relies on a combination of patent, copyright, trademark, trade secret and other intellectual property law, nondisclosure agreements and other protective measures to protect its proprietary technology. The InterNAP logo, InterNAP and P-NAP are trademarks of InterNAP which are registered in the United States. The United States Patent and Trademark Office, or USPTO, issued a patent in September 1999 relating to an initial patent application the Company filed on September 3, 1997. The patent is enforceable for a duration of 20 years from the date of filing, or until September 3, 2017. In addition, the Company acquired an additional patent in its acquisition of VPNX.com, Inc. There can be no assurance that these patents or any future issued patent will provide significant proprietary protection or commercial advantage to the Company or that the USPTO will allow any additional or future claims. The Company has a second application pending and may file additional applications in the future. Additional claims that were included by amendment in the Company's initial application have now been included in its second patent application. The Company's patent and patent applications relate to its P-NAP facility technology. In addition, the Company has filed a corresponding international patent application under the Patent Cooperation Treaty.

It is possible that any patents that have been or may be issued to the Company could still be successfully challenged by third parties, which could result in the Company's loss of the right to prevent others from exploiting the inventions claimed in those patents. Further, current and future competitors may independently develop similar technologies, duplicate the Company's services and products or design around any patents that may be issued to the Company. In addition, effective patent protection may not be available in every country in which the Company intends to do business.

In addition to patent protection, the Company believes the protection of its copyrightable materials, trademarks and trade secrets is important to its future success. The Company relies on a combination of laws, such as copyright, trademark and trade secret laws and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect its proprietary rights. In particular, the Company generally enters into confidentiality agreements with its employees and nondisclosure agreements with its customers and corporations with whom the Company has strategic relationships. In addition, the Company generally registers its important trademarks with the USPTO to preserve their value and establish proof of its ownership and use of these trademarks. Any trademarks that may be issued to the Company may not provide significant proprietary protection or commercial advantage to the Company. Despite any precautions that the Company has taken, intellectual property laws and contractual restrictions may not be sufficient to prevent misappropriation of its technology or deter others from developing similar technology.

THE COMPANY MAY FACE LITIGATION AND LIABILITY DUE TO CLAIMS OF INFRINGEMENT OF THIRD PARTY INTELLECTUAL PROPERTY RIGHTS. The telecommunications industry is characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. From time to time, third parties may assert patent, copyright, trademark and other intellectual property rights to technologies that are important to the Company's business. Any claims that the Company's services infringe or may infringe proprietary rights of third parties, with or without merit, could be time-consuming, result in costly litigation, divert the efforts of the Company's technical and management personnel or require the Company to enter into royalty or licensing agreements, any of which could significantly harm its operating results. In addition, in its customer agreements, the Company agrees to indemnify its customers for any expenses or liabilities resulting from claimed infringement of patents, trademarks or copyrights of third parties. If a claim against the Company were to be successful and the Company were not able to obtain a license to the relevant or a substitute technology on acceptable terms or redesign its products to avoid infringement, its ability to compete successfully in its competitive market would be impaired.

BECAUSE THE COMPANY DEPENDS ON THIRD PARTY SUPPLIERS FOR KEY COMPONENTS OF ITS NETWORK INFRASTRUCTURE, FAILURES OF THESE SUPPLIERS TO DELIVER THEIR COMPONENTS AS AGREED COULD HINDER ITS ABILITY TO PROVIDE ITS SERVICES ON A COMPETITIVE AND TIMELY BASIS. Any failure to obtain required products or services from third party suppliers on a timely basis and at an acceptable cost would affect the Company's ability to provide its Internet connectivity services on a competitive and timely basis. The Company is dependent on other companies to supply various key components of its infrastructure, including the local loops between its service points and its Internet backbone providers and between its service points and its customers' networks. In addition, the routers and switches used in the Company's network infrastructure are currently supplied by a limited number of vendors, including Cisco Systems, Inc. Additional sources of these services and products may not be available in the future on satisfactory terms, if at all. The Company purchases these services and products pursuant to purchase orders placed from time to time. Furthermore, the Company does not carry significant inventories of the products it purchases, and the Company has no guaranteed supply arrangements with its vendors. The Company has in the past experienced delays in installation of services and receiving shipments of equipment purchased. To date, these delays have neither been material nor have adversely affected the Company, but these delays could affect the Company's ability to deploy service points in the future on a timely basis. If Cisco Systems does not provide the Company with its routers, or if the Company's limited source suppliers

fail to provide products or services that comply with evolving Internet and telecommunications standards or that interoperate with other products or services the Company uses in its network infrastructure, the Company may be unable to meet its customer service commitments.

THE COMPANY HAS ACQUIRED AND EXPECTS TO ACQUIRE OTHER BUSINESSES, AND THESE ACQUISITIONS INVOLVE NUMEROUS RISKS. The Company recently completed two significant business acquisitions. In June and July 2000, the Company acquired CO Space, Inc. and VPNX.com, Inc., respectively, in merger transactions. The Company expects to engage in additional acquisitions in the future in order to, among other things, enhance its existing services and enlarge its customer base. Acquisitions involve a number of risks that could potentially, but not exclusively, include the following:

- difficulties in integrating the operations, personnel, technologies, products and services of the acquired companies in a timely and efficient manner;
- diversion of management's attention from normal daily operations;
- insufficient revenues to offset significant unforeseen costs and increased expenses associated with the acquisitions;
- difficulties in completing projects associated with in-process research and development being conducted by the acquired businesses;
- risks associated with the Company's entrance into markets in which it has little or no prior experience and where competitors have a stronger market presence;
- deferral of purchasing decisions by current and potential customers as they evaluate the likelihood of success of the acquisitions;
- difficulties in pursuing relationships with potential strategic partners who may view the combined company as a more direct competitor than its predecessor entities taken independently;
- issuance by the Company of equity securities that would dilute ownership of existing shareholders;
- incurrence of significant debt, contingent liabilities and amortization expenses; and
- loss of key employees of the acquired companies.

Acquiring high-technology businesses as a means of achieving growth is inherently risky. To meet these risks, the Company must maintain its ability to manage effectively any growth that results from using these means. Failure to

manage effectively its growth through mergers and acquisitions, could harm the Company's business and operating results.

RISKS RELATED TO THE COMPANY'S INDUSTRY

BECAUSE THE DEMAND FOR THE COMPANY'S SERVICES DEPENDS ON CONTINUED GROWTH IN USE OF THE INTERNET, A SLOWING OF THIS GROWTH COULD HARM THE DEVELOPMENT OF THE DEMAND FOR THE COMPANY'S SERVICES. Critical issues concerning the commercial use of the Internet remain unresolved and may hinder the growth of Internet use, especially in the business market the Company targets. Despite growing interest in the varied commercial uses of the Internet, many businesses have been deterred from purchasing Internet connectivity services for a number of reasons, including inconsistent or unreliable quality of service, lack of availability of cost-effective, high-speed options, a limited number of local access points for corporate users, inability to integrate business applications on the Internet, the need to deal with multiple and frequently incompatible vendors and a lack of tools to simplify Internet access and use. Capacity constraints caused by growth in the use of the Internet may, if left unresolved, impede further development of the Internet to the extent that users experience delays, transmission errors and other difficulties. Further, the adoption of the Internet for commerce and communications, particularly by those individuals and enterprises that have historically relied upon alternative means of commerce and communication, generally requires an understanding and acceptance of a new way of conducting business and exchanging information. In particular, enterprises that have already invested substantial resources in other means of conducting commerce and exchanging information may be particularly reluctant or slow to adopt a new strategy that may make their existing personnel and infrastructure obsolete. The failure of the market for business related Internet solutions to further develop could cause the Company's revenues to grow more slowly than anticipated and reduce the demand for its services.

BECAUSE THE MARKET FOR THE COMPANY'S SERVICES, INCLUDING ITS INTERNET CONNECTIVITY AND COLLOCATION SERVICES, IS NEW AND ITS VIABILITY IS UNCERTAIN, THERE IS A RISK THE COMPANY'S SERVICES MAY NOT BE ACCEPTED. The Company faces the risk that the market for its services, including its high performance Internet connectivity and collocation services, might fail to develop, or develop more slowly than expected, or that its services may not achieve widespread market acceptance. This market has only recently begun to develop, is evolving rapidly and likely will be characterized by an increasing number of entrants. There is significant uncertainty as to whether this market ultimately will prove to be viable or, if it becomes viable, that it will grow. Furthermore, the Company may be unable to market and sell its services successfully and cost-effectively to a sufficiently large number of customers. The Company typically charges more for its services than do its competitors, which may affect market acceptance of its services. Finally, if the Internet becomes subject to a form of central management, or if the Internet backbone providers establish an economic settlement arrangement regarding the exchange of traffic between backbones, the problems of congestion, latency and data loss addressed by the Company's Internet connectivity services could be largely resolved and its core business rendered obsolete.

IF THE COMPANY IS UNABLE TO RESPOND EFFECTIVELY AND ON A TIMELY BASIS TO RAPID TECHNOLOGICAL CHANGE, THE COMPANY MAY LOSE OR FAIL TO ESTABLISH A COMPETITIVE ADVANTAGE IN ITS MARKET. The Internet connectivity industry is characterized by rapidly changing technology, industry standards, customer needs and competition, as well as by frequent new product and service introductions. The Company may be unable to successfully use or develop new technologies, adapt its network infrastructure to changing customer requirements and industry standards, introduce new services or enhance its existing services on a timely basis. Furthermore, new technologies or enhancements that the Company uses or develops may not gain market acceptance. The Company's pursuit of necessary technological advances may require substantial time and expense, and the Company may be unable to successfully adapt its network and services to alternate access devices and technologies.

If its services do not continue to be compatible and interoperable with products and architectures offered by other industry members, the Company's ability to compete could be impaired. The Company's ability to compete successfully is dependent, in part, upon the continued compatibility and interoperability of its services with products and architectures offered by various other industry participants. Although the Company intends to support emerging standards in the market for Internet connectivity, there can be no assurance that the Company will be able to conform to new standards in a timely fashion, if at all, or maintain a competitive position in the market.

NEW TECHNOLOGIES COULD DISPLACE THE COMPANY'S SERVICES OR RENDER THEM OBSOLETE. New technologies and industry standards have the potential to replace or provide lower cost alternatives to the Company's services. The adoption of such new technologies or industry standards could render the Company's existing services obsolete and unmarketable. For example, the Company's services rely on the continued widespread commercial use of the set of protocols, services and applications for linking computers known as Transmission Control

Protocol/Internetwork Protocol, or TCP/IP. Alternative sets of protocols, services and applications for linking computers could emerge and become widely adopted. A resulting reduction in the use of TCP/IP could render the Company's services obsolete and unmarketable. The Company's failure to anticipate the prevailing standard or the failure of a common standard to emerge could hurt its business. Further, the Company anticipates the introduction of other new technologies, such as telephone and facsimile capabilities, private networks, multimedia document distribution and transmission of audio and video feeds, requiring broadband access to the Internet, but there can be no assurance that such technologies will create opportunities for the Company.

SERVICE INTERRUPTIONS CAUSED BY SYSTEM FAILURES COULD HARM CUSTOMER RELATIONS, EXPOSE THE COMPANY TO LIABILITY AND INCREASE THE COMPANY'S CAPITAL COSTS. Interruptions in service to the Company's customers could harm the Company's customer relations, expose the Company to potential lawsuits and require the Company to spend more money adding redundant facilities. The Company's operations depend upon its ability to protect its customers' data and equipment, its equipment and its network infrastructure, including its connections to its backbone providers, against damage from human error or "acts of God." Even if the Company takes precautions, the occurrence of a natural disaster or other unanticipated problem could result in interruptions in the services the Company provides to its customers.

CAPACITY CONSTRAINTS COULD CAUSE SERVICE INTERRUPTIONS AND HARM CUSTOMER RELATIONS. Failure of the backbone providers and other Internet infrastructure companies to continue to grow in an orderly manner could result in capacity constraints leading to service interruptions to the Company's customers. Although the national telecommunications networks and Internet infrastructures have historically developed in an orderly manner, there is no guarantee that this orderly growth will continue as more services, users and equipment connect to the networks. Failure by the Company's telecommunications and Internet service providers to provide the Company with the data communications capacity it requires could cause service interruptions.

THE COMPANY'S NETWORK AND SOFTWARE ARE VULNERABLE TO SECURITY BREACHES AND SIMILAR THREATS WHICH COULD RESULT IN ITS LIABILITY FOR DAMAGES AND HARM ITS REPUTATION. Despite the implementation of network security measures, the core of the Company's network infrastructure is vulnerable to computer viruses, break-ins, network attacks and similar disruptive problems. This could result in the Company's liability for damages, and its reputation could suffer, thereby deterring potential customers from working with the Company. Security problems caused by third parties could lead to interruptions and delays or to the cessation of service to the Company's customers. Furthermore, inappropriate use of the network by third parties could also jeopardize the security of confidential information stored in the Company's computer systems and in those of its customers.

Although the Company intends to continue to implement industry-standard security measures, in the past some of these industry-standard measures have occasionally been circumvented by third parties, although not in its system. Therefore, there can be no assurance that the measures the Company implements will not be circumvented. The costs and resources required to eliminate computer viruses and alleviate other security problems may result in interruptions, delays or cessation of service to the Company's customers, which could hurt its business.

SHOULD THE GOVERNMENT MODIFY OR INCREASE ITS REGULATION OF THE INTERNET, THE PROVISION OF ITS SERVICES COULD BECOME MORE COSTLY. There is currently only a small body of laws and regulations directly applicable to access to or commerce on the Internet. However, due to the increasing popularity and use of the Internet, international, federal, state and local governments may adopt laws and regulations, which affect the Internet. The nature of any new laws and regulations and the manner in which existing and new laws and regulations may be interpreted and enforced cannot be fully determined. The adoption of any future laws or regulations might decrease the growth of the Internet, decrease demand for the Company's services, impose taxes or other costly technical requirements or otherwise increase the cost of doing business on the Internet or in some other manner have a significantly harmful effect on the Company or its customers. The government may also seek to regulate some segments of the Company's activities as it has with basic telecommunications services. Moreover, the applicability to the Internet of existing laws governing intellectual property ownership and infringement, copyright, trademark, trade secret, obscenity, libel, employment, personal privacy and other issues is uncertain and developing. The Company cannot predict the impact, if any, that future regulation or regulatory changes may have on its business.

PART II. OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

On July 31, 2000, the Company issued an aggregate of approximately 2.0 million shares of its common stock in exchange for the outstanding capital stock of VPNX.com. in an unregistered offering in reliance upon Rule 506 of Regulation D under the Securities Act of 1933, as amended. The sales were made without general solicitation or advertising. All recipients of the shares were accredited investors.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

2.1 Agreement and Plan of Merger and Reorganization, dated as of July 6, 2000, by and among the Company, Virginia Acquisition Corp., a Delaware corporation, and VPNX.com, Inc., a Delaware corporation (incorporated by reference to the Company's Current Report on Form 8-K, dated July 31, 2000, as amended by the Company's amended Current Report on Form 8-K/A, dated October 4, 2000).

4.1 Form of Registration Rights Agreement by and among the Company and the stockholders of VPNX.com, Inc., a Delaware corporation (incorporated by reference to the Company's Current Report on Form 8-K, dated July 31, 2000, as amended by the Company's amended Current Report on Form 8-K/A, dated October 4, 2000).

10.1 Amended and Restated InterNAP Network Services Corporation 1998 Stock Options/Stock Issuance Plan.

10.2 Amended and Restated InterNAP Network Services Corporation 1999 Stock Incentive Plan for Non-Officers.

27.1 Financial Data Schedule (filed only with the electronic submission of Form 10-Q in accordance with the Edgar requirements).

(b) Reports on Form 8-K:

On September 5, 2000, the Company filed an amendment on Form 8-K/A to its Current Report on Form 8-K filed on June 29, 2000 announcing its acquisition of CO Space, Inc.

On July 31, 2000, the Company filed a Current Report on Form 8-K announcing its acquisition of VPNX.com, Inc. and, on October 4, 2000, filed an amendment on Form 8-K/A to this July 31, 2000 Current Report on Form 8-K.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 13th day of November, 2000.

INTERNAP NETWORK SERVICES CORPORATION
(Registrant)

By: /s/ Paul E. McBride

Paul E. McBride
SENIOR VICE PRESIDENT AND CHIEF FINANCIAL OFFICER
(PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER)

EXHIBIT INDEX

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INTERNAP NETWORK SERVICES CORPORATION
1998 STOCK OPTION/STOCK ISSUANCE PLAN

AMENDED AND RESTATED SEPTEMBER 20, 2000

ARTICLE I

GENERAL PROVISIONS

SECTION 1. PURPOSE

This 1998 Stock Option/Stock Issuance Plan is intended to promote the interests of InterNAP Network Services Corp. (the "Corporation") by providing eligible individuals who are responsible for the management, growth and financial success of the Corporation or who otherwise render valuable services to the Corporation with the opportunity to acquire a proprietary interest, or increase their proprietary interest, in the Corporation and thereby encourage them to remain in the service of the Corporation.

Capitalized terms used herein shall have the meanings ascribed to such terms in Section 6 of this Article I.

SECTION 2. STRUCTURE OF THE PLAN

The Plan shall be divided into two separate components: the Option Grant Program specified in Article II and the Stock Issuance Program specified in Article III. The provisions of Articles I, IV and V of the Plan shall apply to both the Option Grant Program and the Stock Issuance Program and shall accordingly govern the interests of all individuals in the Plan.

SECTION 3. ADMINISTRATION OF THE PLAN

(a) The Plan shall be administered by the Board. The Board at any time may appoint a Committee and delegate to such Committee some or all of the administrative powers allocated to the Board pursuant to the provisions of the Plan. Members of the Committee shall serve for such period of time as the Board may determine and shall be subject to removal by the Board at any time. The Board at any time may terminate the functions of the Committee and reassume all powers and authority previously delegated to the Committee.

(b) The Plan Administrator (either the Board or the Committee, to the extent the Committee is at the time responsible for the administration of the Plan) shall have full power and authority (subject to the provisions of the Plan) to establish such rules and regulations as it may deem appropriate for the proper plan administration and to make such determinations under, and issue such interpretations of, the Plan and any outstanding option grants or share issuances as it may deem necessary or advisable. Decisions of the Plan Administrator shall be final and binding on all parties who have an interest in the Plan or any outstanding option or share issuance.

(c) At such time as the Common Stock is publicly traded, in the discretion of the Board, a Committee may consist solely of two or more Outside Directors, in accordance with Section 162(m) of the Code, and/or solely of two or more Non-Employee Directors, in accordance with Rule 16b-3. Within the scope of such authority, the Board or the Committee may (1) delegate to a committee of one or more members of the Board who are not Outside Directors the authority to grant Stock Awards to eligible persons who are either (a) not then Covered Employees and are not expected to be Covered Employees at the time of recognition of income resulting from such Stock Award or (b) not persons with respect to whom the Corporation wishes to comply with Section 162(m) of the Code and/or) (2) delegate to a committee of one or more members of the Board who are not Non-Employee Directors the authority to grant Stock Awards to eligible persons who are not then subject to Section 16 of the Exchange Act.

SECTION 4. OPTION GRANTS AND SHARE ISSUANCES

(a) The persons eligible to receive option grants pursuant to the Option Grant Program (each an "Optionee") and/or share issuances under the

Stock Issuance Program (each a "Participant") are limited to the following:

(1) key employees (including officers and directors) of the Corporation (or its Parent or Subsidiary corporations, if any) who render services that contribute to the success and growth of the Corporation (or its Parent or Subsidiary corporations), or that reasonably may be anticipated to contribute to the future success and growth of the Corporation (or its Parent or Subsidiary corporations);

(2) the non-employee members of the Board or the non-employee members of the board of directors of any Parent or Subsidiary corporations; and

(3) those consultants or independent contractors who provide valuable services to the Corporation (or its Parent or Subsidiary corporations, if any).

(b) The Plan Administrator shall have full authority to determine: (i) with respect to the option grants made under the Plan, which eligible individuals are to receive option grants, the number of shares to be covered by each such grant, the status of the granted option as either an Incentive Option or a Non-Statutory Option, the time or times at which each granted option is to become exercisable and the maximum term for which the option may remain outstanding, and (ii) with respect to share issuances under the Stock Issuance Program, the number of shares to be issued to each Participant, the vesting schedule (if any) to be applicable to the issued shares, and the consideration to be paid by the individual for such shares.

(c) The Plan Administrator shall have the absolute discretion either to grant options in accordance with Article II of the Plan or to effect share issuances in accordance with Article III of the Plan.

SECTION 5. STOCK SUBJECT TO THE PLAN

(a) The stock issuable under the Plan shall be shares of the Corporation's authorized but unissued or reacquired Common Stock (the "Common Stock"). The

maximum number of shares that may be issued over the term of the Plan shall not exceed four million thirty-five thousand (4,035,000) shares of Common Stock. The total number of shares issuable under the Plan shall be subject to adjustment from time to time in accordance with the provisions of Section 5(c).

(b) Shares subject to (i) the portion of one or more outstanding options that are not exercised or surrendered prior to expiration or termination and (ii) outstanding options canceled in accordance with the cancellation-regrant provisions of Section 5 of Article II will be available for subsequent option grants or stock issuances under the Plan. Shares issued under either the Option Grant Program or the Stock Issuance Program (whether as vested or unvested shares) that are repurchased by the Corporation shall not be available for subsequent option grants or stock issuances under the Plan.

(c) If any change is made in the Common Stock subject to the Plan, or subject to any Stock Award, without the receipt of consideration by the Corporation (through merger, consolidation, reorganization, recapitalization, reincorporation, stock dividend, dividend in property other than cash, stock split, liquidating dividend, combination of shares, exchange of shares, change in corporate structure or other transaction not involving the receipt of consideration by the Corporation), the Plan will be appropriately adjusted in the class(es) and maximum number of securities subject to the Plan pursuant to Article I, Section 5(a) and the maximum number of securities subject to award to any person pursuant to subsection 5(e), and the outstanding Stock Awards will be appropriately adjusted in the class(es) and number of securities and price per share of Common Stock subject to such outstanding Stock Awards. The Board shall make such adjustments, and its determination shall be final, binding and conclusive. (The conversion of any convertible securities of the Corporation shall not be treated as a transaction "without receipt of consideration" by the Corporation.)

(d) Common Stock issuable under the Plan, whether under the Option Grant Program or the Stock Issuance Program, may be subject to such restrictions on transfer, repurchase rights or other restrictions as may be determined by the Plan Administrator.

(e) Subject to the provisions of Article I, Section 5(c) relating to adjustments upon changes in the shares of Common Stock, no Employee shall be eligible to be granted options covering more than two million (2,000,000) shares of Common Stock during any calendar year.

SECTION 6. DEFINITIONS

The following definitions shall apply to the respective capitalized terms used herein:

BOARD means the Board of Directors of InterNAP Network Services Corp.

CAUSE shall have such meaning as is defined in the Participant's employment or consulting agreement with a Paticipating Company. If the Participant does not have an employment or consulting agreement with a Paticipating Company, or if such agreement does not define the term "Cause," then the term "Cause" shall mean: (i) misconduct or dishonesty that materially adversely affects a Paticipating Company, including without limitation (A) an act

materially in conflict with the financial interests of a Paticipating Company, (B) an act that could damage the reputation or customer relations of a Paticipating Company, (C) an act that could subject a Paticipating Company to liability, (D) an act constituting sexual harassment or other violation of the civil rights of coworkers, (E) failure to obey any lawful instruction of the Board or any officer of a Paticipating Company and (F) failure to comply with, or perform any duty required under, the terms of any confidentiality, inventions or non-competition agreement the Participant may have with a Paticipating Company, or (ii) acts constituting the unauthorized disclosure of any of the trade secrets or confidential information of a Paticipating Company, unfair competition with a Paticipating Company or the inducement of any customer of a Paticipating Company to breach any contract with a Paticipating Company. The right to exercise any Option shall be suspended automatically during the pendency of any investigation by the Board or its designee, and/or any negotiations by the Board or its designee and the Participant, regarding any actual or alleged act or omission by the Participant of the type described in this section.

CHANGE IN CONTROL means the transaction described in Article V, Section (b), which is referred to as a Change in Control or Corporate transaction.

CODE means the Internal Revenue Code of 1986, as amended.

COMMITTEE means either the Compensation Committee of the Board or another committee comprised of two or more members thereof and appointed pursuant to the Plan to function as the Plan Administrator.

CORPORATION means InterNAP Network Services Corp., a Washington corporation.

CORPORATE TRANSACTION means the transaction described in Article V, Section (b), which is referred to as a Change in Control or Corporate Transaction.

COVERED EMPLOYEE means the chief executive officer and the four (4) other highest compensated officers of the Corporation for whom total compensation is required to be reported to shareholders under the Exchange Act, as determined for purposes of Section 162(m) of the Code.

EMPLOYEE means an individual who is in the employ of the Corporation or one or more Parent or Subsidiary corporations. An optionee shall be considered to be an Employee for so long as such individual remains

in the employ of the Corporation or one or more Parent or Subsidiary corporations, subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

EXCHANGE ACT means the Securities Exchange Act of 1934, as amended.

EXERCISE DATE shall be the date on which written notice of the exercise of an outstanding option under the Plan is delivered to the Corporation. Such exercise shall be effected pursuant to a stock purchase agreement incorporating any repurchase rights or first refusal rights retained by the Corporation with respect to the Common Stock purchased under the option.

FAIR MARKET VALUE of a share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(a) If the Common Stock is at the time listed or admitted to trading on any stock exchange, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question on the stock exchange determined by the Plan Administrator to be the primary market for the Common Stock. If there is no reported sale of Common Stock on such exchange on the date in question, then the Fair Market Value shall be the closing selling price on the exchange on the last preceding date for which such quotation exists.

(b) If the Common Stock is not at the time listed or admitted to trading on any stock exchange but is traded in the over-the-counter market, the Fair Market Value shall be the mean between the highest bid and the lowest asked prices (or if such information is available the closing selling price) per share of Common Stock on the date in question in the over-the-counter market, as such prices are reported by the National Association of Securities Dealers through its NASDAQ National Market System or any successor system. If there are no reported bid and asked prices (or closing selling price) for the Common Stock on the date in question, then the mean between the highest bid and lowest asked prices (or closing selling price) on the last preceding date for which such quotations exist shall be determinative of Fair Market Value.

(c) If the Common Stock is at the time neither listed nor admitted to trading on any stock exchange nor traded in the over-the-counter market, or if the Plan Administrator determines that the valuation provisions of subsections (a) and (b) above will not result in a true and accurate valuation of the Common Stock, then the Fair Market Value shall be determined by the Plan Administrator after taking into account such factors as the Plan Administrator shall deem appropriate under the circumstances.

INCENTIVE OPTION means an incentive stock option that satisfies the requirements of Section 422 of the Code.

NON-EMPLOYEE DIRECTOR means a Director who either (i) is not a current Employee or Officer of the Corporation or its parent or a subsidiary, does not receive compensation (directly or indirectly) from the Corporation or its parent or a subsidiary for services rendered as a consultant or in any capacity other than as a Director (except for an amount as to which disclosure would not be required under Item 404(a) of Regulation S-K promulgated pursuant to the Securities Act ("Regulation S-K")), does not possess an interest in any other transaction as to which disclosure would be required under Item 404(a) of Regulation S-K and is not engaged in a business relationship as to which disclosure would be required under Item 404(b) of Regulation S-K; or (ii) is otherwise considered a "non-employee director" for purposes of Rule 16b-3.

NON-STATUTORY OPTION means an option not intended to meet the statutory requirements prescribed for an Incentive Option.

OFFICER means a person who is an officer of the Corporation within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.

OUTSIDE DIRECTOR means a Director who either (i) is not a current employee of the Corporation or an "affiliated corporation" (within the meaning of Treasury Regulations promulgated under Section 162(m) of the Code), is not a former employee of the Corporation or an "affiliated corporation" receiving compensation for prior services (other than benefits under a tax qualified pension plan), was not an officer of the Corporation or an "affiliated corporation" at any time and is not currently receiving direct or indirect remuneration from the Corporation or an "affiliated corporation" for services in any capacity other than as a Director or (ii) is otherwise considered an "outside director" for purposes of Section 162(m) of the Code.

PARENT corporation means any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each such corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

PARTICIPATING COMPANY means the Corporation, a Parent, or a Subsidiary.

PERMANENT DISABILITY means the inability of an individual to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expect to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.

PLAN means this 1998 Stock Option/Stock Issuance Plan.

PLAN ADMINISTRATOR means the Board or the Committee, to the extent the Committee is responsible for plan administration in accordance with Article I, Section 3.

RULE 16b-3 means Rule 16b-3 promulgated under the Exchange Act or any successor to Rule 16b-3, as in effect from time to time.

SECURITIES ACT means the Securities Act of 1933, as amended.

SERVICE means the performance of services for the Corporation or one or more Parent or Subsidiary corporations by an individual in the capacity of an Employee, a non-employee member of the board of directors or an independent consultant or advisor, unless a different meaning is specified in the option agreement evidencing the option grant, the purchase agreement evidencing the purchased option shares or the issuance agreement evidencing any direct stock issuance. An optionee shall be deemed to remain in Service for so long as such individual renders services to the Corporation or any Parent or Subsidiary corporation on a periodic basis in the capacity of an Employee, a non-employee member of the board of directors or an independent consultant or advisor.

STOCK AWARD means any right granted under the Plan including an Incentive Stock Option, Non-Statutory Option or stock issuance.

STOCK AWARD AGREEMENT means any written agreement between the Corporation and the holder of a Stock Award evidencing the terms and conditions of the Stock Award. Each Stock Award Agreement shall be subject to the terms and conditions of the Plan.

SUBSIDIARY corporation means each corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each such corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

TEN PERCENT SHAREHOLDER means the owner of stock (as determined under Section 424(d) of the Code) possessing ten percent (10%) or more of the total combined voting power of all classes of stock of the Corporation or any Parent or Subsidiary corporation.

ARTICLE II

OPTION GRANT PROGRAM

SECTION 1. TERMS AND CONDITIONS OF OPTIONS

Options granted pursuant to the Plan shall be authorized by action of the Plan Administrator and, at the discretion of the Plan Administrator, may be either Incentive Options or Non-Statutory Options. Each granted option shall be evidenced by one or more instruments in the form approved by the Plan Administrator; provided, that each such instrument shall comply with and incorporate the terms and conditions specified below. In addition, each instrument evidencing an Incentive Option shall be subject to the applicable provisions of Section 2 of this Article II.

(a) OPTION PRICE.

(1) The option price per share shall be fixed by the Plan Administrator.

(2) The option price shall become immediately due upon exercise of the option, and subject to the provisions of Article IV, Section 2, shall be payable in cash or check drawn to the Corporation's order. Should the Corporation's outstanding Common Stock be registered under Section 12(g) of the Securities Exchange Act of 1934, as amended (the "1934 Act") at the time the option is exercised, then the option price may also be paid as follows:

(A) in shares of Common Stock held by the optionee for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date; or

(B) through a special sale and remittance procedure pursuant to which the Optionee is to (i) provide irrevocable written instructions to a designated brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds, an amount sufficient to cover the aggregate option price payable for the purchased shares plus all applicable Federal and State income and employment taxes required to be withheld by the Corporation by reason of such purchase and (ii) concurrently provide written directives to the Corporation to deliver the certificates for the

purchased shares directly to such brokerage firm in order to effect the sale transaction.

(b) TERM AND EXERCISE OF OPTIONS. Each option granted under the Plan shall be exercisable at such time or times, during such period, and for such number of shares as shall be determined by the Plan Administrator and set forth in the notice of grant and stock option agreement evidencing such option. No option granted under the Plan, however, shall have a term in excess of ten (10) years from the grant date. During the lifetime of the Optionee, the option shall be exercisable only by the Optionee and shall not be assignable or transferable by the Optionee otherwise than by will or by the laws of descent and distribution following the Optionee's death.

(c) TERMINATION OF SERVICE.

(1) Should the Optionee cease to remain in Service for any reason (including death or Permanent Disability) while holding one or more outstanding options under the Plan, then except to the extent otherwise provided pursuant to Section 6 of this Article II, each such option shall remain exercisable for the limited period of time (not to exceed twelve (12) months after the date of such cessation of Service) specified by the Plan Administrator in the option agreement. In no event, however, shall any such

option be exercisable after the specified expiration date of the option term. During such limited period of exercisability, the option may not be exercised for more than that number of shares (if any) for which such option is exercisable on the date of the Optionee's cessation of Service. Upon the expiration of such period or (if earlier) upon the expiration of the option term, the option shall terminate and cease to be exercisable.

(2) Any option granted to an Optionee under the Plan and exercisable in whole or in part on the date of the Optionee's death may be subsequently exercised by the personal representative of the Optionee's estate or by the person or persons to whom the option is transferred pursuant to the Optionee's will or in accordance with the laws of descent and distribution. The maximum number of shares for which such option may be exercised shall be limited to the number of shares (if any) for which the option is exercisable on the date of the Optionee's cessation of Service. Any such exercise of the option must be effected prior to the EARLIER of the first anniversary of the date of the Optionee's death or the specified expiration date of the option term. Upon the occurrence of either such event, the option shall terminate and cease to be exercisable.

(3) Notwithstanding subsections (1) and (2) above, the Plan Administrator shall have discretion, exercisable either at the time the option is granted or at the time the Optionee ceases Service, to allow one or more outstanding options held by the Optionee to be exercised, during the limited period of exercisability following the Optionee's cessation of Service, not only with respect to the number of shares for which the option is exercisable at the time of the Optionee's cessation of Service but also with respect to one or more subsequent installments of purchasable shares for which the option otherwise would have become exercisable had such cessation of Service not occurred.

(4) Notwithstanding any provision of this Article II or any other provision of this Plan to the contrary, any options granted under this Plan shall terminate as of the date the Optionee ceases to be in the Service of the Corporation if the Optionee was terminated for "cause" or could have been terminated for "cause." If the Optionee has an employment or consulting agreement with the Corporation, the term "cause" shall have the meaning given that term in such employment or consulting agreement. If the Optionee does not have an employment or consulting agreement with the Corporation, or if such agreement does not define the term "cause," the term "cause" shall mean: (A) misconduct or dishonesty that materially adversely affects the Corporation, including without limitation (i) an act materially in conflict with the financial interests of the Corporation, (ii) an act that could damage the reputation or customer relations of the Corporation, (iii) an act that could subject the Corporation to liability, (iv) an act constituting sexual harassment or other violation of the civil rights of coworkers, (v) failure to obey any lawful instruction of the Board or any officer of the Corporation and (vi) failure to comply with, or perform any duty required under, the terms of any confidentiality, inventions or non-competition agreement the Optionee may have with the Corporation, or (B) acts constituting the unauthorized disclosure of any of the trade secrets or confidential information of the Corporation, unfair competition with the Corporation or the inducement of any customer of the Corporation to breach any contract with the Corporation. The right to exercise any option shall be suspended automatically during the pendency of any investigation by the Board or its designee, and/or any negotiations by the Board or its designee and the Optionee, regarding any actual or alleged act or omission by the Optionee of the type described in this section.

(d) SHAREHOLDER RIGHTS. An Optionee shall have none of the rights of a shareholder with respect to any shares covered by the option until such Optionee shall have exercised the option and paid the option price.

(e) REPURCHASE RIGHTS. The shares of Common Stock issued under the Plan shall be subject to certain repurchase rights of the Corporation in accordance with the following provisions:

(1) (A) The Plan Administrator shall have the discretion to authorize the issuance of unvested shares of Common Stock under the Plan. Should the optionee cease Service or should the Corporation consummate a

Corporate Transaction while the optionee is holding such unvested shares, the Corporation shall have the right to repurchase, at the option price paid per share, all or (at the discretion of the Corporation and with the consent of the Optionee) any portion of those such shares. The terms and conditions upon which such repurchase right shall be exercisable (including the period and procedure for exercise and the appropriate vesting schedule for the purchased shares) shall be established by the Plan Administrator and set forth in an instrument evidencing such right.

(B) The repurchase right shall be assignable to any person or entity selected by the Corporation, including one or more of the Corporation's shareholders. If the selected assignee is other than a Parent or Subsidiary corporation, however, then the assignee must make a cash payment to the Corporation, upon the assignment of the repurchase right, in an amount equal to the amount by which the Fair Market Value of the unvested shares at the time

subject to the assigned right exceeds the aggregate repurchase price payable for such unvested shares.

(C) Upon the occurrence of a Corporate Transaction, the Plan Administrator may, at its sole discretion, (i) terminate all or any outstanding repurchase rights under the Plan and thereby cause the shares subject to such rights to vest immediately in full, (ii) arrange for all or any of the repurchase rights to be assigned to the successor corporation (or parent thereof) in connection with the Corporate Transaction or (iii) exercise the Corporation's right to repurchase any unvested shares contemporaneously with the consummation of the Corporate Transaction if such right is provided in the instrument pursuant to which such unvested shares were issued.

(2) Until such time as the Corporation's outstanding shares of Common Stock are first registered under Section 12(g) of the 1934 Act, the Corporation shall have the right of first refusal with respect to any proposed sale or other disposition by the Optionee (or any successor in interest by reason of purchase, gift or other mode of transfer) of any shares of Common Stock issued under the Plan. Such right of first refusal shall be exercisable by the Corporation (or its assignees) in accordance with the terms and conditions established by the Plan Administrator and set forth in the instrument evidencing such right.

SECTION 2. INCENTIVE OPTIONS

The terms and conditions specified below shall be applicable to all Incentive Options granted under the Plan. Incentive Options may be granted only to individuals who are Employees. Options that are specifically designated as Non-Statutory Options when issued under the Plan shall not be subject to the following terms and conditions.

(a) OPTION PRICE. The option price per share of the Common Stock subject to an Incentive Option shall in no event be less than one hundred percent (100%) of the Fair Market Value of a share of Common Stock on the grant date; PROVIDED, if the individual to whom the option is granted is at the time a Ten Percent Shareholder, then the option price per share shall not be less than one hundred ten percent (110%) of the Fair Market Value of the Common Stock on the grant date.

(b) DOLLAR LIMITATION. The aggregate Fair Market Value (determined as of the respective date or dates of grant) of the Common Stock for which one or more options granted to any Employee under this Plan (or any other option plan of the Corporation or any Parent or Subsidiary corporation) may for the first time become exercisable as incentive stock options under the Federal tax laws during any one calendar year shall not exceed the sum of one hundred thousand dollars ($100,000). To the extent the Employee holds two or more such options which become exercisable for the first time in the same calendar year, the foregoing limitation on the exercisability thereof as Incentive Options under the Federal tax laws shall be applied on the basis of the order in which such options are granted.

(c) OPTION TERM FOR TEN PERCENT SHAREHOLDER. No option granted

to a Ten Percent Shareholder shall have a term in excess of five (5) years from the grant date.

Except as modified by the preceding provisions of this Section 2, all the provisions of the Plan shall be applicable to the Incentive Options granted hereunder.

SECTION 3. CORPORATE TRANSACTION

(a) The exercisability as incentive stock options under the Federal tax laws of any options accelerated in connection with the Corporate Transaction shall remain subject to the applicable dollar limitation of subsection 2(b) of this Article II.

(b) The grant of options under this Plan shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

SECTION 4. CANCELLATION AND NEW GRANT OF OPTIONS

The Plan Administrator shall have the authority to effect, at any time and from time to time, with the consent of the affected Optionees, the cancellation of any or all outstanding options under the Plan and to grant in substitution therefor new options under the Plan covering the same or different numbers of shares of Common Stock but having, in the case of an Incentive Option, an option price per share not less than one hundred percent (100%) of such Fair Market Value per share of Common Stock on the new grant date, or, in the case of a Ten Percent Shareholder, not less than one hundred and ten percent (110%) of such Fair Market Value.

SECTION 5. EXTENSION OF EXERCISE PERIOD

The Plan Administrator shall have full power and authority to extend (either at the time the option is granted or at any time that the option remains outstanding) the period of time for which the option is to remain exercisable following the Optionee's cessation of Service, from the limited period set forth in the option agreement, to such greater period of time as the Plan Administrator may deem appropriate under the circumstances. In no event, however, shall such option be exercisable after the specified expiration date of the option term.

ARTICLE III

STOCK ISSUANCE PROGRAM

SECTION 1. TERMS AND CONDITIONS OF STOCK ISSUANCES

Shares of Common Stock shall be issuable under the Stock Issuance Program through direct and immediate issuances without any intervening stock option grants. Each such stock issuance shall be evidenced by a Stock Issuance Agreement ("Issuance Agreement") that complies with the terms and conditions of this Article III.

(a) ISSUE PRICE.

(1) Shares may, in the absolute discretion of the Plan Administrator, be issued for consideration with a value less than one-hundred percent (100%) of the Fair Market Value of the issued shares.

(2) Shares shall be issued under the Plan for such consideration as the Plan Administrator shall from time to time determine, provided that in no event shall shares be issued for consideration other than:

(A) cash or check payable to the Corporation,

(B) a promissory note in favor of the Corporation, which may be subject to cancellation by the Corporation in whole or in part upon such terms and conditions as the Plan Administrator shall specify, or

(C) services rendered.

(b) VESTING SCHEDULE.

(1) In the discretion of the Plan Administrator, the interest of a Participant in the shares of Common Stock issued to such Participant under the Plan may be fully and immediately vested upon issuance or may vest in one or more installments in accordance with the vesting provisions of subsection (b)(4) below. Except as otherwise provided in subsection (b)(2), the Participant may not transfer any issued shares in which such Participant does not have a vested interest. Accordingly, all unvested shares issued under the Plan shall bear the restrictive legend specified in Article IV, Section 1, until such legend is removed in accordance with such section. Regardless of whether or not a Participant's interest in such shares is vested, such Participant shall be entitled to exercise all the rights of a shareholder with respect to the shares of Common Stock issued to Participant hereunder, including the right to vote such shares and to receive any cash dividends or other distributions paid or made with respect to such shares. Any new, additional or different shares of stock or other property (including money paid other than as a regular cash dividend) that the holder of unvested Common Stock may have the right to receive with respect to such unvested shares by reason of a stock dividend, stock split, reclassification or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration therefor shall be issued subject to (i) the same vesting requirements under subsection (b)(4) applicable to the unvested Common Stock and (ii) such escrow arrangements as the Plan Administrator shall deem appropriate.

(2) As used in this Article III, the term "transfer" shall include (without limitation) any sale, pledge, encumbrance, gift or other disposition of such shares. A Participant shall have the right to make a gift of unvested shares acquired under the Stock Issuance Program to Participant's spouse, parents or issue or to a trust established for such spouse, parents or issue, provided the donee of such shares delivers to the Corporation, at the time of such donee's acquisition of the gifted shares, a written agreement to be bound by all the provisions of the Plan and the Issuance Agreement executed by the Participant.

(3) Should the Participant cease Service for any reason while Participant's interest in the Common Stock remains unvested, then the Corporation shall have the

right to repurchase, at the original purchase price paid by the Participant, all or (at the discretion of the Corporation and with the consent of the Participant) any portion of the shares in which the Participant is not at the time vested, and the Participant shall thereafter cease to have any further shareholder rights with respect to the repurchased shares.

(4) Any shares of Common Stock issued under the Stock Issuance Program that are not vested at the time of such issuance shall vest in one or more installments thereafter. The elements of the vesting schedule, specifically, the performance or service objectives to be completed or achieved, the number of installments in which the shares are to vest, the interval or intervals (if any) that are to lapse between installments and the effect that death, Permanent Disability or other event designated by the Plan Administrator is to have upon the vesting schedule, shall be determined by the Plan Administrator and specified in the Issuance Agreement.

(5) In its discretion, the Plan Administrator may elect not to exercise, in whole or in part, its repurchase rights with respect to any unvested Common Stock or other assets that would otherwise at the time be subject to repurchase pursuant to the provisions of subsection (b)(3) above.

Such an election shall result in the immediate vesting of the Participant's interest in the shares of Common Stock as to which the election applies.

(6) No shares of Common Stock or other assets shall be issued or delivered under this Plan unless and until, in the opinion of counsel for the Corporation (or its successor in the event of any Corporate Transaction), there shall have been compliance with all applicable requirements of the securities exchange on which stock of the same class is then listed and all other requirements of Federal and state law or of any regulatory bodies having jurisdiction over such issuance and delivery.

(c) RIGHT OF FIRST REFUSAL. The Plan Administrator may also in its discretion establish as a term and condition of the issuance of one or more shares of Common Stock under the Stock Issuance Program that the Corporation shall have a right of first refusal with respect to any proposed disposition by the Participant (or any successor in interest by reason of purchase, gift or other mode of transfer) of one or more shares of such Common Stock. Such right of first refusal shall be exercisable by the Corporation (or its assignees) in accordance with the terms and conditions specified in the instrument evidencing such right.

ARTICLE IV

MISCELLANEOUS

SECTION 1. STOCK LEGEND. Each certificate representing shares of Common Stock (or other securities) issued pursuant to the Plan may bear a restrictive legend substantially as follows:

(1) "This certificate and the shares represented hereby may not be sold, assigned, transferred, encumbered, or in any manner disposed of except in conformity with the terms of written agreements between the Corporation and the registered holder

of the shares (or the predecessor in interest to the shares). Upon written request, the Corporation will furnish without charge a copy of such agreements to the holder hereof."

SECTION 2. LOANS

(a) The Plan Administrator, in its discretion, may assist any Optionee or Participant (including an Optionee or Participant who is an officer or director of the Corporation) in the exercise of one or more options granted to such Optionee under the Article II Option Grant Program or the purchase of one or more shares issued to such Participant under the Article III Stock Issuance Program, including the satisfaction of any Federal and State income and employment tax obligations arising therefrom, by

(1) authorizing the extension of a loan from the Corporation to such Optionee or Participant, or

(2) permitting the Optionee or Participant to pay the option price or purchase price for the purchased Common Stock in installments over a period of years.

(b) The terms of any loan or installment method of payment (including the interest rate and terms of repayment applicable thereto) shall be established by the Plan Administrator. Loans or installment payments may be granted with or without security or collateral; provided, that any loan made to a consultant or other non-employee advisor must be secured by property other than the purchased shares of Common Stock. In all events the maximum credit available to each Optionee or Participant may not exceed the sum of (i) the aggregate option price or purchase price payable for the purchased shares (less the par value of such shares rounded up to the nearest whole cent) plus (ii) any Federal and State income and employment tax liability incurred by the Optionee or Participant in connection with such exercise or purchase.

(c) The Plan Administrator, in its discretion, may determine that one

or more loans extended under the financial assistance program shall be subject to forgiveness by the Corporation in whole or in part upon such terms and conditions as the Board deems appropriate.

SECTION 3. AMENDMENT OF THE PLAN AND AWARDS

(a) The Board shall have complete and exclusive power and authority to amend or modify the Plan in any or all respects whatsoever; PROVIDED, that no such amendment or modification shall adversely affect the rights and obligations of an Optionee with respect to options at the time outstanding under the Plan, nor adversely affect the rights of any Participant with respect to Common Stock issued under the Plan prior to such action, unless the Optionee or Participant consents to such amendment. In addition, the Board shall not, without the approval of the Corporation's shareholders, amend the Plan to (i) materially increase the maximum number of shares issuable under the Plan (except for permissible adjustments under Article I, Section 5(c)), (ii) materially increase the benefits accruing to individuals who participate in the Plan, or (iii) materially modify the eligibility requirements for participation in the Plan.

(b) Options to purchase shares of Common Stock may be granted under the Option Grant Program and shares of Common Stock may be issued under the Stock Issuance Program, which in both instances are in excess of the number of shares then available for issuance under the Plan, provided any excess shares actually issued under the Option Grant Program or the Stock Issuance Program are held in escrow until the Corporation's shareholders approve an amendment that sufficiently increases the number of shares of Common Stock available for issuance under the Plan. If such shareholder approval is not obtained within twelve (12) months after the date the initial excess stock option grants or direct stock issuances are made, then any unexercised options representing such excess shall terminate and cease to be exercisable and the Corporation shall promptly refund to the Optionees and Participants the option or purchase price paid for any excess shares issued under the Plan and held in escrow, together with interest (at the applicable Short Term Federal Rate) thereon for the period the shares were held in escrow.

SECTION 4. EFFECTIVE DATE AND TERM OF PLAN

(a) The Plan shall become effective when adopted by the Board, but no option granted under the Plan shall become exercisable, and no shares shall be issuable under the Stock Issuance Program, unless and until the Plan shall have been approved by the Corporation's shareholders. If such shareholder approval is not obtained within twelve (12) months after the date of the Board's adoption of the Plan, then all options previously granted under the Plan shall terminate, and no further options shall be granted and no shares shall be issued under the Stock Issuance Program. Subject to such limitation, the Plan Administrator may grant options under the Plan at any time after the effective date and before the date fixed herein for termination of the Plan.

(b) The Plan shall terminate upon the earlier of (i) ten years after the adoption of the Plan or (ii) the date on which all shares available for issuance under the Plan have been issued or canceled pursuant to the exercise of options granted under Article II or the issuance of shares under Article III. If the date of termination is determined under clause (i) above, then no options outstanding on such date under Article II and no shares issued and outstanding on such date under Article III shall be affected by the termination of the Plan, and such securities shall thereafter continue to have force and effect in accordance with the provisions of the stock option agreements evidencing such Article II options and the stock purchase agreements evidencing the issuance of such Article III shares.

SECTION 5. USE OF PROCEEDS

Any cash proceeds received by the Corporation from the issuance of shares of Common Stock under the Plan shall be used for general corporate purposes.

SECTION 6. WITHHOLDING

The Corporation's obligation to deliver shares upon the exercise of any options granted under Article II or upon the purchase of any shares issued under Article III shall be subject to the satisfaction of all applicable Federal, state and local income and employment tax withholding requirements.

SECTION 7. REGULATORY APPROVALS

The implementation of the Plan, the granting of any options under the Option Grant Program, the issuance of any shares under the Stock Issuance Program, and the issuance of Common Stock upon the exercise of the option grants made hereunder shall be subject to the Corporation's procurement of all approvals and permits required by regulatory authorities having jurisdiction over the Plan, the options granted under it, and the Common Stock issued pursuant to it.

SECTION 8. ACCELERATION OF EXERCISABILITY AND VESTING

The Board shall have the power to accelerate the time at which a Stock Award may first be exercised or the time during which a Stock Award or any part thereof will vest in accordance with the Plan, notwithstanding the provisions in the Stock Award stating the time at which it may first be exercised or the time during which it will vest.

ARTICLE V

CHANGE IN CONTROL OR CORPORATE TRANSACTIONS

(a) DISSOLUTION OR LIQUIDATION. In the event of a dissolution or liquidation of the Corporation, then all outstanding Options shall terminate immediately prior to such event.

(b) CERTAIN CHANGES IN CONTROL. In the event of (i) a sale, lease or other disposition of all or substantially all of the assets of the Corporation, (ii) a merger or consolidation in which the Corporation is not the surviving corporation or (iii) a reverse merger in which the Corporation is the surviving corporation but the shares of Common Stock outstanding immediately preceding the merger are converted by virtue of the merger into other property, whether in the form of securities, cash or otherwise (collectively, a "Change in Control" or "Corporate Transaction"), then any surviving corporation or acquiring corporation may assume or continue any Stock Awards outstanding under the Plan or may substitute similar stock awards (including an award to acquire the same consideration paid to the shareholders in the transaction described in this paragraph) for those outstanding under the Plan. In the event any surviving corporation or acquiring corporation refuses to assume or continue such Stock Awards or to substitute similar stock awards for those outstanding under the Plan, then with respect to Stock Awards held by Participants whose Service has not terminated, the vesting of such Stock Awards (and, if applicable, the time during which such Stock Awards may be exercised) shall be accelerated in full, and the Stock Awards shall terminate if not exercised (if applicable) at or prior to such event. With respect to any other Stock Awards outstanding under the Plan, such Stock Awards shall terminate if not exercised (if applicable) prior to such event.

(c) TERMINATION OF SERVICE FOLLOWING A CHANGE IN CONTROL. Unless otherwise specified in the applicable Stock Award Agreement, in the event of the occurrence of a Change in Control and provided that a participant's Stock Award remains in effect following such Change in Control or is assumed, continued or substituted for any similar stock award in connection with the Change in Control, then, if such participant's Service is terminated by the

Corporation without Cause within thirteen (13) months following the effective date of the Change in Control, all Stock Awards held by such participant (or

any substituted stock awards) shall, as of the date of such termination of Service, vest in full and become fully exercisable (if applicable) to the extent not previously vested or exercisable. Such Stock Awards shall remain exercisable until they expire in accordance with their terms. For the purposes of this section, Cause shall have the same meaning as is defined in Article II, Section 1(c)(4).

(d) SECURITIES ACQUISITION. In the event of an acquisition by any person, entity or group within the meaning of Section 13(d) or 14(d) of the Exchange Act, or any comparable successor provisions (excluding any employee benefit plan, or related trust, sponsored or maintained by the Corporation or an Affiliate) of the beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act, or comparable successor rule) of securities of the Corporation representing at least fifty percent (50%) of the combined voting power entitled to vote in the election of Corporation's Board of Directors, then with respect to Stock Awards held by Participants whose Service has not terminated, the vesting of such Stock Awards (and, if applicable, the time during which such Stock Awards may be exercised) shall be accelerated in full. Such Stock Awards shall remain exercisable until they expire in accordance with their terms.

(e) PARACHUTE PAYMENTS. If any payment or benefit a Participant would receive in connection with a Change in Control from the Corporation or otherwise ("Payment") would (i) constitute a "parachute payment" within the meaning of Section 280G of the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) but for this sentence, be subject to the excise tax imposed by Section 4999 of the Code (the "Excise Tax"), then such Payment shall be reduced to the Reduced Amount. The "Reduced Amount" shall be either (x) the largest portion of the Payment that would result in no portion of the Payment being subject to the Excise Tax or (y) the largest portion, up to and including the total, of the Payment, whichever amount, after taking into account all applicable federal, state and local employment taxes, income taxes, and the Excise Tax (all computed at the highest applicable marginal rate), results in Participant's receipt, on an after-tax basis, of the greater amount of the Payment notwithstanding that all or some portion of the Payment may be subject to the Excise Tax. If a reduction in payments or benefits constituting "parachute payments" is necessary so that the Payment equals the Reduced Amount, reduction shall occur in the following order unless the Participant elects in writing a different order (PROVIDED, HOWEVER, that such election shall be subject to Corporation approval if made on or after the effective date of the Change of Control): reduction of cash payments; cancellation of accelerated vesting of stock awards; reduction of employee benefits. In the event that acceleration of vesting of stock award compensation is to be reduced, such acceleration of vesting shall be cancelled in the reverse order of the date of grant of the Participant's stock awards unless the Participant elects in writing a different order for cancellation.

The accounting firm engaged by the Corporation for general audit purposes as of the day prior to the effective date of the Change in Control shall perform the foregoing calculations. If the accounting firm so engaged by the Corporation is serving as accountant or auditor for the individual, entity or group effecting the Change in Control, the Corporation shall appoint a nationally recognized accounting firm to make the determinations required hereunder. The Corporation shall bear all expenses with respect to the determinations by such accounting firm required to be made hereunder.

The accounting firm engaged to make the determinations hereunder shall provide its calculations, together with detailed supporting documentation, to the Corporation and Participant within fifteen (15) calendar days after the date on which Participant's right to a Payment arises (if requested at that time by the Corporation or Participant) or at such other time as requested by the Corporation or Participant. If the accounting firm determines that no Excise Tax is payable with respect to a Payment, either before or after the application of the Reduced Amount, it shall furnish the Corporation and Participant with an opinion reasonably acceptable to Participant that no Excise Tax will be imposed with respect to such Payment. Any good faith determination of the accounting firm made hereunder shall be final, binding and conclusive upon the Corporation and Participant.

AMENDED AND RESTATED
INTERNAP NETWORK SERVICES CORPORATION
1999 STOCK INCENTIVE PLAN FOR NON-OFFICERS

(Originally adopted on June 28, 1999 as the CO SPACE Stock Incentive Plan, amended on December 22, 1999, January 11, 2000, and March 30, 2000 and assumed by InterNap Network Services Corporation in connection with the Merger Agreement dated May 26, 2000. Amended and Restated as the InterNAP Network Services Corporation 1999 STOCK INCENTIVE PLAN FOR NON-OFFICERS on September 20, 2000)

1. PURPOSE. This 1999 Stock Incentive Plan For Non-Officers (the "Plan") is intended to provide incentives: (a) to non-officer employees and consultants of InterNAP Network Services Corporation, a Delaware corporation (the "Company"), and any present or future parent or subsidiaries of the Company (collectively, "Related Corporations") by providing them with opportunities to purchase stock in the Company pursuant to Non-Qualified Stock Options ("NSOs") that do not qualify as Incentive Stock Options under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code") and (b) to non-officer employees and consultants of the Company and Related Corporations by providing them with opportunities to receive awards of stock in the Company whether such stock awards are in the form of bonus shares, deferred stock awards, or of performance share awards (the "Awards"), and (c) to non-officer employees and consultants of the Company and Related Corporations by providing them with opportunities to make direct purchases of restricted stock in the Company ("Restricted Stock Purchases"). Non-Qualified Options are referred to hereafter as "Option." Options, Awards and authorizations to make Restricted Stock Purchases are referred to hereafter individually as a "Stock Right" and collectively as "Stock Rights." Documents evidencing the award of Stock Rights may be referred to collectively as "Stock Rights Agreements." As used herein, the terms "parent" and "subsidiary" mean "parent corporation" and "subsidiary corporation", respectively, as those terms are defined in Section 424 of the Code.

2. ADMINISTRATION OF THE PLAN.

A. BOARD OR COMMITTEE ADMINISTRATION. The Plan shall be administered by the Board of Directors of the Company (the "Board"). The Board may appoint a Compensation Committee or a Stock Incentive Plan Committee (as the case may be, the "Committee") of two (2) or more of its members to administer the Plan and to grant Stock Rights hereunder, provided such Committee is delegated such powers in accordance with state law. (All references in this Plan to the "Committee" shall mean the Board if no such Compensation Committee or Stock Incentive Plan Committee has been so appointed).

B. AUTHORITY OF BOARD OR COMMITTEE. Subject to the terms of the Plan, the Committee shall have the authority to: (i) determine the employees of the Company and Related Corporations to whom Options may be granted; (ii) determine the time or times at which Options or Awards may be granted or Restricted Stock Purchases made; (iii) determine the exercise price of shares subject to each Option, which price shall not be less than the minimum price specified in paragraph 6, and the purchase price of shares subject to each Restricted Stock Purchase or Award; (iv) determine (subject to paragraph 7) the time or times when each Option shall become exercisable and the duration of the exercise period; (v) determine whether restrictions such as

repurchase options are to be imposed on shares subject to Options, Awards and Restricted Stock Purchases and the nature of such restrictions, if any; (vi) impose such other terms and conditions with respect to capital stock issued pursuant to Stock Rights not inconsistent with the terms of this Plan as it deems necessary or desirable; and (vii) interpret the Plan and prescribe and rescind rules and regulations relating to it.

The interpretation and construction by the Committee of any provisions of the Plan or of any Stock Right granted under it shall be final unless otherwise determined by the Board. The Committee may from time to time adopt such rules and regulations for carrying out the Plan as it may deem best. No member of the Board or the Committee shall be liable for any action or determination made in good faith with respect to the Plan or any Stock Right granted under it.

C. DELEGATION OF AUTHORITY TO GRANT AWARDS TO OFFICER. Without limiting the foregoing, the Board, in its discretion, may also delegate to a single officer of the Company who is a member of the Board (to the extent consistent with state law) all or part of the Board's or Committee's authority and duties with respect to the granting of Stock Rights to individuals. Such officer (the "Delegated Officer") shall act as a one member committee of the Board, and shall in any event be subject to the same limitations as are applicable to the Committee. References to the Committee in this Plan shall also include the Delegated Officer, but only to the extent consistent with the authorities and duties delegated to the Delegated Officer by the Board. The Board may revoke or amend the terms of a delegation at any time but such action shall not invalidate any prior actions of the Delegated Officer that were consistent with the terms of the Plan.

D. COMMITTEE ACTIONS. The Committee may select one of its members as its chairman and shall hold meetings at such time and places as it may determine. Acts by a majority of the Committee, acting at a meeting (whether held in person or by teleconference), or acts reduced to or approved in writing by all of the members of the Committee, shall be the valid acts of the Committee. From time to time the Board may increase the size of the Committee and appoint additional members thereof, remove members (with or without cause) and appoint new members in substitution therefor, fill vacancies however caused, or remove all members of the Committee and thereafter directly administer the Plan, subject to compliance with paragraph 2A.

3. ELIGIBLE EMPLOYEES AND OTHERS. Stock Rights may be granted to any employee, consultant or advisor of the Company or any Related Corporation. However, notwithstanding any other provision herein to the contrary, no person shall be eligible for a Stock Right under the Plan (i) who holds a position of vice president or higher of the Company or Related Corporations, (ii) who would be considered an "officer" or " director" within the meaning of those terms under Rule 4460(i)(1)(A) of the National Association of Securities Dealers Manual (or such amended or successor rule), (iii) who would be considered a person subject to Section 16b of the Exchange Act of 1934, as amended (and regulations promulgated thereunder), or (iv) whose eligibility would require approval of the Plan by the stockholders of the Company under any law or regulation or the rules of any stock exchange or market system upon which the Common Stock may then be listed. If not inconsistent with any such law, regulation or rule, a Stock Right may be granted to a person, not previously employed by the Company or a Related Corporation, as an inducement essential to entering into an employment contract with the Company or a Related Corporation.

The Committee may take into consideration a recipient's individual circumstances in determining whether to grant a Stock Right. Granting a Stock Right to any individual or entity shall neither entitle that individual or entity to, nor disqualify him from, participation in any other grant of Stock Rights.

4. STOCK. The stock subject to Stock Rights shall be the common stock of the Company (the "Common Stock"), or shares of Common Stock reacquired by the Company in any manner. The aggregate number of shares which may be issued pursuant to the Plan is 1,346,840, subject to adjustment as provided in paragraph 13.

5. GRANTING OF STOCK RIGHTS. Stock Rights may be granted under the Plan at any time after June 29, 1999 and prior to June 28, 2009. The date of grant of a Stock Right under the Plan will be the date specified by the Committee at the time it grants the Stock Right or such date that is specified in the instrument or agreement evidencing such Stock Right; provided, however, that such date shall not be prior to the date on which the Committee acts to

approve the grant.

6. MINIMUM OPTION PRICE.

A. PRICE FOR INCENTIVE STOCK OPTIONS. Incentive Stock Options shall not be granted under this Plan.

B. DETERMINATION OF FAIR MARKET VALUE. "Fair Market Value" shall be determined as of the last business day for which the prices or quotes discussed in this sentence are available prior to the date such Option is granted and shall mean (i) the average (on that date) of the high and low prices of the Common Stock on the principal national securities exchange on which the Common Stock is traded, if the Common Stock is then traded on a national securities exchange; or (ii) the last reported sale price (on that date) of the Common Stock on the NASDAQ National Market List, if the Common Stock is not then traded on a national securities exchange; or (iii) the closing bid price (or average of bid prices) last quoted (on that date) by an established quotation service for over-the-counter securities, if the Common Stock is not then traded on a national securities exchange and is not reported on the NASDAQ National Market List.

7. OPTION DURATION. Subject to earlier termination as provided in paragraphs 9, 10, and 13, each Option shall expire on the date specified by or shall have such duration as may be specified by the Committee and set forth in the original stock option agreement granting such Option, but not more than ten years from the date of grant. Options shall expire on the date specified in the agreement granting such Options, subject to extension as determined by the Committee.

8. EXERCISE OF OPTION. Subject to the provisions of paragraphs 9 through 13, each Option granted under the Plan shall be exercisable as follows:

A. VESTING. Unless otherwise specified by the Committee, Options granted to employees shall vest in accordance with the following schedule: (a) as to 25% of the shares subject to the Option, on the first anniversary of the date of grant of the Option; and (b) as to the remaining 75% of the shares subject to the Option, in 36 equal monthly installments (such monthly vesting dates shall commence one months following such first annual anniversary on

the exact day of the month as the date of such first annual anniversary, and continue at one month intervals thereafter, except with respect to any month that does not have such date, in which case the date in such month shall be the last day of such month). The Committee may also specify such other conditions precedent as it deems appropriate to the exercise of an Option.

B. FULL VESTING OF INSTALLMENTS. Once an installment becomes exercisable it shall remain exercisable until expiration or termination of the Option, unless otherwise specified by the Committee.

C. PARTIAL EXERCISE. Each Option or installment may be exercised at any time or from time to time, in whole or in part, for up to the total number of shares with respect to which it is then exercisable, provided that the Committee may specify a certain minimum number or percentage of the shares issuable upon exercise of any Option that must be purchased upon any exercise.

D. ACCELERATION OF VESTING. The Committee shall have the right to accelerate the date of exercise of any installment of any Option, despite the fact that such acceleration may cause the application of Sections 280G and 4999 of the Code if a Change in Control Event, as defined below in paragraph 13C, occurs.

9. TERMINATION OF EMPLOYMENT. Nothing in the Plan shall be deemed to give any grantee of any Stock Right the right to be retained in employment or other service by the Company or any Related Corporation for any period of time.

Notwithstanding anything contained in this paragraph 9 to the contrary,

the Board or Committee may establish rules in particular stock option agreements with respect to Misconduct, committed by a grantee of a Stock Right. Misconduct shall have the same meaning as the term Cause, as defined below.

In the event that grantee's Service terminates (other than upon death or Disability or for Cause), the grantee may exercise his or her Option (to the extent that the grantee was entitled to exercise such Option as of the date of termination) but only within such period of time ending on the earlier of (i) the date three (3) months following the termination of the grantee's Service, or (ii) the expiration of the term of the Option as set forth in the Option. If, after termination, the grantee does not exercise his or her Option within the time specified in the Option, the Option shall terminate. In the event an grantee's Service terminates for Cause, then his or her Option shall terminate immediately upon such event.

10. DEATH; DISABILITY.

A. DEATH. If an optionee ceases to be employed by the Company and all Related Corporations by reason of his death, or if the employee dies within the thirty (30) day period after the employee ceases to be employed by the Company and all Related Corporations, any Option of his may be exercised, to the extent of the number of shares with respect to which he could have exercised it on the date of his death, by his estate, personal representative or beneficiary who has acquired the Option by will or by the laws of descent and distribution, at any time prior to the earlier of the specified expiration date of the Option or one hundred and eighty (180) days from the date of such optionee's death.

B. DISABILITY. If an optionee ceases to be employed by the Company and all Related Corporations by reason of his disability, he shall have the right to exercise any Option held by him on the date of termination of employment, to the extent of the number of shares with respect to which he could have exercised it on that date, at any time prior to the earlier of the specified expiration date of the Option or one (1) year from the date of the termination of the optionee's employment. For the purposes of the Plan, the term "disability" shall mean "permanent and total disability" as defined in Section 22(e)(3) of the Code or successor statute.

11. ASSIGNABILITY. Except for Options which may be transferred for estate planning purposes to the extent provided in the instrument or agreement granting such Options, no Stock Right shall be assignable or transferable by the grantee except by will or by the laws of descent and distribution, and during the lifetime of the grantee each Stock Right shall be exercisable only by him. No Stock Right, nor the right to exercise any portion thereof, shall be subject to execution, attachment, or similar process, assignment, or any other alienation or hypothecation. Upon any attempt so to transfer, assign, pledge, hypothecate, or otherwise dispose of any Stock Right, or of any right or privilege conferred thereby, contrary to the provisions thereof or hereof or upon the levy of any attachment or similar process upon any Stock Right, right or privilege, such Stock Right and such rights and privileges shall immediately become null and void. The foregoing shall not be construed to restrict the ability to assign or transfer shares of Common Stock issued upon the exercise or award of a Stock Right to the extent that the instrument or agreement granting such Stock Right permits such assignment or transfer.

12. TERMS AND CONDITIONS OF STOCK RIGHTS. Stock Rights shall be evidenced by instruments (which need not be identical) in such forms as the Committee may from time to time approve. Such instruments shall conform to the terms and conditions set forth in paragraphs 6 through 11 hereof to the extent applicable and may contain such other provisions as the Committee deems advisable which are not inconsistent with the Plan. Without limiting the foregoing, such provisions may include transfer restrictions, rights of refusal, vesting provisions, and repurchase rights with respect to shares of Common Stock issuable upon exercise of Stock Rights, and such other restrictions applicable to shares of Common Stock issuable upon exercise of Stock Rights as the Committee may deem appropriate. The Committee may from time to time confer authority and responsibility on one or more of its own members and/or one or more officers of the Company to execute and deliver

such instruments. The proper officers of the Company are authorized and directed to take any and all action necessary or advisable from time to time to carry out the terms of such instruments.

13. ADJUSTMENTS. Upon the occurrence of any of the following events, an individual's rights with respect to Stock Rights granted to him hereunder shall be adjusted as hereinafter provided, unless otherwise specifically provided in the written agreement between the optionee and the Company relating to such Stock Right:

A. CAPITALIZATION ADJUSTMENTS. If any change is made in the Common Stock subject to the Plan, or subject to any Stock Rights, without the receipt of consideration by the Company (through merger, consolidation, reorganization, recapitalization, reincorporation, stock dividend, dividend in property other than cash, stock split, liquidating dividend, combination of shares, exchange of shares, change in corporate structure or other transaction not involving the receipt of consideration by the Company), the Plan will be appropriately adjusted in the class(es)

and maximum number of securities subject to the Plan pursuant to subsection 4 and the outstanding Stock Rights will be appropriately adjusted in the class(es) and number of securities and price per share of Common Stock subject to such outstanding Stock Rights. The Board shall make such adjustments, and its determination shall be final, binding and conclusive. (The conversion of any convertible securities of the Company shall not be treated as a transaction "without receipt of consideration" by the Company.)

B. DISSOLUTION OR LIQUIDATION. In the event of a dissolution or liquidation of the Company, then all outstanding Stock Rights shall terminate immediately prior to such event.

C. CERTAIN CHANGES IN CONTROL. In the event of (i) a sale, lease or other disposition of all or substantially all of the assets of the Company, (ii) a merger or consolidation in which the Company is not the surviving corporation or (iii) a reverse merger in which the Company is the surviving corporation but the shares of Common Stock outstanding immediately preceding the merger are converted by virtue of the merger into other property, whether in the form of securities, cash or otherwise (collectively, a "Change in Control" or "Corporate Transaction"), then any surviving corporation or acquiring corporation may assume or continue any Stock Rights outstanding under the Plan or may substitute similar stock awards (including an award to acquire the same consideration paid to the shareholders in the transaction described in this subsection 13C) for those outstanding under the Plan. In the event any surviving corporation or acquiring corporation refuses to assume or continue such Stock Rights or to substitute similar stock awards for those outstanding under the Plan, then with respect to Stock Rights held by participants whose Service has not terminated, the vesting of such Stock Rights (and, if applicable, the time during which such Stock Rights may be exercised) shall be accelerated in full, and the Stock Rights shall terminate if not exercised (if applicable) at or prior to such event. With respect to any other Stock Rights outstanding under the Plan, such Stock Rights shall terminate if not exercised (if applicable) prior to such event.

D. TERMINATION OF SERVICE FOLLOWING A CHANGE IN CONTROL. Unless otherwise specified in the applicable Stock Rights Agreement, in the event of the occurrence of a Change in Control and provided that a participant's Stock Right remains in effect following such Change in Control or is assumed, continued or substituted for any similar stock award in connection with the Change in Control, then, if such participant's Service is terminated by the Company without Cause within thirteen (13) months following the effective date of the Change in Control, all Stock Rights held by such participant (or any substituted stock awards) shall, as of the date of such termination of Service, vest in full and become fully exercisable (if applicable) to the extent not previously vested or exercisable. Such Stock Rights shall remain exercisable until they expire in accordance with their terms.

The term "Cause" shall have such meaning as is defined in the grantee's employment or consulting agreement with the Company or a Related Corporation. If the grantee does not have an employment or consulting agreement with the Company or a Related Corporation, or if such agreement does not define the

term "cause," then the term "cause" shall mean: (i) misconduct or dishonesty that materially adversely affects the Company or a Related Corporation, including without limitation (A) an act materially in conflict with the financial interests of the Company or a Related Corporation, (B) an act that could damage the reputation or customer relations of the Company or a Related Corporation, (C) an act that could subject the Company or a Related

Corporation to liability, (D) an act constituting sexual harassment or other violation of the civil rights of coworkers, (E) failure to obey any lawful instruction of the Board or any officer of the Company or of a Related Corporation and (F) failure to comply with, or perform any duty required under, the terms of any confidentiality, inventions or non-competition agreement the grantee may have with the Company or a Related Corporation, or (ii) acts constituting the unauthorized disclosure of any of the trade secrets or confidential information of the Company or a Related Corporation, unfair competition with the Company or a Related Corporation or the inducement of any customer of the Company or a Related Corporation to breach any contract with the Company or a Related Corporation. The right to exercise any Option shall be suspended automatically during the pendency of any investigation by the Board or its designee, and/or any negotiations by the Board or its designee and the grantee, regarding any actual or alleged act or omission by the grantee of the type described in this section.

The term "Service" means the performance of services for the Company or a Related Corporation by an individual. An individual shall be deemed to remain in Service for so long as such individual renders services to the Company or a Related Corporation on a periodic basis in the capacity of an employee or an independent consultant or advisor.

E. SECURITIES ACQUISITION. In the event of an acquisition by any person, entity or group within the meaning of Section 13(d) or 14(d) of the Exchange Act of 1934, as amended (the "Exchange Act"), or any comparable successor provisions (excluding any employee benefit plan, or related trust, sponsored or maintained by the Company or an Affiliate) of the beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act, or comparable successor rule) of securities of the Company representing at least fifty percent (50%) of the combined voting power entitled to vote in the election of Directors, then with respect to Stock Rights held by participants whose Service has not terminated, the vesting of such Stock Rights (and, if applicable, the time during which such Stock Rights may be exercised) shall be accelerated in full. Such Stock Rights shall remain exercisable until they expire in accordance with their terms.

F. PARACHUTE PAYMENTS. If any payment or benefit participant would receive in connection with a Change in Control from the Company or otherwise ("Payment") would (i) constitute a "parachute payment" within the meaning of Section 280G of the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) but for this sentence, be subject to the excise tax imposed by Section 4999 of the Code (the "Excise Tax"), then such Payment shall be reduced to the Reduced Amount. The "Reduced Amount" shall be either (x) the largest portion of the Payment that would result in no portion of the Payment being subject to the Excise Tax or (y) the largest portion, up to and including the total, of the Payment, whichever amount, after taking into account all applicable federal, state and local employment taxes, income taxes, and the Excise Tax (all computed at the highest applicable marginal rate), results in paraticipant's receipt, on an after-tax basis, of the greater amount of the Payment notwithstanding that all or some portion of the Payment may be subject to the Excise Tax. If a reduction in payments or benefits constituting "parachute payments" is necessary so that the Payment equals the Reduced Amount, reduction shall occur in the following order unless the participant elects in writing a different order (provided, however, that such election shall be subject to Company approval if made on or after the effective date of the Change of Control): reduction of cash payments; cancellation of accelerated vesting of stock awards; reduction of employee benefits. In the event

that acceleration of vesting of stock award compensation is to be reduced, such acceleration of vesting shall be cancelled in the reverse order of the date of grant of the participant's stock awards unless the participant elects in writing a different order for cancellation.

The accounting firm engaged by the Company for general audit purposes as of the day prior to the effective date of the Change in Control shall perform the foregoing calculations. If the accounting firm so engaged by the Company is serving as accountant or auditor for the individual, entity or group effecting the Change in Control, the Company shall appoint a nationally recognized accounting firm to make the determinations required hereunder. The Company shall bear all expenses with respect to the determinations by such accounting firm required to be made hereunder.

The accounting firm engaged to make the determinations hereunder shall provide its calculations, together with detailed supporting documentation, to the Company and participant within fifteen (15) calendar days after the date on which participant's right to a Payment arises (if requested at that time by the Company or participant) or at such other time as requested by the Company or participant. If the accounting firm determines that no Excise Tax is payable with respect to a Payment, either before or after the application of the Reduced Amount, it shall furnish the Company and participant with an opinion reasonably acceptable to participant that no Excise Tax will be imposed with respect to such Payment. Any good faith determination of the accounting firm made hereunder shall be final, binding and conclusive upon the Company and participant.

G. ISSUANCES OF SECURITIES AND NON-STOCK DIVIDENDS. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares subject to Options. No adjustments shall be made for dividends paid in cash or in property other than securities of the Company (and, in the case of securities of the Company, such adjustments shall be made pursuant to the foregoing subparagraph A).

H. FRACTIONAL SHARES. No fractional shares shall be issued under the Plan, and the optionee shall receive from the Company cash in lieu of such fractional shares.

I. ADJUSTMENTS. Upon the happening of any of the foregoing events described in subparagraphs A, B or C above, the class and aggregate number of shares set forth in paragraph 4 hereof that are subject to Stock Rights which previously have been or subsequently may be granted under the Plan shall also be appropriately adjusted to reflect the events described in such subparagraphs. The Committee or the board of directors of the surviving entity shall determine the specific adjustments to be made under this paragraph 13 and its determination shall be conclusive.

If any person or entity owning Common Stock obtained by exercise of a Stock Right made hereunder receives shares or securities or cash in connection with a corporate transaction described in this section as a result of owning such Common Stock, such shares or securities or cash shall be subject to all of the conditions and restrictions applicable to the Common Stock

with respect to which such shares or securities or cash were issued, unless otherwise determined by the Committee or the Board of Directors of the surviving entity.

J. POOLING-OF-INTERESTS ACCOUNTING. If the Company proposes to engage in a Corporate Transaction or Change in Control intended to be accounted for as a pooling-of-interests, and in the event that the provisions of this Plan or of any agreement hereunder, or any actions of the Board taken in connection with such Corporate Transaction or Change in Control, are determined by the Company's or the surviving entity's independent public accountants to cause such Change in Control or Corporate Transaction to fail to be accounted for as a pooling-of-interests, then such provisions or actions may be amended or rescinded at the election of the Committee, without

the consent of any grantee, to be consistent with pooling-of-interests accounting treatment for such Corporate Transaction or Change in Control.

14. MEANS OF EXERCISING OPTIONS. An Option (or any part or installment thereof) shall be exercised by giving written notice to the Company at its principal office address. Such notice shall identify the Option being exercised and specify the number of shares as to which such Option is being exercised, accompanied by full payment of the purchase price therefor either (a) in United States dollars in cash or by check, or (b) at the discretion of the Committee, by delivery of an irrevocable and unconditional undertaking, satisfactory in form and substance to the Company, by a creditworthy broker to deliver promptly to the Company sufficient funds to pay the exercise price, or delivery to the Company of a copy of irrevocable and unconditional instructions, satisfactory in form and substance to the Company, to a creditworthy broker to deliver promptly to the Company cash or a check sufficient to pay the exercise price, or (c) at the discretion of the Committee through delivery of shares of Common Stock having a fair market value equal as of the date of the exercise to the cash exercise price of the Option, provided, however, that such shares of Common Stock delivered must have been acquired by the holder of the Option more than six months prior to the exercise of the Option, or (d) at the discretion of the Committee, by delivery of the grantee's personal recourse note bearing interest payable not less than annually at no less than 100% of the applicable Federal rate, as defined in Section 1274(d) of the Code, or (e) at the discretion of the Committee, by any combination of (a), (b) (c) and (d) above. The holder of an Option shall not have the rights of a shareholder with respect to the shares covered by his Option until the date of issuance of a stock certificate to him for the shares subject to the Option. Except as expressly provided above in paragraph 13 with respect to changes in capitalization and stock dividends, no adjustment shall be made for dividends or similar rights for which the record date is before the date such stock certificate is issued.

15. TERM AND AMENDMENT OF PLAN. The Plan shall expire on June 28, 2009 (except as to Options outstanding on that date). The Board may terminate or amend the Plan in any respect at any time; provided, however that Stock Rights outstanding on such date shall not be affected by the termination of the Plan.

16. SECTION 162(m): Section 162(m) does not apply to grants of Stock Rights under this Plan.

17. AMENDMENT OF STOCK RIGHTS. The Board or Committee may amend, modify or terminate any outstanding Stock Rights including, but not limited to, substituting therefor another Stock Right of the same or a different type, and changing the date of exercise or

realization, provided, that, except as otherwise provided in paragraphs 9 or 10, the grantee's consent to such action shall be required unless the Board or Committee determines that the action, taking into account any related action, would not materially and adversely affect the grantee.

18. APPLICATION OF FUNDS. The proceeds received by the Company from the sale of shares pursuant to Options granted and Restricted Stock Purchases authorized under the Plan shall be used for general corporate purposes.

19. GOVERNMENTAL REGULATION. The Company's obligation to sell and deliver shares of the Common Stock under this Plan is subject to the approval of any governmental authority required in connection with the authorization, issuance or sale of such shares.

20. WITHHOLDING OF ADDITIONAL INCOME TAXES. Upon the exercise of a Non-Qualified Option, the making of a Restricted Stock Purchase for less than its fair market value, the granting of an Award, or the vesting of restricted Common Stock acquired on the exercise of a Stock Right hereunder, the Company, in accordance with Section 3402(a) of the Code, may require the grantee or purchaser to pay additional withholding taxes in respect of the amount that is considered compensation includible in such person's gross income. The Committee in its discretion may condition (i) the exercise of an Option, (ii) the making of a Restricted Stock Purchase for less than its fair market value, (iii) the granting of an Award, or (iv) the vesting of

restricted Common Stock acquired by exercising a Stock Right, on the grantee's payment of such additional withholding taxes.

21. GOVERNING LAW; CONSTRUCTION. The validity and construction of the Plan and the instruments evidencing Options shall be governed by the laws of the state of Washington. In construing this Plan, the singular shall include the plural and the masculine gender shall include the feminine and neuter, unless the context otherwise requires.

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