MCLEODUSA INC
Form PRES14A
December 11, 2001

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SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant /x/
Filed by a Party other than the Registrant / /

Check the appropriate box:

/x/ Preliminary Proxy Statement
/ / **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
/ / Definitive Proxy Statement
/ / Definitive Additional Materials
/ / Soliciting Material Pursuant to §240.14a-12

MCLEODUSA INCORPORATED

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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(1) Amount Previously Paid:

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(2) Form, Schedule or Registration Statement No.:

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(3) Filing Party:

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(4) Date Filed:

MCLEODUSA INCORPORATED
MCLEODUSA TECHNOLOGY PARK
6400 C STREET SW, P.O. BOX 3177
CEDAR RAPIDS, IOWA 52406-3177
(319) 364-0000

December [ ], 2001

Dear Stockholder:

You are cordially invited to attend a special meeting of the stockholders of McLeodUSA Incorporated. The meeting will be held on January 14, 2002 at 10:00 a.m., local time, at [ ].

We have initiated a broad strategic and operational restructuring to re-focus our business on our core areas of expertise within our 25-state footprint, improve business disciplines and processes and reduce our cost structure, all with a goal of eventually developing positive cash flow from operations. Key elements of the operational restructuring include reducing our employee base, consolidating facilities, reducing capital expenditures, selling certain non-core assets and de-emphasizing certain unprofitable services. Given the magnitude of the operational restructuring, particularly in light of the uncertain general economic environment and the challenging conditions facing competitive telecommunications companies, prudence dictates that we address our highly leveraged balance sheet and develop a restructuring plan to reduce our debt load. In that regard, we formed an independent special committee of our board of directors, which excludes management and Forstmann Little & Co. and its affiliates (collectively, "Forstmann Little"), and a comprehensive financial restructuring was negotiated in which Forstmann Little sponsors a number of transactions to effectuate a substantial deleveraging of McLeodUSA.

The material elements of the restructuring include:

- Forstmann Little will purchase our directory publishing business for $535 million, subject to higher bids and without a break-up fee. Forstmann Little's commitment is subject to consummation of the restructuring.

- Forstmann Little will make a new money investment of $100 million for (i) new convertible preferred stock that is mandatorily convertible into our Class A common stock and (ii) new warrants to purchase approximately 5% of our Class A common stock.

Our senior notes, in an aggregate principal and accreted amount of approximately $2.9 billion, will be exchanged for $560 million in cash and 56,813,984 shares of our Class A common stock, representing approximately 15% of our Class A common stock following the restructuring (subject to dilution).

Our outstanding Series A preferred stock, which has a liquidation preference plus accrued dividends of approximately $300 million, will be reclassified into 44,883,856 shares of our Class A common stock, representing approximately 11.9% of our Class A common stock following the restructuring (subject to dilution).

Our Series D and E preferred stock, which has an aggregate liquidation preference of $1 billion and is owned by Forstmann Little, will be reclassified into 151,515,152 shares of our Class A common stock, representing approximately 40% of our Class A common stock following the restructuring (subject to dilution).

Our outstanding Class A common stock will be diluted to approximately 33.1% of our Class A common stock following the restructuring (subject to dilution).

A new management incentive plan will be implemented.

We are simultaneously pursuing the financial restructuring via two alternative mechanisms: (1) the out-of-court alternative and (2) the in-court alternative.

The consummation of the out-of-court alternative is conditioned upon approval by the requisite vote of our stockholders of the proposals described in the attached Proxy/Disclosure Statement and Solicitation of Acceptances, the tender and exchange of at least 95% of the aggregate principal and accreted amount of the senior notes via a separate exchange offer we commenced on December 7, 2001, and the satisfaction of certain other conditions.

If, however, for any reason, we determine that it would be more advantageous or expeditious, we will consider effectuating the restructuring by filing a voluntary petition for relief under Chapter 11 of the Bankruptcy Code and seeking court approval of the restructuring. To facilitate approval of the in-court alternative, we are soliciting acceptances of our Chapter 11 plan of reorganization, a copy of which is attached hereto as Appendix I. The plan, if approved, would result in the same consideration to stockholders as they would receive in the out-of-court restructuring. Our board of directors has not at this time taken any corporate action approving a bankruptcy filing or in furtherance thereof.

The special committee of our board of directors and the disinterested members of our board of directors have unanimously approved the restructuring and recommend that you vote FOR approval of the restructuring proposals described in the attached Proxy/Disclosure Statement and Solicitation of Acceptances.

Sincerely,

Clark E. McLeod
Chairman of the Board of Directors

PRELIMINARY COPY

MCLEODUSA INCORPORATED

McLeodUSA Technology Park
6400 C Street SW, P.O. Box 3177
Cedar Rapids, Iowa 52406-3177
(319) 364-0000

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS

TO BE HELD ON JANUARY 14, 2002

NOTICE IS HEREBY GIVEN that a special meeting of common stockholders and preferred stockholders of McLeodUSA Incorporated ("McLeodUSA") will be held on January 14, 2002, at 10:00 a.m., local time, at [ ] (the "Special Meeting"), for the purpose of considering and voting upon the following, all of which are more fully described in the attached Proxy/Disclosure Statement and Solicitation of Acceptances (the "Proxy/Disclosure Statement"):

(1) Series A Reclassification Proposal. To approve an amendment to our certificate of incorporation in order to provide for the reclassification of our Series A preferred stock into Class A common stock on a basis of 39.05 shares of Class A common stock for each share of Series A preferred stock (based on the $250 liquidation preference per share of the Series A preferred stock plus accrued dividends and 627,734,497 shares of Class A common stock outstanding);

(2) Series D Reclassification Proposal. To approve an amendment to our certificate of incorporation in order to provide for the reclassification of our Series D preferred stock into Class A common stock on a basis of 378.79 shares of Class A common stock for each share of Series D preferred stock (based on the $2,500 liquidation preference per share of the Series D preferred stock and 627,734,497 shares of Class A common stock outstanding);

(3) Series E Reclassification Proposal. To approve an amendment to our certificate of incorporation in order to provide for the reclassification of our Series E preferred stock into Class A common stock on a basis of 378.79 shares of Class A common stock for each share of Series E preferred stock (based on the $2,500 liquidation preference per share of the Series E preferred stock and 627,734,497 shares of Class A common stock outstanding);

(4) Reverse Stock Split Proposal. To approve an amendment to our certificate of incorporation in order to provide for a 5-to-1 reverse stock split of each outstanding share of our Class A common stock into one-fifth of a share of Class A common stock (meaning the approximately 627,734,497 shares of our outstanding Class A common stock will be converted into approximately 125,546,898 shares);

(5) Section 203 Proposal. To approve an amendment to our certificate of incorporation in order to eliminate certain anti-takeover provisions by electing that we not be subject to Section 203 of the Delaware General Corporation Law, which deals with business combinations with interested stockholders;

(6) Issuance Proposal. To approve the issuance of our Class A common stock, including the issuance of:

(a) shares of Class A common stock issuable upon conversion of 10,000,000 shares of a new class of mandatorily convertible preferred stock to be issued to Forstmann Little;

(b) shares of Class A common stock issuable upon the exercise of 18,937,995 new warrants being issued to Forstmann Little in connection with the issuance of the new class of mandatorily convertible preferred stock;

(c) 56,813,984 shares of Class A common stock to holders of McLeodUSA's senior notes pursuant to the exchange offer;

(d) 196,399,008 shares of Class A common stock, in the aggregate, in connection with the Series A reclassification, the Series D reclassification and the Series E reclassification;

(7) Management Incentive Plan Proposal. To approve the adoption of the McLeodUSA 2001 Omnibus Equity Plan; and

(8)

Other Business. To approve such other business as may properly be raised at the Special Meeting or any adjournments or postponements thereof.

The Series A reclassification proposal, Series D reclassification proposal, Series E reclassification proposal, reverse stock split proposal, Section 203 proposal, issuance proposal and management incentive plan proposal are collectively referred to herein and in the attached Proxy/Disclosure Statement as the "restructuring proposals." Effectiveness of each of the restructuring proposals is conditioned upon approval of all the other restructuring proposals and other conditions discussed more fully in the attached Proxy/Disclosure Statement.

We are seeking the approval of the restructuring proposals in connection with our proposed financial restructuring. The proposed text of the amendments to our certificate of incorporation necessary to effect the Series A, D and E reclassification proposals, the reverse stock split proposal and the Section 203 proposal are set forth in Appendex III to the attached Proxy/Disclosure Statement.

All stockholders are also being asked to indicate their acceptance of a plan of reorganization of McLeodUSA under Chapter 11 of the United States Bankruptcy Code which would, if approved, result in the same consideration to all parties as such parties would receive through the out-of-court alternative. The terms of the plan are described under "The Plan" section in the attached Proxy/Disclosure Statement. Our board of directors has not at this time taken any corporate action approving a bankruptcy filing or in furtherance thereof.

Our board of directors has fixed the close of business on December [ ], 2001 as the voting record date for the determination of stockholders entitled to notice of and to vote at the Special Meeting and any adjournments or postponements thereof. Only stockholders of record at the close of business on such date are entitled to notice of and to vote at the Special Meeting.

Your vote is important regardless of the number of shares you own. Each stockholder, even if he or she now plans to attend the Special Meeting, is requested to sign, date and return the enclosed proxy, without delay in the enclosed postage-paid envelope marked "Proxy" or vote by telephone or over the Internet in accordance with the directions contained on the proxy card. You may revoke your proxy at any time prior to its exercise. Any stockholder present at the Special Meeting or at any adjournments or postponements thereof may revoke his or her proxy and vote personally on each matter brought before the Special Meeting.

All stockholders should also vote on the plan of reorganization by signing, marking and returning the enclosed ballot for that purpose in the enclosed envelope marked "Ballot."

By Order of the Board of Directors,
[________________________]

DECEMBER [ ], 2001

THE SPECIAL COMMITTEE OF THE BOARD OF DIRECTORS AND THE DISINTERESTED MEMBERS OF THE BOARD OF DIRECTORS RECOMMEND THAT YOU VOTE FOR THE RESTRUCTURING PROPOSALS AND IN FAVOR OF THE PLAN.

PLEASE DATE AND SIGN THE ENCLOSED PROXY AND MAIL IT PROMPTLY IN THE ENCLOSED POSTAGE-PAID RETURN ENVELOPE MARKED "PROXY."

PLEASE DATE AND SIGN THE ENCLOSED BALLOT AND MAIL IT PROMPTLY IN THE ENCLOSED POSTAGE-PAID RETURN ENVELOPE MARKED "BALLOT."

MCLEODUSA INCORPORATED

PROXY/DISCLOSURE STATEMENT AND SOLICITATION OF ACCEPTANCES

This Proxy/Disclosure Statement and the accompanying form of proxy and ballot are first being mailed to stockholders on or about December [ ], 2001. We are soliciting your proxy to vote your shares at a Special Meeting of stockholders to be held on January 14, 2002, and any adjournment or postponement thereof. We solicit proxies to give all stockholders of record an opportunity to vote on the matters to be presented at the Special Meeting. In the following pages of this Proxy/Disclosure Statement, you will find information on these matters. This information is provided to assist you in voting your shares.

As of December [ ], 2001, there were [ ] shares of Class A common stock outstanding and entitled to vote, [ ] shares of Series A preferred stock outstanding and entitled to vote, [ ] shares of Series D preferred stock outstanding and entitled to vote, and [ ] shares of

Series E preferred stock outstanding and entitled to vote.

QUESTIONS AND ANSWERS

Q:

WHY ARE YOU SENDING THIS PROXY/DISCLOSURE STATEMENT TO STOCKHOLDERS?

A:

We are sending this Proxy/Disclosure Statement to seek stockholder approval of certain elements of our proposed financial restructuring, the major elements of which include:

An affiliate of Forstmann Little & Co. (Forstmann Little & Co., together with its affiliates, "Forstmann Little") will purchase our directory publishing business ("Pubco") for $535 million, subject to higher bids and without a break-up fee. Forstmann Little's commitment is subject to consummation of the restructuring.

Forstmann Little will make a new money investment of $100 million for (i) new convertible preferred stock that is mandatorily convertible into our Class A common stock and (ii) new warrants to purchase approximately 5% of our Class A common stock.

Our senior notes, in an aggregate principal and accreted amount of approximately $2.9 billion, will be exchanged for $560 million in cash and 56,813,984 shares of our Class A common stock, representing approximately 15% of the Class A common stock following the restructuring (subject to dilution).

Our outstanding Series A preferred stock, which has a liquidation preference plus accrued dividends of approximately $300 million, will be reclassified into 44,883,856 shares of our Class A common stock, representing approximately 11.9% of the Class A common stock following the restructuring (subject to dilution).

Our Series D and E preferred stock, which has an aggregate liquidation preference of $1 billion and is owned by Forstmann Little, will be reclassified into 151,515,152 shares of our Class A common stock, representing approximately 40% of our Class A common stock following the restructuring (subject to dilution).

Our outstanding Class A common stock will be diluted to approximately 33.1% of our Class A common stock following the restructuring (subject to dilution).

A new management incentive plan will be implemented.

See "Restructuring The Financial Restructuring;" " Agreement with Forstmann Little;" and " Management Incentive Plan."

Q:

WHY ARE YOU RESTRUCTURING MCLEODUSA'S CAPITAL STRUCTURE?

A.

Our proposed financial restructuring, and related restructuring proposals, are part of a larger strategic and operational restructuring through which we intend to reduce our outstanding debt, improve business practices and operational processes and improve our liquidity. We have determined that due to the significant uncertainties associated with our business plan, it is prudent that we address our capital structure and eliminate the debt service requirements of our senior notes. Otherwise, we believe that there is a risk of exhausting our available liquidity in the foreseeable future. While we considered other available restructuring alternatives, we believe that by offering our stockholders and the holders of our senior notes an ownership interest in a company with less debt having a committed sponsor, the restructuring provides the best available outcome for our stockholders and noteholders given the

circumstances.

See "Background."

Q:

WHAT ARE YOU ASKING STOCKHOLDERS TO DO?

A:

We are requesting that:

- Class A common stockholders approve the restructuring proposals;
- Series A preferred stockholders approve the Series A reclassification proposal; and
- Class A common stockholders and Series A, D and E preferred stockholders vote for the bankruptcy plan described in this Proxy/Disclosure Statement that provides the same consideration to stockholders that will result if the restructuring proposals are approved and the other conditions to the out-of-court restructuring are satisfied.

Forstmann Little, as the only Series D and E stockholder, has agreed to vote for the Series D reclassification proposal, Series E reclassification proposal and the bankruptcy plan.

See "Discussion of the Restructuring Proposals."

Q.

WHY ARE YOU ASKING STOCKHOLDERS TO VOTE ON THE BANKRUPTCY PLAN IN ADDITION TO VOTING FOR THE RESTRUCTURING PROPOSALS?

A.

We have prepared the bankruptcy plan as an alternate means to restructure our capital structure on terms that would result in the same consideration to stockholders that will result if the restructuring proposals are approved and the other conditions to the out-of-court restructuring are satisfied. If we conclude that it would be more advantageous or expeditious to us, we may file a bankruptcy case under Chapter 11 of the Bankruptcy Code. However, no decision has been made at this time to commence a bankruptcy case, and we reserve our right to pursue other strategic alternatives in the event the restructuring proposals are not approved or the other conditions to the out-of-court restructuring are not satisfied. Our board of directors has not at this time taken any corporate action approving a bankruptcy filing or in furtherance thereof.

Q.

WHAT ARE THE DIFFERENCES BETWEEN THE RESTRUCTURING PROPOSALS AND THE BANKRUPTCY PLAN?

A.

There is no difference in the consideration to be received by stockholders in the out-of-court restructuring and the bankruptcy plan. However, the voting thresholds for the bankruptcy plan are lower than the voting thresholds for the restructuring proposals.

Q.

WHAT VOTES ARE NEEDED TO APPROVE THE RESTRUCTURING PROPOSALS?

A.

Each of the restructuring proposals requires the following approvals:

- Series A Reclassification Proposal: (1) the affirmative vote of the majority of the outstanding shares of Class A common stock entitled to vote and (2) the affirmative vote of the majority of the outstanding shares of Series A preferred stock entitled to vote. Abstentions and broker non-votes will have the effect of a vote against the Series A reclassification proposal.

Series D Reclassification Proposal: (1) the affirmative vote of the majority of the outstanding shares of Class A common stock entitled to vote and (2) the affirmative vote of the majority of the outstanding shares of Series D preferred stock entitled to vote. Forstmann Little as the only holder of Series D preferred stock has agreed to vote for the Series D reclassification proposal. Abstentions and broker non-votes will have the effect of a vote against the Series D reclassification proposal.

Series E Reclassification Proposal: (1) the affirmative vote of the majority of the outstanding shares of Class A common stock entitled to vote and (2) the affirmative vote of the majority of the outstanding shares of Series E preferred stock entitled to vote. Forstmann Little as the only holder of Series E preferred stock has agreed to vote for the Series E reclassification proposal. Abstentions and broker non-votes will have the effect of a vote against the Series E reclassification proposal.

Reverse Stock Split Proposal: the affirmative vote of the majority of the outstanding shares of Class A common stock entitled to vote. Abstentions and broker non-votes will have the effect of a vote against the reverse stock split proposal.

Section 203 Proposal: the affirmative vote of the majority of the outstanding shares of Class A common stock entitled to vote. Abstentions and broker non-votes will have the effect of a vote against the Section 203 proposal.

Issuance Proposal: the affirmative vote of the majority of the outstanding shares of Class A common stock represented at the special meeting and entitled to vote. Abstentions will have the effect of a vote against the issuance proposal, while broker non-votes will have no effect.

Management Incentive Plan Proposal: the affirmative vote of the majority of the outstanding shares of Class A common stock represented at the special meeting and entitled to vote. Abstentions will have the effect of a vote against the management incentive plan proposal, while broker non-votes will have no effect.

See "Discussion of the Restructuring Proposals."

Q.

WHAT VOTES ARE NEEDED TO APPROVE THE BANKRUPTCY PLAN?

A.

The bankruptcy plan requires separate approval by each of the following classes:

the noteholders as a single class; and

the holders of Series A, D and E preferred stock as a single class.

The bankruptcy plan must be approved by holders of at least two-thirds in principal and accreted amount and a majority in number of those noteholders who vote on the bankruptcy plan, voting together as a single class, and by holders of at least two-thirds of the number of shares of preferred stock, voting together as a single class. Only votes that are actually cast are counted in determining whether these thresholds are met. McLeodUSA is requesting that all common stockholders vote on the bankruptcy plan. Absent a favorable vote on the bankruptcy plan by the common stockholders as a class, however, McLeodUSA reserves the right to seek approval of the

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bankruptcy plan from a Bankruptcy Court, notwithstanding any rejection, or deemed rejection, by such holders.

See "The Plan."

Q.
ARE THERE ANY OTHER CONDITIONS TO IMPLEMENTATION OF THE OUT-OF-COURT RESTRUCTURING?

A.
Yes:

we need to complete an exchange offer in which at least 95% of the aggregate principal and accreted amount of our senior notes are tendered and not withdrawn in order to implement the exchange offer and amend the senior notes;

we must consummate the sale of Pubco for at least $535 million;

we must consummate the sale of $100 million of new preferred stock and warrants to Forstmann Little; and

we must resolve all tax matters related to the restructuring in a manner satisfactory to us.

See "Terms and Conditions of the Exchange Offer and Consent Solicitation" and "Restructuring."

Q.
HOW WILL YOU RAISE THE CASH NECESSARY TO COMPLETE THE EXCHANGE OFFER?

A.
We will raise the necessary cash by:

selling Pubco for at least $535 million; and

selling to Forstmann Little mandatorily convertible preferred stock and warrants to purchase our Class A common stock for a total price of $100 million.

Q:
WHAT WILL I RECEIVE IN THE RESTRUCTURING?

A:
In the restructuring, (i) each outstanding share of Class A common stock will be converted into one-fifth of a share of Class A common stock, and (ii) each outstanding share of preferred stock will be converted into Class A common stock on a basis of (a) 39.05 shares of Class A common stock for each one share of Series A preferred stock (based on the $250 liquidation preference per share of the Series A preferred stock plus accrued dividends), and (b) 378.79 shares of Class A common stock for each one share of Series D and Series E preferred stock (based on the $2,500 liquidation preference per share of the Series D and Series E preferred stock). The conversion ratios set forth above for the preferred stock are based on 627,734,497 shares of Class A common stock issued and outstanding on November 5, 2001. Such conversion ratios will be adjusted to affect the post-restructuring ownership levels otherwise set forth herein, to the extent the issued and outstanding shares of Class A common stock differ at the closing of the restructuring.

See "Restructuring The Financial Restructuring."

Q.
WHY ARE THE SHARES OF CLASS A COMMON STOCK TO BE ISSUED TO ME "SUBJECT TO DILUTION?"

A:
The new preferred stock to be purchased by Forstmann Little mandatorily converts into a number of shares of our Class A common stock equal to $100 million divided by an average of the Class A common stock's post-restructuring trading prices, calculated by

taking the closing price per share of Class A common stock on 10 randomly selected trading days during the 60-day period following consummation of the exchange offer, discarding the two highest and the two lowest prices and taking the mathematical average of the remaining six prices. Therefore, the exact number of shares

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of Class A common stock to be issued to Forstmann Little in connection with the restructuring cannot be determined until the end of such 60-day period. The Class A common stock is subject to further dilution from future issuances of Class A common stock upon exercise of warrants issued to Forstmann Little and securities convertible into or exercisable for our Class A common stock under the management incentive plan.

Q.

WHAT PERCENTAGE OF MCLEODUSA WILL STOCKHOLDERS OWN?

A:

Initially, the common and preferred stockholders will own 33.1% and 51.9%, respectively, of our Class A common stock. Following the conversion of the new preferred stock issued to Forstmann Little, and assuming a post-restructuring equity value of $2.74 per share, the common and preferred stockholders will own approximately 30.2% and 47.3%, respectively, of our Class A common stock. The estimated post-restructuring equity value is based on a number of assumptions and is not intended to be an indication of future trading value. See "Restructuring The Financial Restructuring" and "Valuation Analysis."

Q:

IF YOU FILE A CHAPTER 11 PETITION IN BANKRUPTCY COURT, HOW WILL THAT AFFECT YOUR BUSINESS?

A:

We are comprised of a large group of affiliated companies. If we commence Chapter 11 proceedings, we expect that only our parent holding company, and perhaps one non-operating subsidiary, would actually file petitions. Because our business is conducted primarily through our operating subsidiaries, our holding company does not have any material ongoing business. Thus, our actual business operations generally should not be affected by any Chapter 11 filing. It is our intention to continue operating in the ordinary course of business, including by paying employees, trade creditors and certain other creditors according to normal terms.

Q:

WILL SHARES OF CLASS A COMMON STOCK AND SERIES A PREFERRED STOCK CONTINUE TO BE TRADED ON THE NASDAQ NATIONAL MARKET?

A:

Following the restructuring, we expect the Class A common stock to continue to trade on The Nasdaq National Market under its current symbol. The Series A preferred stock will be converted into Class A common stock.

Q:

WHAT DOES OUR SPECIAL COMMITTEE AND BOARD OF DIRECTORS RECOMMEND?

A:

The special committee of our board of directors and the disinterested members of our board of directors unanimously recommend that you execute the proxy in favor of the restructuring proposals so that we can proceed with the restructuring.

Q:

CAN I CHANGE MY VOTE?

A:

Yes. If you are a stockholder of record on December [   ] 2001, you may change your vote or revoke your proxy at any time before your shares are voted at the Special Meeting by:

voting again by telephone or over the Internet;

sending us a proxy card dated later than your last vote;

notifying the secretary of McLeodUSA in writing; or

voting at the Special Meeting.

Q: IF MY SHARES ARE HELD IN "STREET NAME" BY MY BROKER, WILL MY BROKER VOTE MY SHARES FOR ME?

A: Your broker will vote your shares only if you provide instructions to your broker on how to vote. You should follow the directions provided by your broker regarding how to instruct your broker to vote your shares. Without instructions to your broker, your shares will not be voted on the restructuring proposals and will have the same effect as a vote against the restructuring proposals, except for the issuance proposal and management incentive plan proposal, where such non-vote by your broker will have no effect on the outcome of such proposals.

Q: HOW DO I VOTE, AND WHAT DOCUMENTS SHOULD I SUBMIT, IF I AM A STOCKHOLDER VOTING ON THE RESTRUCTURING PROPOSALS OR THE PLAN?

A: You may vote by telephone, over the Internet or by following the instructions on the enclosed proxy card. If you choose to vote by telephone or over the Internet, you should follow the instructions on the proxy card. Otherwise, you should return your proxy card by mail. Delivery instructions are set forth on the back page of this Proxy/Disclosure Statement and on the proxy card. The proxies set forth in the proxy card will vote your shares in accordance with your directions. If you sign and return a proxy card but do not mark the boxes showing how you wish to vote, the proxies will vote your shares FOR the adoption of each of the restructuring proposals. Unsigned proxy cards will not be voted at all and will have the same effect as a vote against the restructuring proposals. If you are a stockholder of record (that is, if you are registered on our books), you may also vote in person by attending the meeting.

In addition, you should vote on the bankruptcy plan by submitting the enclosed ballot in accordance with the delivery instructions set forth on the back page of this Proxy/Disclosure Statement and the voting instructions included in the ballot.

Q: IS THE RESTRUCTURING TAXABLE TO ME?

A: The restructuring generally will be tax-free to stockholders. The material U. S. federal income tax consequences of the restructuring are described in more detail under "Material United States Federal Income Tax Considerations Consequences to Holders of Series A Preferred Stock or Class A Common Stock." The tax consequences to you will depend on the facts of your own situation. We urge you to consult your own tax advisor regarding the tax consequences to you of the restructuring.

Q: AM I ENTITLED TO APPRAISAL RIGHTS?

A: No. You will not be entitled to appraisal rights in connection with the restructuring.

Q: SHOULD I SEND MY STOCK CERTIFICATES NOW?

A: No. After we complete the restructuring, we will send instructions explaining how to exchange your certificates representing shares of Class A common stock and preferred stock.

Q: WHO CAN I CALL WITH QUESTIONS ABOUT VOTING?

A:

If you have any questions about submitting your proxy, voting on the restructuring proposals or voting on the bankruptcy plan or would like copies of any of the documents we refer to in this Proxy/Disclosure Statement, you should call Innisfree M&A Incorporated at (888) 750-5834, or banks and brokers should call collect at (212) 750-5833.

NONE OF (i) THE CLASS A COMMON STOCK, (ii) THE OUT-OF-COURT RESTRUCTURING (INCLUDING THE RESTRUCTURING PROPOSALS) NOR (iii) THE PLAN OF REORGANIZATION HAS BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION (THE "SEC") OR ANY STATE SECURITIES COMMISSION, NOR HAS THE SEC OR ANY STATE SECURITIES COMMISSION PASSED UPON THE FAIRNESS OR MERITS OF THESE TRANSACTIONS OR THE ACCURACY OR ADEQUACY OF THIS PROXY/DISCLOSURE STATEMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

THIS ACCEPTANCE SOLICITATION IS BEING CONDUCTED TO OBTAIN SUFFICIENT ACCEPTANCES OF THE PLAN OF REORGANIZATION *PRIOR* TO THE FILING OF A VOLUNTARY CASE UNDER CHAPTER 11 OF THE BANKRUPTCY CODE. BECAUSE NO CHAPTER 11 CASE HAS YET BEEN COMMENCED, THIS PROXY/DISCLOSURE STATEMENT HAS NOT BEEN APPROVED BY THE BANKRUPTCY COURT AS CONTAINING ADEQUATE INFORMATION WITHIN THE MEANING OF SECTION 1125(A) OF THE BANKRUPTCY CODE. THE BOARD OF DIRECTORS OF MCLEODUSA HAS NOT AT THIS TIME TAKEN ANY CORPORATE ACTION APPROVING A BANKRUPTCY FILING OR IN FURTHERANCE THEREOF.

THIS PROXY/DISCLOSURE STATEMENT CONSTITUTES NEITHER AN OFFER TO EXCHANGE NOR A SOLICITATION OF ACCEPTANCES IN ANY JURISDICTION IN WHICH, OR FROM ANY PERSON TO OR FROM WHOM, IT IS UNLAWFUL TO MAKE SUCH OFFER OR SOLICITATION UNDER APPLICABLE FEDERAL SECURITIES OR STATE SECURITIES LAWS. THE DELIVERY OF THIS PROXY/DISCLOSURE STATEMENT SHALL NOT UNDER ANY CIRCUMSTANCES CREATE ANY IMPLICATION THAT THE INFORMATION CONTAINED HEREIN IS CORRECT AS OF ANY TIME SUBSEQUENT TO THE DATE HEREOF OR THAT THERE HAS BEEN NO CHANGE IN THE INFORMATION SET FORTH HEREIN OR ANY ATTACHMENTS HERETO OR IN THE AFFAIRS OF MCLEODUSA OR ANY OF ITS SUBSIDIARIES SINCE THE DATE HEREOF.

PRIOR TO VOTING, STOCKHOLDERS ARE ENCOURAGED TO READ AND CONSIDER CAREFULLY THIS ENTIRE PROXY/DISCLOSURE STATEMENT, INCLUDING THE PLAN OF REORGANIZATION ANNEXED HERETO AS APPENDIX I AND THE MATTERS DESCRIBED IN THIS PROXY/DISCLOSURE STATEMENT.

IN MAKING A DECISION IN CONNECTION WITH THE RESTRUCTURING PROPOSALS OR THE PLAN OF REORGANIZATION, STOCKHOLDERS MUST RELY ON THEIR OWN EXAMINATION OF MCLEODUSA AND THE TERMS OF THE RESTRUCTURING PROPOSALS AND THE PLAN OF REORGANIZATION, INCLUDING THE MERITS AND RISKS INVOLVED. STOCKHOLDERS SHOULD NOT CONSTRUE THE CONTENTS OF THIS PROXY/DISCLOSURE STATEMENT AS PROVIDING ANY LEGAL, BUSINESS, FINANCIAL OR TAX ADVICE. EACH STOCKHOLDER SHOULD CONSULT WITH ITS OWN LEGAL, BUSINESS, FINANCIAL AND TAX ADVISORS WITH RESPECT TO ANY SUCH MATTERS CONCERNING THIS PROXY/DISCLOSURE STATEMENT, THE RESTRUCTURING PROPOSALS, THE PLAN OF REORGANIZATION OR THE TRANSACTIONS CONTEMPLATED THEREBY.

CAUTIONARY STATEMENTS

Certain statements in this Proxy/Disclosure Statement may constitute "forward-looking" statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Private Securities Litigation Reform Act of 1995, as the same may be amended from time to time (the "Act") or in releases made by the SEC. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of McLeodUSA, or industry results, to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Statements that are not historical fact are forward-looking statements. Forward-looking statements can be identified by, among other things, the use of forward-looking language, such as the words "estimate," "project," "intend," "expect," "believe," "may," "will," "would," "could," "should," "seeks," "plans," "scheduled to," "anticipates," or "intends," or the negative of these terms or other variations of these terms or comparable language, or by discussions of strategy or intentions, when used in

connection with McLeodUSA, including its management. See "Unaudited Pro Forma Financial Information," "Projections of Certain Financial Data for In-Court Restructuring" and "Risk Factors." These cautionary statements are being made pursuant to the Securities Act, the Exchange Act and the Act, with the intention of obtaining the benefits of the "safe harbor" provisions of such acts. McLeodUSA cautions investors that any forward-looking statements made by McLeodUSA are not guarantees or indicative of future performance. Important assumptions and other important factors that could cause actual results to differ materially from those in the forward-looking statements with respect to McLeodUSA include, but are not limited to, the risks and uncertainties affecting its business described in the section of this Proxy/Disclosure Statement captioned "Risk Factors," as well as elsewhere in this Proxy/Disclosure Statement. McLeodUSA undertakes no obligation to update or revise any forward-looking statements for events or circumstances after the date on which such statement is made. New factors emerge from time to time, and it is not possible for McLeodUSA to predict all of such factors or the impact of each such factor on its business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

AVAILABLE INFORMATION

McLeodUSA is subject to the information and reporting requirements of the Exchange Act, and, in accordance therewith, files periodic reports, proxy statements and other information with the SEC. Such reports and other information filed with the SEC can be inspected and copied at the public reference facilities of the SEC at its principal office, located at 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such material also can be obtained by mail from the public reference facilities of the SEC at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. The SEC maintains an Internet Web Site that contains reports, proxy and information statements and other information regarding McLeodUSA. The address of such site is: "http://www.sec.gov."

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SUMMARY

This Proxy/Disclosure Statement, the proxy and the ballot each contain important information which should be read carefully before any decision is made with respect to the restructuring proposals or the acceptance of the plan of reorganization. The following summary therefore is qualified in its entirety by reference to, and should be read in conjunction with, the information appearing elsewhere in this Proxy/Disclosure Statement, the proxy and the ballot.

McLeodUSA

McLeodUSA Incorporated, a Delaware corporation ("McLeodUSA"), provides integrated communications services, including local services, primarily in 25 Midwest, Southwest, Northwest and Rocky Mountain states. McLeodUSA's principal executive offices are located at 6400 C Street SW, Cedar Rapids, Iowa 52406. Its telephone number is (319) 364-0000. For additional information concerning McLeodUSA and its business, financial position and prospects, see "Selected Financial Data," "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Business" and "Properties."

Background

McLeodUSA has initiated a broad strategic and operational restructuring to re-focus its business on its core areas of expertise within its 25-state footprint, improve business discipline and processes and reduce the company's cost structure, all with a goal of eventually developing positive cash flow from operations. Key elements of the operational restructuring include reducing McLeodUSA's employee base, consolidating facilities, reducing capital expenditures, selling certain non-core assets and de-emphasizing certain unprofitable services. The operational initiatives present substantial challenges and require significant management time and resources to implement.

The circumstances that have prompted the operational restructuring have adversely affected McLeodUSA's revenue growth, profitability and cash flow and have raised questions about McLeodUSA's liquidity position. Given the magnitude of the operational restructuring, particularly in light of the uncertain general economic environment and the challenging conditions facing competitive telecommunications companies, prudence dictates that McLeodUSA address its highly leveraged balance sheet and develop a restructuring plan to reduce its debt load.

McLeodUSA formed an independent special committee of its board of directors, excluding management and persons affiliated with Forstmann Little, and retained outside advisors to assist in exploring alternatives for a financial restructuring. The special committee engaged in extensive discussions and negotiations with Forstmann Little to sponsor a comprehensive restructuring transaction that would result in a substantial deleveraging of McLeodUSA. A restructuring plan was designed (based on recent telecommunications company restructuring transactions) to provide McLeodUSA's senior noteholders with a large cash payment, which payment would not otherwise be available without the sponsorship of Forstmann Little and agreement by McLeodUSA's senior secured lenders.

Agreement with Senior Secured Lenders

Concurrently with the negotiations with Forstmann Little regarding a possible restructuring, McLeodUSA and Forstmann Little began discussions with representatives of McLeodUSA's senior secured lenders for support of a Forstmann Little sponsored restructuring involving a significant cash payment to McLeodUSA's senior noteholders. Any restructuring involving a payment to McLeodUSA's senior noteholders, other than regularly scheduled payments of principal and interest, requires majority consent under McLeodUSA's credit agreement. After substantial negotiations, McLeodUSA and its senior secured lenders agreed to amend the credit agreement to permit the restructuring. The key elements of the restructuring that induced McLeodUSA's senior secured lenders to allow the sale of Pubco and the use of the proceeds therefrom

to make a payment to McLeodUSA's senior noteholders were (1) the additional $100 million Forstmann Little investment, with $35 million of the net proceeds

from such investment applied to prepay term loans under the credit agreement, (2) Forstmann Little's agreement to purchase Pubco for $535 million, subject to completion of the restructuring and other customary closing conditions, (3) Forstmann Little's substantial continued involvement in the operations and corporate governance of McLeodUSA, (4) McLeodUSA's commitment to sell its Illinois independent local exchange carrier ("ICTC") following the completion of the restructuring and use the first $225 million in net proceeds to prepay term loans under the credit agreement, (5) McLeodUSA's commitment to use the first $25 million of any additional net proceeds from the sale of Pubco to prepay term loans under the credit agreement, (6) a permanent reduction of $140 million of revolving credit commitments under the credit agreement upon completion of the restructuring, (7) a 1% increase in the interest rates under the credit agreement, (8) amendment and arranger fees and (9) modified financial and restrictive covenants under the credit agreement.

Any changes to the terms of the restructuring that are materially inconsistent with the restructuring approved by the senior secured lenders, or that have an adverse effect on the senior secured lenders, would require the majority consent of McLeodUSA's senior secured lenders. Specifically, the amendment to the credit agreement requires that Forstmann Little have approximately a 40% equity ownership stake in McLeodUSA upon consummation of the restructuring. McLeodUSA does not believe that its senior secured lenders would consent to any restructuring involving a cash payment to McLeodUSA's senior noteholders without the substantial commitments provided by Forstmann Little and Forstmann Little's continued involvement in the operations of McLeodUSA and significant ownership position in the Class A common stock. In addition, there can be no assurance that Forstmann Little would invest an additional $100 million in McLeodUSA unless the restructuring were consummated on substantially the same terms as those described in this Proxy/Disclosure Statement.

Many of the amendments and waivers to the credit agreement that permit the restructuring will terminate if McLeodUSA fails to satisfy certain "progress conditions" on a timely basis. One important progress condition is that the restructuring is consummated on or before August 1, 2002. The complete list of progress conditions is set forth in the amendment to the credit agreement which was filed as an exhibit to McLeodUSA's Current Report on Form 8-K on December 7, 2001.

McLeodUSA expects to obtain an interim debtor-in-possession financing facility of up to $50 million in the event McLeodUSA pursues the restructuring through a Chapter 11 proceeding. In addition, McLeodUSA expects to obtain an exit financing facility upon consummation of a plan of reorganization under a Chapter 11 proceeding in an amount up to $160 million. Such exit financing facility will provide working capital for its future operations and be used to repay any amounts outstanding under any debtor-in-possession financing facility. While McLeodUSA has not yet obtained firm commitments for such facilities, it expects to obtain such commitments prior to filing a Chapter 11 case.

The Financial Restructuring

The material elements of the restructuring include:

- Forstmann Little will purchase Pubco for $535 million, subject to higher bids and without a break-up fee. A nationally recognized investment banking firm has provided a fairness opinion on the purchase price and has commenced a marketing process to seek higher bids that was publicly announced on December 3, 2001. Forstmann Little's commitment is subject to consummation of the restructuring.

- Forstmann Little will make a new money investment of $100 million for (i) new convertible preferred stock that is mandatorily convertible into Class A common stock at an average of the post-transaction trading price, as described elsewhere in this Proxy/Disclosure Statement, and (ii) new warrants to purchase approximately 5% of the Class A common stock at an exercise price equal to 150% of the average of the post-transaction trading price.

- McLeodUSA's outstanding senior notes, in an aggregate principal and accreted amount of approximately $2.9 billion, will be exchanged for $560 million in cash, available from the sale of Pubco and $25 million of Forstmann Little's new money investment, and 56,813,984 shares of Class A common stock, representing approximately 15% of the Class A common stock

following the restructuring (subject to dilution).

McLeodUSA's outstanding Series A preferred stock, which has a liquidation preference plus accrued dividends of approximately $300 million, will be reclassified into 44,883,856 shares of Class A common stock, representing approximately 11.9% of the Class A common stock following the restructuring (subject to dilution).

McLeodUSA's Series D and E preferred stock, which has an aggregate liquidation preference of $1 billion and is owned by Forstmann Little, will be reclassified into 151,515,152 shares of Class A common stock, representing approximately 40% of the Class A common stock following the restructuring (subject to dilution).

McLeodUSA's outstanding Class A common stock will be diluted to approximately 33.1% of the Class A common stock following the restructuring (subject to dilution).

Summary of Restructuring Plan

Consideration

	Cash	Estimated Number of Shares and % of Class A Common Stock Ownership			
		Before Dilution		After Dilution(1)	
Noteholders	$ 560,000,000	56,813,984	15.0%	56,813,984	13.7%
Series A Preferred Stock		44,883,856	11.9%	44,883,856	10.8%
Series D Preferred Stock		104,166,667	27.5%	104,166,667	25.1%
Series E Preferred Stock		47,348,485	12.5%	47,348,485	11.4%
Class A Common Stock		125,546,898	33.1%	125,546,898	30.2%
New Preferred Stock		NA	NA	36,433,233	8.8%
		378,759,890	100.0%	415,193,123	100.0%

Sources and Uses of Cash
($ in millions)

Sources	
Sale of Pubco	$ 535
Forstmann Little Investment	100
Working Capital/Available Cash	25
	$ 660
Uses	
Cash Payment to Noteholders	$ 560
Mandatory Pre-Payment on Term Loans	35
Fees and Expenses	65
	$ 660

(1) Estimated common stock ownership after giving effect to the mandatory conversion of the new convertible preferred stock to be issued to Forstmann Little at an assumed price per share equal to the reorganization equity value per share of $2.74 prior to dilution for warrants and the management incentive plan. See "Valuation Analysis."

While McLeodUSA believes the percentage estimates set forth above and referred to elsewhere in this Proxy/Disclosure Statement are helpful in describing the allocation of Class A common stock among its noteholders, preferred stockholders and current Class A common stockholders, there can be no assurance that actual allocations will correspond exactly to these estimated percentages.

After the Restructuring

Upon consummation of the restructuring and giving effect to the sale of non-core businesses set forth in McLeodUSA's strategic restructuring plan and as contemplated by the amendment to the credit

agreement, McLeodUSA's operations will consist primarily of the sale of voice and data services to small and medium size businesses and residential customers ("CLEC") in its core 25-state footprint. To date, the retail CLEC operations of McLeodUSA have not generated positive cash flow in any quarterly period. In addition, the preponderance of historical EBITDA of McLeodUSA has been attributable to Pubco, ICTC and other non-core assets that McLeodUSA plans to sell. While the initiatives set forth in McLeodUSA's strategic plan are designed to result in the core retail CLEC business eventually operating profitably, there can be no assurance that these steps will be successful in the time and magnitude expected. Moreover, the remaining operations are expected to continue generating negative cash from operations until fiscal 2005, even if McLeodUSA achieves its targeted level of EBITDA, as a result of capital expenditures and projected interest on the remaining amounts due under the credit agreement. Completion of asset sales within a time frame and for aggregate amounts described in McLeodUSA's business plan and retention of access to the amounts that remain available to borrow under the amended credit agreement are critical in funding McLeodUSA's operations.

McLeodUSA is simultaneously pursuing the restructuring via two alternative mechanisms: (1) the out-of-court alternative and (2) the in-court alternative. Each of these alternatives is described in detail in this Proxy/Disclosure Statement. You are being requested to take action on *both* alternatives.

Out-of-Court Alternative

The out-of-court restructuring is comprised of the following elements:

Special Meeting and Voting Procedures

Date, Time and Place of Special Meeting:	The Special Meeting to consider and to vote upon the restructuring proposals will be held on January 14, 2002 at 10:00 a.m., local time, at [ ].
Voting Record Date, Stockholders Entitled to Vote and Quorum:	Common stockholders and preferred stockholders of record at the close of business on December [ ], 2001, will be entitled to vote at the Special Meeting. Common stockholders will be entitled to one vote per share with respect to each of the restructuring proposals. Preferred stockholders will be entitled to one vote per share, with each series of preferred stock voting as a separate class, on each of the applicable reclassification proposals. The presence, either in person or by properly executed proxy, of the holders of a majority of the Class A common stock and each class of preferred stock outstanding and entitled to vote is necessary to constitute a quorum at the Special Meeting.
Purpose of Stockholders' Meeting:	The purpose of the Special Meeting is to consider and vote on the restructuring proposals. The disinterested members of McLeodUSA's board of directors have unanimously adopted resolutions adopting the restructuring proposals, subject to stockholder approval. The board of directors is soliciting proxies to be voted at the Special Meeting.

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Restructuring Proposals and Votes Required:	Series A Reclassification Proposal. To approve an amendment to McLeodUSA's certificate of incorporation in order to provide for the reclassification of its Series A preferred stock into Class A common stock on a basis of 39.05 shares of Class A common stock for each share of Series A preferred stock (based on the $250 liquidation preference per share of the Series A preferred stock plus accrued dividends and 627,734,497 shares of Class A common stock outstanding). The Series A reclassification proposal requires (1) the affirmative vote of the majority of the outstanding shares of Class A common stock entitled to vote and (2) the affirmative vote of the majority of the outstanding shares of Series A preferred stock entitled to vote. Series D Reclassification Proposal. To approve an amendment to McLeodUSA's certificate of incorporation in order to provide for the reclassification of its Series D preferred stock into Class A common stock on a basis of 378.79 shares of Class A common stock for each share of Series D preferred stock (based on the $2,500 liquidation preference per share of the Series D preferred stock and 627,734,497 shares of Class A common stock outstanding). The Series D reclassification proposal requires (1) the affirmative vote of the majority of the outstanding shares of Class A common stock entitled to vote and (2) the affirmative vote of the majority of the outstanding shares of Series D preferred stock entitled to vote. Forstmann Little as the only holder of Series D preferred stock has agreed to vote for the Series D reclassification proposal. Series E Reclassification Proposal. To approve an amendment to McLeodUSA's certificate of incorporation in order to provide for the reclassification of its Series E preferred stock into Class A common stock on a basis of 378.79 shares of Class A common stock for each share of Series E preferred stock (based on the $2,500 liquidation preference per share of the Series E preferred stock and 627,734,497 shares of Class A

common stock outstanding). The Series E reclassification proposal requires (1) the affirmative vote of the majority of the outstanding shares of Class A common stock and (2) the affirmative vote of the majority of the outstanding shares of Series E preferred stock entitled to vote. Forstmann Little as the only holder of Series E preferred stock has agreed to vote for the Series E reclassification proposal.

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Reverse Stock Split Proposal. To approve an amendment to McLeodUSA's certificate of incorporation in order to provide for a 5-to-1 reverse stock split of each outstanding share of its Class A common stock into one-fifth of a share of Class A common stock (meaning the approximately 627,734,497 shares of its outstanding Class A common stock will be converted into approximately 125,546,898 shares). The reverse stock split proposal requires the affirmative vote of the majority of the outstanding shares of Class A common stock.

Section 203 Proposal. To approve an amendment to McLeodUSA's certificate of incorporation in order to eliminate certain anti-takeover provisions by electing that McLeodUSA not be subject to Section 203 of the Delaware General Corporation Law, which deals with business combinations with interested stockholders. The Section 203 proposal requires the affirmative vote of the majority of the outstanding shares of Class A common stock entitled to vote.

Issuance Proposal. To approve the issuance of McLeodUSA's Class A common stock, including the issuance of:

- shares of Class A common stock issuable upon conversion of 10,000,000 shares of a new class of mandatorily convertible preferred stock to be issued to Forstmann Little;
- shares of Class A common stock issuable upon the exercise of 18,937,995 new warrants to be issued to Forstmann Little in connection with the issuance of the new class of mandatorily convertible preferred stock;
- 56,813,984 shares of Class A common stock to holders of McLeodUSA's senior notes pursuant to the exchange offer; and
- 196,399,008 shares of Class A common stock, in the aggregate, in connection with the Series A reclassification, the Series D reclassification and the Series E reclassification.

The issuance proposal requires the affirmative vote of the majority of the outstanding shares of Class A common stock represented at the Special Meeting and entitled to vote.

Management Incentive Plan Proposal. To approve the adoption of the McLeodUSA 2001 Omnibus Equity Plan. The management incentive plan proposal requires the affirmative vote of the majority of the outstanding shares of Class A common stock represented at the Special Meeting and entitled to vote.

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Conditions to Effectiveness: The Series A reclassification proposal, Series D reclassification proposal, Series E reclassification proposal, reverse stock split proposal, Section 203 proposal, issuance proposal and management incentive plan proposal are collectively referred to herein as the "restructuring proposals." Effectiveness of each of the restructuring proposals is conditioned upon approval of all the other restructuring proposals, completion of the exchange offer in accordance with its terms, consummation of the sale of Pubco for at least $535 million, consummation of the sale of $100 million of new preferred stock and warrants to Forstmann Little and resolution of all tax matters relating to the restructuring in a manner satisfactory to McLeodUSA.

	We are seeking the approval of the restructuring proposals in connection with our proposed financial restructuring. The proposed text of the amendments to the certificate of incorporation are set forth in Annex III of this Proxy/Disclosure Statement.
Dissenters Rights:	Stockholders will not be entitled to dissenters' rights as a result of the undertaking by McLeodUSA of the transactions described herein.
Dilution:	The 56,813,984 and 196,399,008 shares of Class A common stock to be issued directly to holders of McLeodUSA's senior notes and preferred stockholders will represent approximately 15% and 51.9%, respectively, of the total outstanding shares of Class A common stock after giving effect to the restructuring (subject to dilution). Upon consummation of the out-of-court restructuring, the equity interests of the existing holders of Class A common stock, as a percentage of the total number of outstanding shares of Class A common stock, will be significantly diluted to 33.1% (subject to dilution).
Changing Votes and Revocation:	Stockholders may change their vote or revoke their proxy at any time before their shares are voted at the Special Meeting by voting again in an acceptable manner, sending a proxy card dated later than their last vote, notifying the Secretary of McLeodUSA in writing or voting at the Special Meeting.

The Exchange Offer and Consent Solicitation

The Exchange Offer:	Pursuant to the exchange offer McLeodUSA is: offering to exchange all of its outstanding senior notes for each noteholder's pro rata share of (1) $560 million in cash plus (2) 56,813,984 shares of Class A common stock, representing approximately 15% of the Class A common stock expected to be outstanding upon consummation of the exchange offer (subject to dilution); and seeking the approval of noteholders of the notes to certain amendments to the indentures pursuant to which the notes were issued.

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	Upon consummation of the exchange offer, each noteholder that validly tenders notes will receive a pro rata portion of $560 million in cash and 56,813,984 shares of Class A common stock based upon the ratio of (x) the principal and accreted amount of the notes tendered by such noteholder plus all accrued and unpaid interest thereon as of the day immediately preceding the closing of the exchange offer to (y) the principal and accreted amount of all outstanding notes plus all accrued and unpaid interest thereon as of the day immediately preceding the closing of the exchange offer.
Conditions to Exchange Offer:	Among other things, the consummation of the exchange offer is conditioned on at least 95% of the aggregate principal and accreted amount of the notes being validly tendered and not withdrawn prior to expiration of the exchange offer, favorable votes on the restructuring proposals from the preferred and common stockholders, consummation of the sale of Pubco, consummation of the sale of the new preferred stock and warrants to Forstmann Little and satisfactory resolution of certain tax matters.
Consent Solicitation and Indenture Amendments:	Senior Noteholders who validly tender notes in the exchange offer will be deemed to have consented to the indenture amendments. The indenture amendments would eliminate or amend substantially all restrictive covenants in the indentures governing the notes.
Expiration Date of the Exchange Offer:	The exchange offer will expire at 5:00 p.m., New York City time, on January 15, 2002, unless extended by

McLeodUSA.

In-Court Alternative

If the conditions to closing the exchange offer are satisfied or waived, including the stockholders' approval of the restructuring proposals, McLeodUSA intends to implement the restructuring via the out-of-court alternative. If, however, for any reason McLeodUSA determines that it would be more advantageous or expeditious, it will consider effectuating the restructuring by filing a voluntary petition for relief under Chapter 11 of the Bankruptcy Code and seeking court approval of the restructuring.

To facilitate court approval of the in-court alternative, McLeodUSA is soliciting acceptances of its plan of reorganization, a copy of which is attached hereto as Appendix I. The plan, if approved, would result in the same consideration to the stockholders as they would receive through the out-of-court restructuring.

MCLEODUSA HAS NOT MADE ANY DECISION AT THIS TIME TO COMMENCE ANY CHAPTER 11 CASE, AND RESERVES ALL OF ITS RIGHTS TO PURSUE ANY AND ALL OF ITS STRATEGIC ALTERNATIVES IN THE EVENT THE OUT-OF-COURT RESTRUCTURING IS NOT CONSUMMATED.

The Plan of Reorganization

Summary:	The plan of reorganization provides for, among other things, the Series A, Series D and Series E preferred stock to be satisfied in full for the same consideration being offered in the reclassification and reverse stock split, as set forth above.

	Under the plan, all claims against and interests in McLeodUSA that will exist on the date McLeodUSA files any voluntary petition for reorganization relief under Chapter 11 of the Bankruptcy Code are divided into classes, exclusive of certain claims, including DIP facility claims (as described herein), administrative claims, and priority tax claims, which are not required to be classified. The following summarizes the classification and treatment under the plan of the principal claims against and interests in McLeodUSA. See "The Plan Summary of the Plan of Reorganization Certain Matters Regarding Classification and Treatment of Claims and Interests."
Class 1 (secured lender claims):	Class 1 is unimpaired by the plan. The estimated percentage recovery to holders of secured lender claims is 100%.
Class 2 (other secured claims):	Class 2 is unimpaired by the plan. The estimated percentage recovery to holders of other secured claims is 100%.
Class 3 (non-tax priority claims):	Class 3 is unimpaired by the plan. The estimated percentage recovery to holders of non-tax priority claims is 100%.
Class 4 (general unsecured claims):	Class 4 is unimpaired by the plan. The estimated percentage recovery to holders of general unsecured claims is 100%.
Class 5 (Note claims):	Class 5 is impaired by the plan. Each holder of an allowed note claim is entitled to vote on the plan. On or as soon as reasonably practicable after the distribution date, each holder of an allowed note claim would receive its pro rata share of (A) $560 million in cash and (B) 56,813,984 shares of Class A common stock. The aggregate amount of Class A common stock to be issued to the noteholders is equal to approximately 15% of the Class A common stock to be outstanding as of the consummation of the plan subject to dilution for Class A common stock that will be

issued upon conversion of new convertible preferred stock to be issued in connection with the exchange offer immediately after the 60th day after the closing of the exchange offer. The estimated value of this consideration is approximately $716 million. **This valuation is based upon a number of assumptions and is subject to a number of significant qualifications and is not intended to be an indication of future trading value. See "Valuation Analysis."**

Class 6 (preferred stock interests): Class 6 is impaired by the plan. Preferred stock interests include the Series A preferred stock, the Series D preferred stock, and the Series E preferred stock and any accrued but unpaid dividends. Each holder of an allowed preferred stock interest is entitled to vote on the plan. On or as soon as reasonably practicable after the distribution date, each holder of an allowed preferred stock interest shall receive, in exchange for such interest, its share of Class A common stock of reorganized McLeodUSA on the effective date, pro rata with all other holders of preferred stock based upon the

liquidation preferences and, if applicable, accrued and unpaid dividends of such preferred stock. The aggregate liquidation preference of the Series A preferred stock, including accrued and unpaid dividends, is estimated to be $296.2 million as of January 31, 2002. The aggregate liquidation preference of the Series D and E preferred stock is $1 billion. Based on such preferences, Series A preferred stock interests shall share, pro rata, 44,883,856 shares of Class A common stock (subject to dilution); Series D preferred stock interests shall share, pro rata, 104,166,667 shares of Class A common stock (subject to dilution); and Series E preferred stock interests shall share, pro rata, 47,348,485 shares of Class A common stock (subject to dilution). The estimated value of the Class A common stock to be delivered to the Series A preferred stock interests is approximately $123 million. The estimated value of the Class A common stock to be delivered to Series D and E preferred stock interests together is approximately $416 million. **This valuation is based upon a number of assumptions and is subject to a number of significant qualifications and is not intended to be an indication of future trading value. See "Valuation Analysis."**

Class 7 (Class A common stock interests): Class 7 is impaired by the plan. McLeodUSA is requesting that all common stockholders vote on the plan. Absent a favorable vote on the plan by the common stockholders as a class, however, McLeodUSA reserves the right to seek approval of the plan from a Bankruptcy Court, notwithstanding any rejection, or deemed rejection, by such holders. On, or as soon as reasonably practicable after the distribution date, each holder of an allowed Class A common stock interest shall receive its pro rata share of approximately 125,546,898 shares of Class A common stock (subject to dilution). The estimated value of this Class A common stock as of the effective date is approximately $344 million. **This valuation is based upon a number of assumptions and is subject to a number of significant qualifications and is not intended to be an indication of future trading value. See "Valuation Analysis."**

Class 8 (options, warrants, call rights, Class 8 is impaired by the plan. Upon the effective date of the

puts or other agreements to acquire Class A common stock):	plan, such rights shall be cancelled and of no further force or effect, and no holder of such rights shall be entitled to receive any distribution under the plan on account of such rights. Upon the effective date of the plan, however, McLeodUSA intends to implement a new management incentive plan. See "Restructuring Management Incentive Plan."

Voting Procedures

Expiration Date:	The solicitation period for acceptances of the plan will expire at 5:00 p.m., New York City time on January 15, 2002, unless extended by McLeodUSA.

Voting on the Plan:	Stockholders who elect to vote on the plan should complete and sign the beneficial owner ballot and check the box entitled "Accepts" the plan or "Rejects" the plan, as appropriate. In all cases, the duly completed beneficial owner ballot must be mailed or delivered as specified in the beneficial owner ballot. Specifically, any beneficial holder whose securities are registered or held of record in the name of his broker, dealer, commercial bank, trust company or other nominee and who wishes to vote on the plan should complete a beneficial owner ballot and return such ballot to such nominee or directly to Innisfree M&A Incorporated, as voting agent, as instructed by such nominee. Nominees in turn must use the information contained in such beneficial owner ballots to complete master ballots, and must return all such master ballots to the voting agent. Stockholders who purchase Class A common stock or preferred stock after the voting record date, and who wish to vote on the plan, must arrange with their seller to receive a beneficial owner ballot from the holder of record. The voting deadline is January 15, 2002. All ballots tendered by the voting deadline may be utilized by McLeodUSA in connection with determining acceptances and rejections of the plan at any time, so long as the plan is consummated on or before August 1, 2002. Thus, all votes represented by such ballots shall be deemed continuously effective until such time. Under the Bankruptcy Code, for purposes of determining whether the requisite acceptances of the plan have been received, only stockholders who vote will be counted. Stockholders who do not send a duly completed and signed ballot will be deemed to constitute an abstention by such stockholder with respect to a vote regarding the plan. Abstentions, as a result of not submitting a duly completed and signed ballot, will not be counted as votes for or against the plan. While each stockholder should check the appropriate box and only one box, any ballot which is validly executed by a stockholder but does not indicate an acceptance or rejection of the plan will be counted as a rejection of the plan. Any ballot which is validly executed by a stockholder and which indicates both acceptance and rejection of the plan will be counted as a rejection of the plan.
Changing Votes:	Votes on the plan may be changed only as provided for in this Proxy/Disclosure Statement. As provided for herein, votes may be changed only by a properly completed and timely submitted ballot that supercedes a prior properly completed and timely submitted ballot.

Support for the Restructuring

Forstmann Little, as the holder of 100% of the Series D and Series E preferred stock with an aggregate liquidation preference of $1 billion, supports the restructuring and has executed a lock-up

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and voting agreement requiring Forstmann Little to vote in favor of the restructuring proposals and the plan.

McLeodUSA's executive officers and directors, as a group, beneficially own approximately 67,311,394 shares of Class A common stock, excluding option shares. See "Security Ownership of Certain Beneficial Owners and Management." Such officers and directors have advised McLeodUSA that they intend to vote in favor of the restructuring proposals and the plan.

Recommendation of the Restructuring

The special committee considered a number of alternatives with respect to restructuring McLeodUSA's capital structure, held numerous lengthy meetings, discussed the restructuring with its advisors and engaged in extensive negotiations with representatives of Forstmann Little regarding the sale of Pubco and the restructuring. In addition, the special committee, through senior management, was involved in negotiations with representatives of McLeodUSA's senior secured lenders regarding amendments to the credit agreement. After considering the alternatives, and in light of these extensive negotiations, the special committee recommended the restructuring to McLeodUSA's board of directors.

The disinterested members of McLeodUSA's board of directors have unanimously approved the restructuring proposals, including the terms of the Series A reclassification proposal, the Series D reclassification proposal, the Series E reclassification proposal, the reverse stock split proposal, the Section 203 proposal, the issuance proposal and the management incentive plan proposal discussed in this Proxy/Disclosure Statement, upon the recommendation of the special committee. However, McLeodUSA's board of directors has not at this time taken any corporate action approving a bankruptcy filing or in furtherance thereof.

Risk Factors

Ownership of the shares of the Class A common stock (following completion of the restructuring) is subject to a number of material risks. Prior to deciding whether to vote for the restructuring proposals or the plan, each stockholder should carefully consider all of the information contained in this Proxy/Disclosure Statement. Certain risks are set forth in detail under "Risk Factors."

Description of the Class A Common Stock

Authorized Shares:	2,000,000,000 shares of Class A common stock are authorized.
Par Value:	$.01 per share.
Voting Rights:	One vote per share.
Preemptive Rights:	None.
Dividends:	Payable at the discretion of the board of directors of McLeodUSA.
Board Representation:	The board of directors will consist of up to 15 members. Mr. Clark E. McLeod will continue to serve as the Chairman of the board of directors. Mr. Theodore J. Forstmann will continue to serve as the Chairman of the executive committee. McLeodUSA's bylaws will be amended as follows: (1) the board of directors will include at least five independent directors and the Chairman, Chief Executive Officer and Chief Financial Officer of McLeodUSA, and (2) the executive committee of the board of directors will consist of no more than seven members, and will include the Chairman of the board of directors, two designees of Forstmann Little, the Chief

	Executive Officer and the Chief Operating Officer of McLeodUSA.
Stock Options:	An amount of shares of Class A common stock equal to 15% of the shares to be outstanding immediately after conversion of the new convertible preferred stock to be issued to Forstmann Little and after giving effect to the options will be reserved for issuance in connection with one or more incentive stock option plans.
Comparison of Class A Common Stock to Outstanding Preferred Stock:	There are significant differences between the rights and preferences of the preferred stock to be reclassified in the restructuring and the Class A common stock. A description of these differences is set forth under "Description of Restructuring Proposals Comparison of Class A Common Stock to Outstanding Preferred Stock."

United States Federal Income Tax Consequences

The preferred stock reclassification and the reverse stock split will generally be tax-free to holders of McLeodUSA's Series A preferred stock and holders of McLeodUSA's Class A common stock. McLeodUSA anticipates that, as a result of the restructuring, its net operating loss carryforwards will be substantially reduced or eliminated, and any remaining net operating losses will be subject to certain limitations. In addition, if the out-of-court restructuring is consummated, McLeodUSA will incur liability for federal alternative minimum tax and state income tax in connection with the restructuring. Resolution of all tax matters in a manner satisfactory to McLeodUSA is a condition to the completion of the exchange offer. See "Material United States Federal Income Tax Considerations."

Market and Trading Information

The shares of Class A common stock and Series A preferred stock are listed on The Nasdaq National Market under the symbols "MCLD" and "MCLDP," respectively. No assurance can be given as to the prices at which the Class A common stock might be traded. The Series A preferred stock will cease to be outstanding. See "Risk Factors Possible Volatility of Class A Common Stock" and "Risk Factors Risk of Delisting."

Information and Voting Agent

Innisfree M&A Incorporated has been appointed as the Information Agent for solicitation of proxies and Voting Agent for the solicitation of acceptances of the plan. Questions regarding voting and requests for assistance may be directed to the Information Agent as set forth on the back cover of this Proxy/Disclosure Statement.

RECENT DEVELOPMENTS

On December 7, 2001, McLeodUSA entered into an agreement to sell certain of its internet/data assets (formerly part of Splitrock Services, Inc.) and wholesale dial-up Internet Service Provider (ISP) customer base to Level 3 Communications, Inc. for $55 million plus the assumption of certain operating liabilities (the "Splitrock Disposition"). Under the terms of the agreement, Level 3 will purchase approximately 350 POPs (points of presence) across the U.S., the related facilities, equipment and underlying circuits, plus the wholesale ISP customer base. The transaction excludes fiber optic cable obtained under the existing IRU Agreement with Level 3 acquired by McLeodUSA in the Splitrock acquisition. The parties will also enter into operating agreements enabling McLeodUSA to continue providing service and support to customers in its 25-state footprint. The Splitrock Disposition is subject to customary closing conditions, and is expected to close prior to May 1, 2002.

SUMMARY UNAUDITED HISTORICAL AND PRO FORMA CAPITALIZATION

The following table sets forth the unaudited capitalization of McLeodUSA as of September 30, 2001, and as adjusted to give effect to the out-of-court restructuring and the Splitrock Disposition as though they had become effective on September 30, 2001. The adjustments giving effect to the out-of-court restructuring assume 100% of McLeodUSA's senior notes are exchanged. If less than 95% of the notes are tendered and McLeodUSA elects to waive the minimum tender condition and accept the tendered notes for exchange, such acceptance would have a material effect upon the information presented below. The information presented below should be read in conjunction with the Consolidated Financial Statements, Unaudited Pro Forma Financial Information and related notes appearing elsewhere herein.

	September 30, 2001	
	Historical	Total Pro Forma
	(unaudited)	(unaudited)
	(In millions, except shares)	
Long-term debt (excludes current maturities)	3,694.0	747.9 (1)(2)
Redeemable convertible preferred stock		
Preferred, Series B, redeemable, convertible, $.01 par value, authorized, issued and outstanding historical none; pro forma none		
Preferred, Series C, redeemable, convertible, $.01 par value, authorized, issued and outstanding historical none; pro forma none		
Preferred, Series D, redeemable, convertible, $.01 par value, authorized, issued and outstanding historical 275,000; pro forma none	104.0	
Preferred, Series E, redeemable, convertible, $.01 par value, authorized, issued and outstanding historical 125,000; pro forma none	43.0	
Total redeemable convertible preferred stock	147.0	
Stockholders' Equity		
Capital Stock:		
Preferred, Series A, $.01 par value: authorized, issued and outstanding historical 1,149,375 shares; pro forma none		
Common, Class A, $.01 par value; authorized 2,000,000,000 shares; issued and outstanding historical 626,950,228 shares; pro forma 415,036,271 shares	6.3	4.1
Common, Class B, convertible, $.01 par value; authorized 22,000,000 shares; issued and outstanding 2001 and pro forma none		
Additional paid-in capital	3,843.2	4,092.9
Accumulated deficit	(3,621.1)	(1,295.5)
Accumulated other comprehensive income	(2.0)	(2.0)
Total stockholders' equity	226.4	2,799.5 (1)
Total capitalization and pro forma capitalization	$ 4,067.4	3,547.4 (1)

(1) If the out-of-court restructuring is consummated at the 95% acceptance level by McLeodUSA's senior noteholders, pro forma long-term debt (excluding current maturities), total pro forma stockholders' equity and total pro forma capitalization would be $893.1 million, $2,681.7 million and $3,574.8 million, respectively.

(2) McLeodUSA borrowed an additional $250 million under its credit agreement subsequent to September 30, 2001. As a result, pro forma long-term debt (excluding current maturities) upon consummation of the restructuring would be $997.9 million (assuming 100% tender by McLeodUSA's senior noteholders) and $1,143.1 (assuming a 95% tender by McLeodUSA's senior noteholders).

RISK FACTORS

Investment in the Class A common stock following completion of the restructuring (whether shares of Class A common stock are issued in the out-of-court restructuring or the in-court restructuring) involves a high degree of risk. Prior to deciding whether to (a) vote for the restructuring proposals and/or (b) vote to accept the plan, each stockholder should carefully consider all of the information contained in this Proxy/Disclosure Statement, especially the factors described or cross-referenced in the following paragraphs.

Implementing McLeodUSA's Operational Restructuring Involves Substantial Risks

There are substantial risks in implementing McLeodUSA's new operational strategy. These risks include:

- spending significant resources and time on the divestiture of non-core assets rather than on the operational restructuring of McLeodUSA;
- the operational restructuring entails significant business process changes throughout the organization, which may be disruptive;
- difficulties arising from the slowing economy, which has adversely affected demand for competitive telecommunications services, may delay revenue growth and the time to profitability and positive cash flow;
- the chance for adverse regulatory, legislative and other governmental developments during the course of the operational restructuring;
- uncertainty surrounding McLeodUSA's restructuring increases the risk that McLeodUSA loses customers and leaves McLeodUSA open to more aggressive tactics of competitors;
- potential difficulties in recruiting and retaining quality management to execute the new operational strategy; and
- McLeodUSA may not have sufficient capital to invest in improved business systems to support a larger and more efficient enterprise.

One or more of these factors, individually or combined, could affect adversely McLeodUSA's ability to conduct its operations.

McLeodUSA Expects to Incur Significant Losses Over the Next Several Years

If McLeodUSA does not become profitable in the future, McLeodUSA could have difficulty obtaining funds to continue its operations. McLeodUSA has incurred net losses every year since McLeodUSA began operations. Since January 1, 1995, McLeodUSA's net losses applicable to Class A common stock have been as follows:

Period	Amount
1995	$ 11.3 million
1996	$ 22.3 million
1997	$ 79.9 million
1998	$ 124.9 million
1999	$ 238.0 million
2000	$ 531.7 million

McLeodUSA expects to incur significant operating losses during the next several years. If McLeodUSA is unable to operate profitably in the time frame expected, there may be adverse consequences to its business.

Risks Particular to Reclassified Preferred Stockholders

Preferred stockholders who receive shares of Class A common stock will lose all rights associated with the preferred stock. The Series A preferred stock obligates McLeodUSA to pay a certain amount of annual dividends. Holders of the Class A common stock will have no right to receive an annual payment of dividends. Moreover, cash dividend payments will continue to be prohibited under the terms of the credit agreement (other than in connection with certain employee benefit plans or to maintain certain licenses and franchises). Also, if McLeodUSA were to be liquidated, preferred stockholders would no longer be entitled to payment prior to holders of Class A common stock.

Issuance of Additional Shares of Class A Common Stock After the Restructuring Will Dilute the Class A Common Stock

If the requisite votes in favor of the restructuring proposals are received, the issuance of shares of Class A common stock to McLeodUSA's noteholders and the holders of Series A, D and E preferred stock will result in dilution of the equity interests of the holders of Class A common stock. In addition, the issuance of shares of Class A common stock or options to management and employees, the conversion of the new preferred stock or the exercise of the new warrants will result in additional dilution of the equity interests of the holders of the Class A common stock which could adversely affect the market price and the value of Class A common stock. There can be no assurance that McLeodUSA will not need to issue additional equity securities in the future in order to execute its business plan if it does not achieve its projected results or for other reasons, which could lead to further dilution to holders of the Class A common stock.

The Businesses that Will Remain Following the Restructuring Do Not Generate Positive Cash Flow

Upon consummation of the restructuring and giving effect to the sale of non-core businesses set forth in McLeodUSA's strategic restructuring plan and as contemplated by the credit agreement, McLeodUSA's operations will consist primarily of its retail CLEC business. To date, the retail CLEC operations of McLeodUSA have not generated positive cash flow in any quarterly period. In addition the preponderance of historical EBITDA of McLeodUSA has been attributable to Pubco, Illinois Consolidated Telephone Company ("ICTC") and other non-core assets that McLeodUSA plans to sell. While the initiatives set forth in McLeodUSA's strategic restructuring plan are designed to result in the CLEC business eventually operating profitably, there can be no assurance that these steps will be successful in the time and magnitude expected. Moreover, the remaining operations are expected to continue generating negative cash from operations until fiscal 2005, even if McLeodUSA achieves its targeted level of EBITDA, as a result of capital expenditures and projected interest on the remaining amounts due under the credit agreement. Completion of asset sales within a time frame and for aggregate amounts described in McLeodUSA's business plan and retention of access to the amounts that remain available to borrow under the amended credit agreement are critical in funding McLeodUSA's operations.

McLeodUSA Has a Risk of Inadequate Liquidity

Consummation of the restructuring and the third amendment to the credit agreement will impact the post-restructuring liquidity position of McLeodUSA in the following manner:

- permanent reduction of the commitments under the revolving credit facility of $140 million;
- higher interest rates;
- divestiture of Pubco, which currently generates positive cash flow; and
- required divestiture of ICTC, which currently generates positive cash flow, and application of the first $225 million of the proceeds of such divestiture to the prepayment of term loans.

Upon consummation of the restructuring, the operations of McLeodUSA will consist primarily of the existing retail CLEC operations of McLeodUSA, which have not generated positive cash flow in any quarterly period. One or more of these factors, individually or combined, could affect adversely McLeodUSA's ability to conduct its operations.

Although Forstmann Little is investing $100 million, after payments to noteholders, prepayments on the credit agreement, and fees and expenses related to the restructuring, McLeodUSA will not retain any proceeds from such investment and, in fact, anticipates using approximately $25 million of available cash to effect the restructuring.

Furthermore, the divestitures of non-core assets is a key component to McLeodUSA's future liquidity. Material variances from the expected level of proceeds received from non-core asset sales and the timing of the receipt of such proceeds would have an adverse effect on liquidity.

Finally, McLeodUSA may need additional capital to expand its business and develop new products, which may be difficult to obtain. Failure to obtain additional capital may preclude McLeodUSA from developing or enhancing its products, taking advantage of future opportunities, growing its business or responding to competitive pressures.

A Long And Protracted Restructuring Could Adversely Affect McLeodUSA's Business

The uncertainty surrounding a prolonged restructuring could have significant adverse affects on McLeodUSA's business.

Specifically:

- To induce McLeodUSA's senior secured lenders to consent to the restructuring, McLeodUSA agreed that it would not borrow more than $50 million under its credit agreement until the later of (a) the date the restructuring is consummated, (b) the date McLeodUSA becomes a debtor in a bankruptcy case, and (c) the date McLeodUSA ceases to pursue the restructuring. McLeodUSA borrowed the entire $50 million on December 4, 2001. Therefore, McLeodUSA may not have sufficient liquidity to endure a prolonged restructuring.

- It will be difficult to attract and retain key employees during a prolonged restructuring.

- Uncertainty about the ultimate outcome of the restructuring could lead to the loss of customers and the tightening of trade credit.

The Class A Common Stock Could Be Volatile, Increasing the Risk of Loss to Holders of Common Stock

The market price of the Class A common stock could be subject to significant fluctuations in response to various factors and events including the depth and liquidity of the trading market for the Class A common stock and variations in McLeodUSA's operating results. In addition, the stock market in general, and the telecommunications sector specifically, in recent years have experienced broad price and volume fluctuations that have often been unrelated to the operating performance of the companies. Broad market fluctuations may also adversely affect the market price of the Class A common stock.

If McLeodUSA's Class A Common Stock is Delisted, the Ability of Holders of Common Stock to Sell Their Shares Would Be Adversely Impacted

It is possible that the Class A common stock will be delisted from The Nasdaq National Market. Officials of The Nasdaq National Market may, upon the issuance of this Proxy/Disclosure Statement, halt the quotation of the Class A common stock and begin an immediate review of McLeodUSA's entire financial situation, including the plan, the projected financial statements and the economic impact of any possible bankruptcy on the Class A common stock. If the results of a review are

unfavorable, The Nasdaq National Market may notify McLeodUSA that it intends to delist the Class A common stock. McLeodUSA would object to any proposed delisting and seek a hearing, but there can be no guarantee that any such objection would be successful. If the Class A common stock is delisted, it would become difficult to make purchases and sales or obtain timely and accurate quotations with respect to trading of the Class A common stock.

McLeodUSA's Future Operational and Financial Performance May Vary Materially from the Projections Included in this Proxy/Disclosure Statement

The projected financial information contained in this Proxy/Disclosure Statement is based on McLeodUSA's estimated results of operations based upon certain assumptions described more fully under "Unaudited Pro Forma Financial Information" and "Projections of Certain Financial Data" in this Proxy/Disclosure Statement. McLeodUSA does not as a matter of course make public projections as to future sales, earnings or other results. However, McLeodUSA's management, together with its financial advisor, has prepared the projected consolidated financial information set forth in this Proxy/Disclosure Statement to present the anticipated effects of the restructuring. These projections were not

prepared with a view towards pubic disclosure or with a view towards complying with the guidelines established by the American Institute of Certified Public Accountants with respect to prospective financial information, but, in the view of McLeodUSA's management, were prepared on a reasonable basis, reflect the best currently available estimates and adjustments and present, to the best of management's knowledge and belief, the course of action and the expected future financial performance of reorganized McLeodUSA after the effective date.

McLeodUSA does not intend to update or otherwise revise its projections to reflect events or circumstances existing or arising after the date of this Proxy/Disclosure Statement or to reflect the occurrence of unanticipated events. The independent public accountants for McLeodUSA have not examined or provided any other form of assurance on the projected financial information. Consequently, no person other than McLeodUSA assumes any responsibility for the projected financial information. The projected financial information necessarily is based upon numerous estimates and assumptions, including that McLeodUSA will successfully implement the restructuring on a timely basis and achieve the results described in the financial projections included in this Proxy/Disclosure Statement. These estimates and assumptions are inherently subject to significant business, economic and competitive uncertainties, contingencies and risks, many of which are beyond the control of McLeodUSA. Actual results may vary from these projections and the variations may be material. Financial projections are necessarily speculative in nature and one or more of the assumptions underlying these projections may prove not to be valid. The projections should not be regarded as a representation by McLeodUSA, any of its affiliates or any other person that the projections will be achieved. Stockholders are cautioned not to place undue reliance on the projected financial information contained in this Proxy/Disclosure Statement.

Election Not to be Subject to Section 203 May Make McLeodUSA More Vulnerable to Takeovers

McLeodUSA is required to opt out of the provisions of Section 203 of the Delaware General Corporation Law under the terms of its agreement with Forstmann Little in order to complete the financial restructuring. The election to eliminate the protection provided by Section 203 of the Delaware General Corporation Law may make McLeodUSA more vulnerable to takeovers without giving McLeodUSA the ability to prohibit or delay such takeovers as effectively.

Adverse Treatment of Cancellation of Debt Income and Net Operating Losses May Adversely Impact McLeodUSA's Financial Position

McLeodUSA will realize substantial cancellation of debt ("COD") income as a result of the restructuring. Under the out-of-court restructuring, McLeodUSA will recognize this income for income

tax purposes. McLeodUSA believes that it and its subsidiaries will have sufficient consolidated net operating losses and net operating loss carryovers ("NOLs") available for federal income tax purposes to offset this income (although some federal alternative minimum tax and state income tax liability will remain). McLeodUSA has estimated for purposes of its unaudited pro forma financial information presented herein that $46 million of current tax liability will result from the out-of-court restructuring. See "Unaudited Pro Forma Financial Information." However, whether McLeodUSA and its subsidiaries will have sufficient NOLs to fully offset the COD income recognized will depend upon a number of factors, including the amount of notes that are tendered in the out-of-court restructuring, the amount of NOLs created by operations in 2001 and 2002, the value of the Class A common stock (determined at the time of the exchange) issued in exchange for notes, the effect of any applicable limitations on McLeodUSA's ability to utilize NOLs (including certain of McLeodUSA's subsidiaries' NOLs that were created before such subsidiaries were acquired by McLeodUSA) and the timing and amount of gain or loss that McLeodUSA will recognize as a result of the divestiture of its non-core business and telecom assets. Accordingly, no assurances can be given that McLeodUSA will have sufficient NOLs available to offset all of the COD income that will be recognized in the out-of-court restructuring. If McLeodUSA and its subsidiaries do not have sufficient NOLs available to offset the COD income recognized in the out-of-court restructuring, McLeodUSA will recognize taxable income without a corresponding receipt of cash.

McLeodUSA believes that all or substantially all of its and its subsidiaries' NOLs will be utilized as a result of the COD income to be recognized in the out-of-court restructuring. McLeodUSA also believes that all of its NOLs will be eliminated as a result of COD income excluded in the in-court restructuring, although the NOLs of McLeodUSA's subsidiaries would not be eliminated as a result of such COD income in the in-court restructuring if McLeodUSA's position that the reduction in tax attributes resulting from the exclusion of such COD income should occur on a separate company basis is sustained. However, the Internal Revenue Service has recently taken the position that consolidated, rather than separate company NOLs must be reduced when COD income is excluded. Accordingly, no assurances can be given in this regard. Because no COD income will be recognized in the in-court restructuring, McLeodUSA will not be liable for the federal alternative minimum tax or state income tax as a result of COD income realized in the in-court restructuring.

If an "ownership change" (as defined in Internal Revenue Code Section 382 ("Section 382")) occurs with respect to McLeodUSA's stock in connection with the restructuring, Section 382 may apply to limit the future ability of McLeodUSA and its subsidiaries to utilize any remaining NOLs generated before the ownership change and certain subsequently recognized "built-in" losses and deductions, if any, existing as of the date of the ownership change. McLeodUSA is likely to incur an ownership change as a result of the restructuring. McLeodUSA's ability to utilize new NOLs arising after the ownership change would not be affected. An ownership change generally occurs if certain persons or groups increase

their aggregate ownership percentage in a corporation's stock by more than 50 percentage points in the shorter of any three-year period or the period since the last ownership change.

McLeodUSA believes that its most recent ownership change occurred in March, 2000 and that the Section 382 limitation arising from that ownership change does not impose material limitations on its ability to utilize its NOLs in connection with the restructuring. However, the determination of whether and when an ownership change occurs is inherently factual and depends in part on the values of McLeodUSA's outstanding stock on each measurement date (as defined for purposes of Section 382). If it were ultimately determined that McLeodUSA's most recent ownership change occurred on a different date (or that an ownership change occurs subsequent to the date hereof and prior to the consummation of the out-of-court restructuring), McLeodUSA's ability to utilize NOLs to offset the COD income recognized in the out-of-court restructuring could be materially affected. See "Material United States Income Tax Considerations."

Failure to Raise Necessary Capital Could Restrict the Ability of McLeodUSA to Develop Its Network and Services and Engage in Strategic Acquisitions

McLeodUSA cannot assure that its capital resources will be sufficient to enable it to achieve operating profitability. Failure to generate or raise sufficient funds may require McLeodUSA to delay or abandon some of its expansion plans or expenditures, which could harm its business and competitive position.

McLeodUSA expects to meet these funding needs through various sources, including existing cash balances, existing lines of credit, prospective sales of selected assets, vendor financing and cash flow from future operations. The estimated aggregate capital expenditure requirements of McLeodUSA include the projected costs of:

- expanding McLeodUSA's fiber optic communications network, including intra-city fiber optic networks;
- adding voice and data switches;
- constructing, acquiring, developing or improving telecommunications assets in existing and new markets; and
- improving the business infrastructure to support a larger and more efficient telecommunications company.

McLeodUSA also requires substantial funds for general corporate and other expenses and may require additional funds for working capital fluctuations.

The third amendment to the credit agreement places restrictions on McLeodUSA's ability to make capital expenditures and engage in acquisitions.

McLeodUSA may meet any additional financial needs by issuing additional debt or equity securities or by borrowing funds under the credit agreement. McLeodUSA cannot assure that it will have timely access to additional financing sources on acceptable terms. McLeodUSA's ability to issue debt securities, borrow funds from additional lenders and participate in vendor financing programs are restricted under the terms of the third amendment, and there can be no assurance that the lenders thereunder will waive these restrictions if McLeodUSA needs additional financing beyond that permitted. If they do not, McLeodUSA may not be able to expand its markets, operations, facilities, network and services as it intends.

McLeodUSA's Dependence on the MegaBells to Provide Most of McLeodUSA's Communications Services Could Make It Harder for McLeodUSA to Offer Its Services at a Profit

The original seven regional Bell companies that resulted from the divestiture by AT&T in 1984 of its local telephone systems are now concentrated into four large incumbent "MegaBells." McLeodUSA depends on these MegaBells to provide much of McLeodUSA's core local and some long distance services and at the same time these MegaBells are McLeodUSA's largest local service competitors. Today, without using the communications facilities of these companies, McLeodUSA could not provide bundled local and long distance services to most of McLeodUSA's customers. Because of this dependence, McLeodUSA's communications services are highly susceptible to changes in the conditions for access to these facilities and to possible inadequate service quality provided by the MegaBells. Therefore, McLeodUSA may have

difficulty offering its services on a profitable and competitive basis.

Qwest Communications International Inc. (successor to U S WEST Communications, Inc.) and SBC Communications Inc. (including its wholly-owned subsidiary Ameritech Corporation) are McLeodUSA's primary suppliers of network elements and communications services that allow McLeodUSA to transfer and connect calls. The communications facilities of McLeodUSA's suppliers allow McLeodUSA to provide local service, long distance service and private lines dedicated to its customers' use. If these MegaBells or other companies deny or limit McLeodUSA's access to their communications network elements or wholesale services, McLeodUSA may not be able to offer its communications services at profitable rates.

In order to interconnect McLeodUSA's network equipment and other communications facilities to network elements controlled by the MegaBells, McLeodUSA must first negotiate and enter into interconnection agreements with them. Interconnection obligations imposed on the MegaBells by the Telecommunications Act of 1996 have been and continue to be subject to a variety of legal proceedings, the outcome of which could affect McLeodUSA's ability to obtain interconnection agreements on acceptable terms. There can be no assurance that McLeodUSA will succeed in obtaining interconnection agreements on terms that would permit McLeodUSA to offer local services using McLeodUSA's own communications network facilities at profitable and competitive rates.

Actions by the MegaBells May Make it More Difficult for McLeodUSA to Offer Its Communications Services

The MegaBells have pursued and continue to pursue several measures that may make it more difficult for McLeodUSA to offer its communications services. McLeodUSA has challenged or is challenging these actions before the FCC or applicable state public utility commissions. McLeodUSA cannot assure that it will succeed in its challenges to these or other actions by the MegaBells that would prevent or deter McLeodUSA from using their service or communications network elements. If the MegaBells withdraw or limit McLeodUSA's access to services or charge McLeodUSA extraordinary charges or high prices relative to retail rates in any location, McLeodUSA may not be able to offer communications services in those locations, which would harm McLeodUSA's business.

McLeodUSA anticipates that the MegaBells will continue to pursue legislation in states within McLeodUSA's target market area to reduce state regulatory oversight over their rates and operations. If adopted, these initiatives could make it more difficult for McLeodUSA to challenge MegaBell actions in the future which could harm McLeodUSA's business.

The MegaBells are also actively pursuing federal legislative and regulatory initiatives to undermine the Telecommunications Act of 1996 requirement to open local networks including by limiting the MegaBells' obligations to provide access to their facilities and by allowing them to provide in-region long distance data services without satisfying the market-opening requirements. If successful, these initiatives could make it more difficult for us to compete with the MegaBells and to offer services on a profitable and competitive basis. In addition to the established long-distance telephone companies, recent regulatory decisions have allowed some of the MegaBells to offer long-distance services within their traditional local service areas in a growing number of states. The regional Bell companies are proving to be strong competitors in the long-distance market.

Competition in the Communications Services Industry Could Cause McLeodUSA to Lose Customers and Revenue and Make It More Difficult for McLeodUSA to Enter New Markets

McLeodUSA faces intense competition in all of its markets. This competition could result in loss of customers and lower revenue for McLeodUSA. It could also make it more difficult for McLeodUSA to enter new markets. Entrenched, traditional local telephone companies, including Qwest, SBC, BellSouth and Verizon, currently dominate their local communications markets and are gaining long distance market share in certain states (as discussed below). Three major competitors, AT&T, WorldCom and its MCI group and Sprint, dominate the long distance market. Hundreds of other

companies also compete in the long distance marketplace. Many companies, including AT&T, WorldCom and Sprint, also compete in the local and long distance marketplace.

Other competitors may include cable television providers, providers of communications network facilities dedicated to particular customers, microwave and satellite carriers, wireless telecommunications providers, private networks owned by large end-users, municipalities, electrical utilities and telecommunications management companies. Increasingly, McLeodUSA is subject to competition from Internet telephone and other IP-based telecommunications service providers, which are currently subject to substantially less regulation than competitive and traditional local telephone companies and are exempt from a number of taxes and regulatory charges that McLeodUSA is required to pay.

These and other firms may enter, and in some cases have entered, the markets where McLeodUSA focuses its sales efforts, which may create downward pressure on the prices for its services and negatively affect its returns. Many of McLeodUSA's existing and potential competitors have financial and other resources far greater than McLeodUSA's. In addition, the trend toward mergers and strategic alliances in the communications industry may strengthen some of McLeodUSA's competitors and could put McLeodUSA at a significant competitive disadvantage.

Many of McLeodUSA's competitors offer a greater range of communications services, or offer them in more geographic areas. For example, while McLeodUSA's target market covers 25 states, many of McLeodUSA's competitors are national or international in scope. Also, some of McLeodUSA's competitors offer wireless services, Internet content services, and other services. McLeodUSA's inability to offer as wide a range of services as many of its competitors or to offer them in as many locations, could result in McLeodUSA not being able to compete effectively against them.

For additional information, see "Business Competition."

MegaBells' Being Allowed to Offer Bundled Local and Long Distance Services in McLeodUSA's Markets Could Cause McLeodUSA to Lose Customers and Revenue and Could Make It More Difficult for McLeodUSA to Enter New Markets

Presently the MegaBells are prohibited from offering interLATA long distance services to customers in their regions until they have shown compliance on a state-by-state basis with the Telecommunications Act of 1996. The MegaBells are attempting to show compliance and are seeking authority to offer in-region interLATA long distance service. SBC has obtained such authority in Texas, Oklahoma, Kansas, Missouri and Arkansas. Qwest has indicated its intention to seek authority in all 14 states where it provides local services. Verizon has obtained such authority in New York, Massachusetts, Connecticut and Pennsylvania and its application for such authority in Rhode Island is pending before the FCC. BellSouth's application for such authority in Georgia and Louisiana is pending. After obtaining authorization to provide interLATA services within a state, the MegaBells have generally been successful in gaining significant market share and forcing down prices in the market for such services.

The MegaBells are also seeking policy changes to reduce or eliminate the requirement that they open their local networks prior to offering interLATA services.

If the MegaBells, which have resources far greater than McLeodUSA's, are authorized to bundle interLATA long distance service and local service in McLeodUSA's markets before the MegaBell local markets are effectively open to competition, the MegaBells could cause McLeodUSA to lose customers and revenues and make it more difficult for McLeodUSA to compete in those markets. McLeodUSA expects that eventually the MegaBells will be permitted to offer interLATA services throughout the United States. As the MegaBells are allowed to offer in-region interLATA in an increasing number of states, McLeodUSA will find it increasingly difficult to compete with them.

Developments in the Wireless Telecommunications Industry Could Make It More Difficult for McLeodUSA to Compete

The wireless telecommunications industry is experiencing increasing competition and significant technological change. Wireless Internet services, high speed data services and other more advanced wireless services are also gaining in popularity. These developments may make it more difficult for McLeodUSA to gain and maintain its share of the communications market, which may facilitate the migration of wireline minutes to wireless services. McLeodUSA presently does not offer wireless services in its bundle of offered services. McLeodUSA could face additional competition from users of new wireless technologies including, but not limited to, currently unlicensed spectrum.

Many of the wireless carriers have financial and other resources far greater than McLeodUSA's and have more experience testing and deploying new or improved products and services. In addition, several wireless competitors operate or plan to operate wireless telecommunications systems that encompass most of the United States, which could give them a significant competitive advantage.

See "Business Competition."

The Success of McLeodUSA's Communications Services Will Depend on McLeodUSA's Ability to Keep Pace with Rapid Technological Changes in McLeodUSA's Industry

Communications technology is changing rapidly. These changes influence the demand for McLeodUSA's services and the competition it faces. McLeodUSA needs to be able to anticipate these changes and to develop and bring to market new and enhanced products and services quickly enough for the changing market. This will determine whether McLeodUSA can continue to increase its revenue and number of subscribers and remain competitive.

The Loss of Key Personnel Could Weaken McLeodUSA's Technical and Operational Expertise, Delay McLeodUSA's Introduction of New Services or Entry into New Markets and Lower the Quality of McLeodUSA's Service

McLeodUSA may not be able to attract, develop, motivate and retain experienced and innovative personnel. There is intense competition for qualified personnel in McLeodUSA's lines of business. The loss of the services of key personnel, or the inability to attract additional qualified personnel, could cause McLeodUSA to make less successful strategic decisions, which could hinder the introduction of new services or the entry into new markets. McLeodUSA could also be less prepared for technological or marketing problems, which could reduce McLeodUSA's ability to serve its customers and lower the quality of its services. As a result, McLeodUSA's financial condition could be adversely affected.

Clark E. McLeod, Chairman of McLeodUSA, Stephen C. Gray, President and Chief Executive Officer of McLeodUSA, and Chris A. Davis, Chief Operating and Financial Officer of McLeodUSA, each play an important role in the future success of McLeodUSA. Loss of these senior executives could adversely affect the financial condition of McLeodUSA.

Failure to Obtain and Maintain Necessary Permits and Rights-of-Way Could Delay Installation of McLeodUSA's Networks and Interfere with McLeodUSA's Operations

To obtain access to rights-of-way needed to install McLeodUSA's fiber optic cable, McLeodUSA must reach agreements with state highway authorities, local governments, transit authorities, local telephone companies and other utilities, railroads, long distance carriers and other parties. The failure to obtain or maintain any rights-of-way could delay McLeodUSA's planned network expansion, interfere with McLeodUSA's operations and harm its business. For example, if McLeodUSA loses access to a right-of-way, McLeodUSA may need to spend significant sums to remove and relocate its facilities. See "Business Regulation."

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Government Regulation May Increase McLeodUSA's Cost of Providing Services, Slow McLeodUSA's Network Construction and Subject McLeodUSA's Services to Additional Competitive Pressures

McLeodUSA's facilities and services are subject to federal, state and local regulations. The time and expense of complying with these regulations could slow down McLeodUSA's network construction, increase its costs of providing services and subject McLeodUSA to additional competitive pressures. One of the primary purposes of the Telecommunications Act of 1996 was to open the local telephone services market to competition. While this has presented McLeodUSA with opportunities to enter local telephone markets, it also provides important benefits to the MegaBells, such as the ability, under specified conditions, to provide long distance service to customers in their respective regions. In addition, McLeodUSA needs to obtain and maintain licenses, permits and other regulatory approvals in connection with some of its services. Any of the following could harm McLeodUSA's business:

- failure to comply with federal and state tariff requirements;
- failure to maintain proper federal, state and municipal certifications or authorizations;
- failure to comply with federal, state or local laws and regulations;
- failure to obtain and maintain required licenses and permits;
- burdensome license or permit requirements to operate in public rights-of-way; and
- burdensome or adverse regulatory requirements.

Regulatory developments have enhanced the ability of other companies to compete against McLeodUSA, including by providing the MegaBells with increased pricing flexibility for many services, decreasing the MegaBells' access charges, and altering the manner in which local telephone services are supported by other services.

The legislative and regulatory environment in which McLeodUSA operates continues to undergo significant changes. Many of the developments discussed in this Proxy/Disclosure Statement are subject to further legislative and regulatory actions as well as litigation and court review. There can be no assurance that McLeodUSA's business will not be adversely affected by future legislation, regulation or court decisions.

State and federal regulations to which McLeodUSA is subject require prior approval for a range of different corporate activities, such as transfers of direct and indirect control of authorized telecommunications carriers, certain corporate reorganizations, acquisitions of telecommunications operations, assignment of carrier assets, carrier stock offerings and incurrence by carriers of significant debt obligations. McLeodUSA does not believe that the restructuring will effect a transfer of control over its regulated subsidiaries under most of the applicable standards, and therefore McLeodUSA does not believe that approval by the FCC and most state communications regulatory agencies is necessary. However, federal and state regulators could view some of the actions that McLeodUSA is taking in connection with the restructuring as requiring prior regulatory approval. The area of law applicable to these actions is subject to a range of possible interpretations by regulators and courts, and it is possible that McLeodUSA would be subjected to penalties if regulators determine that it should have obtained authorization prior to consummating the restructuring. If it becomes necessary to seek a regulatory approval before effectuating the restructuring, there is a risk that such approval may be delayed or denied.

Certificates of authority can generally be conditioned, modified, canceled, terminated or revoked by state regulatory authorities for failure to comply with state law or the rules, regulations and policies of state regulatory authorities. Fines or other penalties also may be imposed for such violations. State utility commissions or third parties could raise issues with regard to McLeodUSA's compliance with applicable laws or regulations which could have a material adverse effect on McLeodUSA's business, results of operations and financial condition.

Risks Associated with the In-Court Restructuring

See "The Plan Risk Factors."

SPECIAL MEETING, VOTING RIGHTS AND PROXIES

Date, Time and Place of Special Meeting

The Special Meeting will be held on January 14, 2002, at 10:00 a.m., local time, at [ ].

Solicitation of Proxies, Voting Record Date

This Proxy/Disclosure Statement is furnished in connection with the solicitation of proxies by McLeodUSA's board of directors to be voted at the Special Meeting. In addition, this Proxy/Disclosure Statement is furnished in connection with the solicitation of Ballots by the board of directors to be voted in connection with the Plan.

Stockholders may vote on the restructuring proposals by telephone, over the Internet, in person, or by marking, signing and dating the enclosed proxy card. Common stockholders are being asked to vote on each of the restructuring proposals. Series A preferred stockholders are only being asked to vote on the Series A reclassification proposal.

STOCKHOLDERS MUST COMPLETE A BALLOT IN ORDER TO VOTE ON THE PLAN. See "Procedures for Voting on The Plan."

THE SPECIAL COMMITTEE OF THE BOARD OF DIRECTORS AND THE DISINTERESTED MEMBERS OF THE BOARD OF DIRECTORS RECOMMEND A VOTE "FOR" EACH OF THE RESTRUCTURING PROPOSALS.

The voting record date for purposes of determining which stockholders are eligible to vote on the restructuring proposals at the Special Meeting is December [ ], 2001 (the "Voting Record Date"). As of the Voting Record Date, (i) there were 2.0 billion shares of Class A common stock authorized for issuance, of which 627.73 million shares were issued and outstanding, and (ii) three (3) series of preferred stock outstanding, including (a) 1.15 million shares of Series A preferred stock with an aggregate liquidation preference, including accrued and unpaid dividends, of $296.2 million; (b) 275,000 shares of Series D preferred stock with an aggregate liquidation preference of $687.5 million; and (c) 125,000 shares of Series E preferred stock with an aggregate liquidation preference of $312.5 million. McLeodUSA's executive officers and directors, as a group, beneficially own 67,311,394 shares of the outstanding Class A common stock, excluding option shares, and have advised McLeodUSA that they intend to vote in favor of the restructuring proposals. Forstmann Little, the beneficial owner of 275,000 shares of Series D preferred stock and 125,000 shares of Series E preferred stock (the "Forstmann Little Shares"), representing 100% of the issued and

outstanding shares of such series of preferred stock, has entered into an agreement with McLeodUSA, dated December 3, 2001 (the "Lock-Up and Voting Agreement"), wherein Forstmann Little agreed, among other things, to vote all of the Forstmann Little Shares held by it in favor of the restructuring proposals. See "Security Ownership of Certain Beneficial Owners and Management."

WHETHER OR NOT YOU ARE ABLE TO ATTEND THE SPECIAL MEETING, YOUR VOTE BY PROXY IS VERY IMPORTANT. STOCKHOLDERS ARE ENCOURAGED TO MARK, SIGN AND DATE THE ENCLOSED PROXY AND MAIL IT PROMPTLY IN THE ENCLOSED RETURN ENVELOPE MARKED "PROXY."

Proxies and Ballots are being solicited by and on behalf of the board of directors. All expenses of this solicitation, including the cost of preparing and mailing this Proxy/Disclosure Statement, will be borne by McLeodUSA. In addition to solicitation by use of the mails, proxies may be solicited by directors, officers and employees of McLeodUSA in person or by telephone, telegram or other means of communication. Such directors, officers and employees will not be additionally compensated, but may be reimbursed for out-of-pocket expenses in connection with such solicitation. Arrangements will also be made with custodians, nominees and fiduciaries for forwarding of proxy solicitation material to

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beneficial owners of stock held of record by such persons, and McLeodUSA may reimburse such custodians, nominees and fiduciaries for reasonable expenses incurred in connection therewith.

Purpose of Special Meeting

The purpose of the Special Meeting is to consider and vote on the restructuring proposals as described below in "Discussion of the Restructuring Proposals." Each of the restructuring proposals is conditioned upon the approval by the appropriate stockholders of each of the other restructuring proposals. If any or all of the restructuring proposals are not approved by the stockholders at the Special Meeting, then none of the restructuring proposals will become effective.

Voting of Proxies

All shares represented by a properly executed proxy will be voted at the Special Meeting in accordance with the directions on such proxy. If no direction is indicated on a properly executed proxy, the shares covered thereby will be voted in favor of the restructuring proposals.

In the event that sufficient votes in favor of any of the restructuring proposals are not received by the time scheduled for the Special Meeting, or if any of the other conditions to the consummation of the Out-of-Court Restructuring (as defined herein) and the other elements of the Out-of-Court Restructuring are not satisfied, the persons named as proxies may propose one or more adjournments of the Special Meeting to permit further solicitation of proxies with respect to such proposals or to permit the satisfaction of any such condition. Any such adjournment will require the affirmative vote of a majority of the voting power present or represented at the Special Meeting.

Voting Rights; Quorum

Pursuant to McLeodUSA's certificate of incorporation, stockholders will be entitled to one vote per share of Class A common stock and preferred stockholders will be entitled to one vote for each share of preferred stock, with each series voting as a separate class, at the Special Meeting. The presence, either in person or by properly executed proxy, of the respective holders of a majority of the shares of the Class A common stock and each series of preferred stock outstanding and entitled to vote is necessary to constitute a quorum at the Special Meeting. There is no quorum or minimum number of votes required to be cast with respect to the Plan.

No Dissenters' Rights

Pursuant to the Delaware General Corporation Law ("DGCL"), stockholders have no appraisal or dissenters' rights with respect to the restructuring proposals or the undertaking by McLeodUSA of any of the transactions described herein.

Revocation of Proxies

A stockholder who has executed and returned a proxy may revoke it at any time before it is voted by executing and returning a Proxy bearing a later date, by giving written notice of revocation to the Secretary of McLeodUSA or by attending the Special Meeting and voting in person.

DISCUSSION OF THE RESTRUCTURING PROPOSALS

General

The disinterested members of the board of directors have unanimously adopted resolutions approving each of the restructuring proposals, subject to stockholder approval. The Series A reclassification proposal, Series D reclassification proposal, Series E reclassification proposal, reverse stock split proposal and Section 203 proposal will be effected by amendments to McLeodUSA's certificate of incorporation, substantially in the form of Annex III hereto (referred to herein as the "Charter Amendments").

In connection with the Series A, D and E reclassification proposals and the reverse stock split proposal, no fractional shares shall be distributed. Instead, McLeodUSA will round such fractional shares up to the next whole number. The number of additional shares of Class A common stock to be issued in connection with the settling of fractional interests is not expected to be material.

The final text of the Charter Amendments is subject to change in order to meet the requirements as to form that may be requested or required by the Delaware Secretary of State's Office. If the requisite approval by the stockholders is obtained, the Charter Amendments will be effective upon the close of business on the date of filing of each of the Charter Amendments with the Delaware Secretary of State.

When the Series A, D and E reclasification proposal and the reverse stock split proposal become effective, stockholders will be asked to surrender certificates representing shares of stock in accordance with the procedures set forth in a letter of transmittal to be sent by McLeodUSA following effectiveness. Upon such surrender, a certificate representing the shares of Class A common stock will be issued and forwarded to the stockholders; however, each certificate representing shares of stock will continue to be valid and represent shares of Class A common stock equal to the appropriate fractional number of shares of stock (rounded up, if appropriate) as described herein. Persons who hold their shares in brokerage accounts or "street name" will not be required to take any further actions to effect the exchange of their certificates.

Series A Reclassification Proposal

McLeodUSA currently has outstanding 1.15 million shares of Series A preferred stock with an aggregate liquidation preference, including accrued and unpaid dividends, of $296.2 million. McLeodUSA elected not to declare the quarterly stock dividend payable on the Series A preferred stock on November 15, 2001. At the time the Charter Amendments become effective, and without any further action on the part of McLeodUSA or its stockholders, each share of Series A preferred stock then issued and outstanding shall be changed and reclassified into 39.05 fully paid and nonassessable shares of Class A common stock. The conversion ratio is based on 627,734,497 shares of Class A common stock issued and outstanding as of November 5, 2001. Such conversion ratio will be adjusted to effect the post-restructuring ownership levels set forth herein, to the extent issued and outstanding shares differ at the closing of the restructuring.

In order to complete the financial structuring (discussed in detail in other parts of this Proxy/Disclosure Statement), McLeodUSA is required to amend its certificate of incorporation in order to cancel its Series A preferred stock and issue a fixed amount of Class A common stock to the former owners of the Series A preferred stock, through a reclassification of the Series A preferred stock (as discussed above). The reclassification of the Series A preferred stock into Class A common stock is an integral part of the restructuring. McLeodUSA does not believe the holders of its senior notes would approve an exchange of its senior notes for cash and Class A common stock (as described elsewhere in this Proxy/Disclosure Statement) unless all the outstanding preferred stock of McLeodUSA is reclassified into Class A common stock.

THE AFFIRMATIVE VOTE OF THE MAJORITY OF THE OUTSTANDING SHARES OF CLASS A COMMON STOCK ENTITLED TO VOTE IS REQUIRED FOR APPROVAL OF THE SERIES A RECLASSIFICATION PROPOSAL. THE AFFIRMATIVE VOTE OF THE MAJORITY OF THE OUTSTANDING SHARES OF SERIES A PREFERRED STOCK ENTITLED TO VOTE IS ALSO REQUIRED FOR APPROVAL OF THE SERIES A RECLASSIFICATION PROPOSAL. ACCORDINGLY, ABSTENTIONS AND BROKER NON-VOTES WILL HAVE THE EFFECT OF A VOTE AGAINST THE SERIES A RECLASSIFICATION PROPOSAL. UNLESS INSTRUCTED TO THE CONTRARY IN THE PROXY, THE SHARES REPRESENTED BY THE PROXIES WILL BE VOTED FOR THE SERIES A RECLASSIFICATION PROPOSAL.

THE SPECIAL COMMITTEE OF THE BOARD OF DIRECTORS AND THE DISINTERESTED MEMBERS OF THE BOARD OF DIRECTORS RECOMMEND A VOTE "FOR" THE SERIES A RECLASSIFICATION.

Series D Reclassification Proposal

McLeodUSA currently has outstanding 275,000 shares of Series D preferred stock with an aggregate liquidation preference of $687.5 million. At the time the Charter Amendments become effective, and without any further action on the part of McLeodUSA or its stockholders, each share of Series D preferred stock, then issued and outstanding, shall be changed and reclassified into 378.79 fully paid and nonassessable shares of Class A common stock. The conversion ratio is based on 627,734,497 shares of Class A common stock issued and outstanding as of November 5, 2001. Such conversion ratio will be adjusted to effect the post-restructuring ownership levels set forth herein, to the extent issued and outstanding shares differ at the closing of the restructuring.

In order to complete the financial structuring (discussed in detail in other parts of this Proxy/Disclosure Statement), McLeodUSA is required to amend its certificate of incorporation in order to cancel its Series D preferred stock and issue a fixed amount of Class A common stock to the former owners of the Series D preferred stock, through a reclassification of the Series D preferred stock (as discussed above). The reclassification of the Series D preferred stock into Class A common stock is an integral part of the restructuring. McLeodUSA does not believe the holders of its senior notes would approve an exchange of its senior notes for cash and Class A common stock (as described elsewhere in this Proxy/Disclosure Statement) unless all the outstanding preferred stock of McLeodUSA is reclassified into Class A common stock.

THE AFFIRMATIVE VOTE OF THE MAJORITY OF THE OUTSTANDING SHARES OF CLASS A COMMON STOCK ENTITLED TO VOTE IS REQUIRED FOR APPROVAL OF THE SERIES D RECLASSIFICATION PROPOSAL. THE AFFIRMATIVE VOTE OF THE MAJORITY OF THE OUTSTANDING SHARES OF SERIES D PREFERRED STOCK ENTITLED TO VOTE IS ALSO REQUIRED FOR APPROVAL OF THE SERIES D RECLASSIFICATION PROPOSAL. ACCORDINGLY, ABSTENTIONS AND BROKER NON-VOTES WILL HAVE THE EFFECT OF A VOTE AGAINST THE SERIES D RECLASSIFICATION PROPOSAL. UNLESS INSTRUCTED TO THE CONTRARY IN THE PROXY, THE SHARES REPRESENTED BY THE PROXIES WILL BE VOTED FOR THE SERIES D RECLASSIFICATION PROPOSAL.

Forstmann Little owns all shares of the Series D preferred stock and has agreed to vote for the Series D reclassification proposal.

THE SPECIAL COMMITTEE OF THE BOARD OF DIRECTORS AND THE DISINTERESTED MEMBERS OF THE BOARD OF DIRECTORS RECOMMEND A VOTE "FOR" THE SERIES D RECLASSIFICATION PROPOSAL.

Series E Reclassification Proposal

McLeodUSA currently has outstanding 125,000 shares of Series E preferred stock with an aggregate liquidation preference of $312.5 million. At the time the Charter Amendments become effective, and without any further action on the part of McLeodUSA or its stockholders, each share of Series E preferred stock, then issued and outstanding, shall be changed and reclassified into 378.79 fully paid and nonassessable shares of Class A common stock. The conversion ratio is based on 627,734,497 shares of Class A common stock issued and outstanding as of November 5, 2001. Such conversion ratio will be adjusted to effect the post-restructuring ownership levels set forth herein, to the extent issued and outstanding shares differ at the closing of the restructuring.

In order to complete the financial structuring (discussed in detail in other parts of this Proxy/Disclosure Statement), McLeodUSA is required to amend its certificate of incorporation in order to cancel its Series E preferred stock and issue a fixed amount of Class A common stock to the former owners of the Series E preferred stock, through a reclassification of the Series E preferred stock (as discussed above). The reclassification of the Series E preferred stock into Class A common stock is an integral part of the restructuring plan. McLeodUSA does not believe the holders of its senior notes would approve an exchange of its senior notes for cash and Class A common stock (as described elsewhere in this Proxy/Disclosure Statement) unless all the outstanding preferred stock of McLeodUSA is reclassified into Class A common stock.

THE AFFIRMATIVE VOTE OF THE MAJORITY OF THE OUTSTANDING SHARES OF CLASS A COMMON STOCK ENTITLED TO VOTE IS REQUIRED FOR APPROVAL OF THE SERIES E RECLASSIFICATION PROPOSAL. THE AFFIRMATIVE VOTE OF THE MAJORITY OF THE OUTSTANDING SHARES OF SERIES E PREFERRED STOCK ENTITLED TO VOTE IS ALSO REQUIRED FOR APPROVAL OF THE SERIES E RECLASSIFICATION PROPOSAL. ACCORDINGLY, ABSTENTIONS AND BROKER NON-VOTES WILL HAVE THE EFFECT OF A VOTE AGAINST THE SERIES E RECLASSIFICATION PROPOSAL. UNLESS INSTRUCTED TO THE CONTRARY IN THE PROXY, THE SHARES REPRESENTED BY THE PROXIES WILL BE VOTED FOR THE SERIES E RECLASSIFICATION PROPOSAL.

Forstmann Little owns all shares of the Series E preferred stock and has agreed to vote for the Series E reclassification proposal.

THE SPECIAL COMMITTEE OF THE BOARD OF DIRECTORS AND THE DISINTERESTED MEMBERS OF THE BOARD OF DIRECTORS RECOMMEND A VOTE "FOR" THE SERIES E RECLASSIFICATION PROPOSAL.

Reverse Stock Split Proposal

McLeodUSA has approximately 627.73 million shares of Class A common stock outstanding. The reverse stock split proposal would effect a 5-to-1 reverse stock split of McLeodUSA's outstanding shares of Class A common stock such that each share of Class A common stock outstanding immediately prior to the completion of the restructuring will automatically convert into one-fifth of one share of Class A common stock immediately thereafter.

If the reverse stock split were not implemented as part of the Out-of-Court Restructuring (as defined herein), there would be approximately 1.89 billion shares of Class A common stock issued and outstanding after giving effect to the Out-of-Court Restructuring (but not including shares to be issued pursuant to the management incentive plan), and the per share stock price of the Class A common stock would likely be less than $1.00 per share. The special committee of the board of directors and the disinterested members of the board of directors determined the reverse stock split is necessary in order to "normalize" the post-restructuring trading of the Class A common stock by reducing the number of outstanding shares and thereby potentially increasing the trading price of the Class A common stock

from where it would otherwise trade in the absence of the reverse stock split assuming the aggregate market capitalization of McLeodUSA remains constant. Such increase of the trading price may, although there is no assurance that it will, (i) enhance the attractiveness of the Class A common stock to certain institutional investors whose investing guidelines require that the securities that they purchase meet certain minimum trading price criteria, (ii) permit investors to purchase Class A common stock from broker/dealers on margin in accordance with applicable regulations and (iii) militate in favor of continued listing of the Class A common stock on The Nasdaq National Market. In addition to the foregoing, the reverse stock split is necessary in order to provide McLeodUSA with a sufficient amount of Class A common stock to issue the shares contemplated in the restructuring, including the Management Incentive Plan.

THE AFFIRMATIVE VOTE OF THE MAJORITY OF THE OUTSTANDING SHARES OF CLASS A COMMON STOCK ENTITLED TO VOTE IS REQUIRED FOR APPROVAL OF THE REVERSE STOCK SPLIT PROPOSAL. ACCORDINGLY, ABSTENTIONS AND BROKER NON-VOTES WILL HAVE THE EFFECT OF A VOTE AGAINST THE REVERSE STOCK SPLIT PROPOSAL. UNLESS INSTRUCTED TO THE CONTRARY IN THE PROXY, THE SHARES REPRESENTED BY THE PROXIES WILL BE VOTED FOR THE REVERSE STOCK SPLIT PROPOSAL.

THE SPECIAL COMMITTEE OF THE BOARD OF DIRECTORS AND THE DISINTERESTED MEMBERS OF THE BOARD OF DIRECTORS RECOMMEND A VOTE "FOR" THE REVERSE STOCK SPLIT PROPOSAL.

Section 203 Proposal

This proposal, if approved by the stockholders, would have the effect of making the anti-takeover protection of Section 203 of the DGCL inapplicable to McLeodUSA. Section 203 of the DGCL provides that a person who acquires fifteen percent (15%) or more of the outstanding voting stock of a Delaware corporation becomes an "interested stockholder." Section 203 prohibits a corporation from engaging in mergers or certain other "business combinations" with an interested stockholder for a period of three (3) years following the time that such interested stockholder becomes an interested stockholder, unless (i) prior to the date the stockholder becomes an interested stockholder, the board of directors of a corporation approves either the business combination or the transaction which results in the stockholder becoming an interested stockholder, or (ii) the interested stockholder is able to acquire ownership of at least 85% of the outstanding voting stock of the corporation (excluding shares owned by directors of the corporation who are also officers and shares owned by certain employee stock plans) in the same transaction by which the stockholder became an interested stockholder, or (iii) the interested stockholder obtains control of the board of directors, which then approves a business combination which is authorized by a vote of the holders of two-thirds of the outstanding voting stock not held by the interested stockholder.

A "business combination" is defined broadly in the DGCL to include any merger or consolidation with the interested stockholder, any merger or consolidation caused by the interested stockholder in which the surviving corporation will not be subject to Delaware law, or the sale, lease, exchange, mortgage, pledge, transfer or other disposition to the interested stockholder of any assets of the corporation having a market value equal to or greater than 10% of the aggregate market value of the assets of the corporation. "Business combination" is also defined to include transfers of stock of the corporation or a subsidiary to the interested stockholder (except for transfers in conversion, exchange or pro rata distribution which do not increase the interested stockholder's proportionate ownership of a class or series), or any receipt by the interested stockholder (except proportionately as a stockholder) of any loans, advances, guaranties, pledges or financial benefits. This summary is qualified in its entirety by Section 203 of the DGCL, attached hereto as Appendix IV.

It is a condition to the effectiveness of the Purchase Agreement with Forstmann Little that the stockholders approve the Section 203 proposal. The Purchase Agreement also prohibits McLeodUSA from adopting or implementing any stockholder rights plan or "poison pill" as long as Forstmann Little holds 60% of the McLeodUSA Securities (on a fully converted basis) it owned at the consummation of the Purchase Agreement or until the date Forstmann Little sells its shares in a Disqualified Transaction. See "Restructuring Agreements with Forstmann Little."

If this proposal is approved, the amendment to opt out of Section 203 will become effective as of the earliest date permitted by law, currently 12 months after adoption of amendments to the certificate of incorporation, and will not apply to any business combination with any interested stockholder prior to adoption.

THE AFFIRMATIVE VOTE OF THE MAJORITY OF THE OUTSTANDING SHARES OF CLASS A COMMON STOCK ENTITLED TO VOTE IS REQUIRED FOR APPROVAL OF THE SECTION 203 PROPOSAL. ACCORDINGLY, ABSTENTIONS AND BROKER NON-VOTES WILL HAVE THE EFFECT OF A VOTE AGAINST THE SECTION 203 PROPOSAL. UNLESS INSTRUCTED TO THE CONTRARY IN THE PROXY, THE SHARES REPRESENTED BY THE PROXIES WILL BE VOTED FOR THE SECTION 203 PROPOSAL.

THE SPECIAL COMMITTEE OF THE BOARD OF DIRECTORS AND THE DISINTERESTED MEMBERS OF THE BOARD OF DIRECTORS RECOMMEND A VOTE "FOR" THE SECTION 203 PROPOSAL.

The Issuance Proposal

Stockholders are being asked to consider and approve, as part of the Out-of-Court Restructuring, the issuance of Class A common stock (including the Class A common stock to be issued upon exercise of the New Warrants). Upon exchange of their Senior Notes, the Senior Noteholders, in the aggregate and as of the exchange date, would receive 56,813,984 shares of Class A common stock, which would represent approximately 15% of the outstanding shares of Class A common stock following consummation of the Out-of-Court Restructuring (subject to dilution). Assuming all of the conditions to the restructuring are fulfilled, McLeodUSA will issue the New Preferred Stock convertible into approximately 36,433,233 shares of Class A common stock, which represent the right to acquire approximately 8.8% of the Class A common stock issued and outstanding immediately following consummation of the Out-of-Court Restructuring (assuming a post-restructuring equity value of $2.74 per share and on a fully diluted basis).

The approval by the Class A common stockholders of the issuance proposal may be required by the applicable rules of the Nasdaq.

NASD Rule 4460(i)(1) requires each issuer of securities authorized for quotation on The Nasdaq National Market receive stockholder approval prior to the issuance of such securities (a) when the issuance will result in a change of control of such issuer, or (b) in connection with a transaction other than a public offering involving the sale or issuance by the issuer of common stock (or securities convertible into or exercisable for common stock) equal to 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance for less than the greater of book or market value of the stock. Where stockholder approval is required, the minimum vote which will constitute shareholder approval is a majority of the total votes cast on the proposal in person or by proxy.

The Class A common stock is authorized for quotation on The Nasdaq National Market and, (A) the issuance to Forstmann Little may be deemed to be a change of control of McLeodUSA, and (B) (i) the aggregate number of shares of Class A common stock issuable in exchange for the Notes, upon reclassification of the preferred stock and upon exercise of the New Warrants is in excess of 20%

of the outstanding shares of Class A common stock and (ii) the issue price could be deemed to be less than the current market value of the Class A common stock. Accordingly, McLeodUSA is seeking approval of the issuance proposal.

THE AFFIRMATIVE VOTE OF A MAJORITY OF THE SHARES OF CLASS A COMMON STOCK REPRESENTED AT THE SPECIAL MEETING AND ENTITLED TO VOTE IS REQUIRED FOR APPROVAL OF THE ISSUANCE PROPOSAL. ACCORDINGLY, ABSTENTIONS WILL HAVE THE EFFECT OF A VOTE AGAINST THE ISSUANCE PROPOSAL, WHILE BROKER NON-VOTES WILL NOT AFFECT THE OUTCOME OF THE VOTE ON THE ISSUANCE PROPOSAL. UNLESS INSTRUCTED TO THE CONTRARY IN THE PROXY, THE SHARES REPRESENTED BY THE PROXIES WILL BE VOTED TO APPROVE THE ISSUANCE PROPOSAL.

THE SPECIAL COMMITTEE OF THE BOARD OF DIRECTORS AND THE DISINTERESTED MEMBERS OF THE BOARD OF DIRECTORS RECOMMEND A VOTE "FOR" THE ISSUANCE PROPOSAL.

The Management Incentive Plan Proposal

The McLeodUSA 2001 Omnibus Equity Plan (the "Management Incentive Plan") was approved by the board of directors, subject to approval by the stockholders of McLeodUSA.

The Management Incentive Plan is intended to promote the interests of McLeodUSA and its stockholders by providing officers and other employees (including directors who are also employees) with appropriate incentives and rewards to encourage them to enter into and continue in the employ of McLeodUSA and to acquire a proprietary interest in the long-term success of McLeodUSA and to reward the performance of individual officers, other employees, consultants and nonemployee directors in fulfilling their personal responsibilities for long-range achievements.

The Management Incentive Plan is intended to provide performance-based compensation within the meaning of Section 162(m) of the Internal Revenue Code of 1986, as amended (the "IRC"), which generally limits the deduction by an employer for compensation of certain covered officers. Under Section 162(m), certain compensation, including compensation based on the attainment of performance goals, may be disregarded for purposes of this deduction limit if certain requirements are met. Among the requirements for compensation to qualify for this exception is that the material terms pursuant to which the compensation is to be paid be disclosed to and approved by the stockholders in a separate vote prior to the payment. Accordingly, if the Management Incentive Plan is approved by stockholders and the other conditions of Section 162(m) relating to performance-based compensation are satisfied, compensation paid to covered officers pursuant to the Management Incentive Plan will not fail to be deductible under Section 162(m).

Description of Principal Features of the Management Incentive Plan

There are generally five types of awards that may be granted under the Management Incentive Plan: Restricted Stock Options (including both incentive stock options ("ISOs") within the meaning of Section 422 of the IRC and nonqualified options ("NQSOs"), which are options that do not qualify as ISOs), Phantom Stock, Stock Bonus awards, and Other Awards (including Stock Appreciation Rights). In addition, the Compensation Committee of the Board of Directors (the "Committee") may, in its discretion, make other awards valued in whole or in part by reference to, or otherwise based on, Class A common stock.

McLeodUSA will reserve for issuance under the Management Incentive Plan a number of shares of Class A common stock equal to 15% of the number of shares of Class A common stock which are outstanding after the conversion of the New Preferred Stock (after giving effect to the issuance of the

Class A common stock pursuant to the exercise of options under the Management Incentive Plan), subject to equitable adjustment upon the occurrence of any stock dividend or other distribution, recapitalization, stock split, subdivision reorganization, merger, consolidation, combination, repurchase, or share exchange, or other similar corporate transaction or event. The market price per share of Class A common stock on December 10, 2001 was approximately $.50.

Officers of McLeodUSA, including the Named Executive Officers (as defined herein), employees, and consultants and directors to McLeodUSA are eligible to receive awards under the Management Incentive Plan in the discretion of the Committee. To date, no awards have been granted under the Management Incentive Plan.

Awards will become exercisable or otherwise vest at the times and upon the conditions that the Committee may determine, as reflected in the applicable award agreement. The Committee has the authority to accelerate the vesting and/or exercisability of any outstanding award at such times and under such circumstances as it, in its sole discretion, deems appropriate. Because awards under the Management Incentive Plan are discretionary it is not possible to determine the size of future awards.

Stock Options. Options entitle the holder to purchase shares of Class A common stock during a specified period at a purchase price specified by the Committee (but in the case of an ISO, at a price not less than 100% of the fair market value of the Class A common stock on the day the ISO is granted). Each Option granted under the Management Incentive Plan will be exercisable for a period of 10 years from the date of grant, or such lesser period as the Committee shall determine. Options may be exercised in whole or in part by the payment of cash of the full option price of the shares purchased, by tendering shares of Class A common stock with a fair market value equal to the option price of the shares purchased, or by other methods in the discretion of the Committee. The Management Incentive Plan provides that each Option shall become exercisable at the time determined by the Committee and set forth in the applicable agreement. The Committee may provide that a participant who delivers shares of Class A common stock to exercise an Option will automatically be granted new Options for the number of shares delivered to exercise the Option ("Reload Options"). Reload Options will be subject to the same terms and conditions as the related Option (except that the exercise price generally will be the fair market value of the Class A common stock on the date the Reload Option is granted).

Restricted Stock. The Committee may grant restricted shares of Class A common stock to such persons, in such amounts, and subject to such terms and conditions (including the attainment of performance goals) as the Committee may determine in its discretion. Except for restrictions on transfer and such other restrictions as the Committee may impose, participants will have all the rights of a stockholder with respect to the restricted stock. Unless the Committee determines otherwise, termination of employment during the restricted period will result in the forfeiture by the participant of all shares still subject to restrictions.

Phantom Stock. A Phantom Stock award is an award of the right to receive an amount of cash or Class A common stock at a future date based upon an increase in the value of the Class A common stock during the term of the award.

Stock Bonus Awards. A Stock Bonus Award is an award of Class A common stock, made at the discretion of the Committee upon such terms and conditions (if any) as the Committee may determine.

Other Awards (Including Stock Appreciation Rights). Other forms of awards (including any Stock Appreciation Rights, hereinafter "Other Awards") valued in whole or in part by reference to, or otherwise based on, Class A common stock may be granted either alone or in addition to other Awards under the Management Incentive Plan. Subject to the provisions of the Management Incentive Plan, the Committee shall have sole and complete authority to determine the persons to whom and the time or times at which such Other Awards shall be granted, the number of shares of Class A common stock

to be granted pursuant to such Other Awards and all other conditions of such Other Awards. A Stock Appreciation Right may be granted in connection with an Option, either at the time of grant or at any time thereafter during the term of the Option, or may be granted unrelated to an Option.

Other Features of the Management Incentive Plan

The Management Incentive Plan will be administered by the Committee. Each member of the Committee is expected to be a "non-employee director" (within the meaning of Rule 16b-3 promulgated under Section 16 of the Securities Exchange Act of 1934, as amended) and an "outside director" (within the meaning of Section 162(m) of the IRC).

The Management Incentive Plan may be amended by the Board of Directors, subject to stockholder approval where necessary to satisfy certain regulatory requirements. The Management Incentive Plan will terminate not later than [, 2011]. However, awards granted before the termination of the Management Incentive Plan may extend beyond that date in accordance with their terms.

New Plan Benefits

Inasmuch as awards under the Management Incentive Plan will be granted at the sole discretion of the Committee, it is not possible at this time to determine either the persons who will receive awards under the Management Incentive Plan or the amount of any such awards.

Certain Federal Income Tax Consequences

Set forth below is a discussion of certain United States federal income tax consequences with respect to Options that may be granted pursuant to the Management Incentive Plan. The following discussion is a brief summary only, and reference is made to the IRC and the regulations and interpretations issued thereunder for a complete statement of all relevant federal tax consequences. This summary is not intended to be exhaustive and does not describe state, local or foreign tax consequences of participation in the Management Incentive Plan.

Incentive Stock Options. In general, no taxable income is realized by a participant upon the grant of an incentive stock option, within the meaning of Section 422 of the IRC. If shares of Class A common stock are issued to a participant ("Option Shares") pursuant to the exercise of an ISO granted under the Management Incentive Plan and the participant does not dispose of the Option Shares within the two-year period after the date of grant or within one year after the receipt of such Option Shares by the participant (a "disqualifying disposition"), then, generally (i) the participant will not realize ordinary income with respect to the Option and (ii) upon sale of such Option Shares, any amount realized in excess of the exercise price paid for the Option Shares will be taxed to such participant as capital gain. The amount by which the fair market value of the Class A common stock on the exercise date of an ISO exceeds the purchase price generally will, however, constitute an item which increases the participant's "alternative minimum taxable income."

If Option Shares acquired upon the exercise of an ISO are disposed of in a disqualifying disposition, the participant generally would include in ordinary income in the year of disposition an amount equal to the excess of the fair market value of the Option Shares at the time of exercise (or, if less, the amount realized on the disposition of the Option Shares), over the exercise price paid for the Option Shares

Subject to certain exceptions, an ISO generally will not be treated as an ISO if it is exercised more than three months following termination of employment. If an ISO is exercised at a time when it no longer qualifies as an ISO, such option will be treated as an NQSO as discussed below.

Nonqualified Stock Options. In general, no taxable income is realized by a participant upon the grant of an NQSO. Upon exercise of an NQSO, the participant generally would include in ordinary income at the time of exercise an amount equal to the excess, if any, of the fair market value of the Option Shares at the time of exercise over the exercise price paid for the Option Shares.

In the event of a subsequent sale of Option Shares received upon the exercise of an NQSO, any appreciation after the date on which taxable income is realized by the participant in respect of the option exercise should be taxed as capital gain in an amount equal to the excess of the sales proceeds for the Option Shares over the participant's basis in such Option Shares. The participant's basis in the Option Shares will generally equal the amount paid for the Option Shares plus the amount included in ordinary income by the participant upon exercise of the nonqualified option described in the immediately preceding paragraph.

Restricted Stock. A participant will not recognize any income upon the receipt of Restricted Stock unless the holder elects under Section 83(b) of the IRC, within thirty days of such receipt, to recognize ordinary income in an amount equal to the fair market value of the Restricted Stock at the time of receipt, less any amount paid for the shares. If the election is made, the holder will not be allowed a deduction for amounts subsequently required to be returned to McLeodUSA. If the election is not made, the holder will generally recognize ordinary income, on the date that the restrictions to which the Restricted Stock are subject are removed, in an amount equal to the fair market value of such shares on such date, less any amount paid for the shares. At the time the holder recognizes ordinary income, McLeodUSA generally will be entitled to a deduction in the same amount.

Generally, upon a sale or other disposition of Restricted Stock with respect to which the holder has recognized ordinary income (*i.e.,* a Section 83(b) election was previously made or the restrictions were previously removed), the holder will recognize capital gain or loss in an amount equal to the difference between the amount realized on such sale or other disposition and the holder's basis in such shares.

Other Types of Awards. The grant of a stock appreciation right will not result in income for the grantee or in a tax deduction for McLeodUSA. Upon the settlement of such a right or the payment of a Stock Bonus Award, the participant will recognize ordinary income equal to the aggregate value of the payment received, and McLeodUSA generally will be entitled to a tax deduction in the same amount.

The approval of the Management Incentive Plan by the Stockholders may be required by the applicable rules of the Nasdaq.

THE AFFIRMATIVE VOTE OF THE MAJORITY OF THE SHARES OF CLASS A COMMON STOCK REPRESENTED AT THE SPECIAL MEETING AND ENTITLED TO VOTE IS REQUIRED FOR APPROVAL OF THE MANAGEMENT INCENTIVE PLAN PROPOSAL. ACCORDINGLY, ABSTENTIONS WILL HAVE THE EFFECT OF A VOTE AGAINST THE MANAGEMENT INCENTIVE PLAN PROPOSAL, WHILE BROKER NON-VOTES WILL NOT AFFECT THE OUTCOME OF THE VOTE ON THE MANAGEMENT INCENTIVE PLAN PROPOSAL. UNLESS INSTRUCTED TO THE CONTRARY IN THE PROXY, THE SHARES REPRESENTED BY THE PROXIES WILL BE VOTED TO APPROVE THE MANAGEMENT INCENTIVE PLAN PROPOSAL.

THE SPECIAL COMMITTEE OF THE BOARD OF DIRECTORS AND THE DISINTERESTED MEMBERS OF THE BOARD OF DIRECTORS RECOMMEND A VOTE "FOR" THE MANAGEMENT INCENTIVE PLAN PROPOSAL.

Conditions to Effectiveness of Each Restructuring Proposal.

Effectiveness of each of the restructuring proposals is conditioned upon each of the other restructuring proposals receiving required approvals from stockholders eligible to vote thereon. The restructuring proposals are also conditioned upon, among other things, at least 95% of the aggregate principal and accreted amount of the Notes being validly tendered and not withdrawn prior to expiration of the Exchange Offer, consummation of the sale of Pubco for at least $535 million, consummation of the sale of the New Preferred Stock and New Warrants to Forstmann Little for at least $100 million and the satisfactory resolution of certain tax matters.

Comparison of Class A Common Stock to Outstanding Preferred Stock.

	Series A Preferred Stock	Class A Common Stock

Dividends	Cumulative dividends at an annual rate of 6.75% of the liquidation preference payable quarterly, at McLeodUSA's option, in cash or shares of Class A common stock. See "Description of Capital Stock Series A Preferred Stock Dividends."	When and as declared by the board of directors.
Liquidation Preference	$250.	None.
Conversion into Class A Common Stock	Convertible at the option of its holder into shares of Class A common stock at a conversion price of $9.69, subject to adjustment. In addition, if on or after August 15, 2002, the closing price of Class A common stock has equaled or exceeded 135% of the conversion price for a specified period, McLeodUSA will have the option to convert all the Series A preferred stock into Class A common stock. See "Description of Capital Stock Series A Preferred Stock Conversion into McLeodUSA Class A Common Stock."	Not applicable.
Redemption	Redeemable for cash, shares of Class A common stock or both, at a redemption price of 104.5% of the liquidation preference, plus accumulated and unpaid dividends to the redemption date, on or after August 15, 2001, but prior to August 15, 2002, if the closing price of Class A common stock equals or exceeds 150% of the conversion price for a specified trading period. In addition, holders will receive a payment equal to the present value of the dividends that would thereafter have been payable on the Series A preferred stock from the redemption date to August 15, 2002. After August 15, 2002, redeemable at	

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	McLeod's option, initially at a redemption price of 103.375% of the liquidation preference and thereafter at prices declining to 100% on and after August 15, 2005, plus in each case, all accumulated and unpaid dividends. See "Description of Capital Stock Series A Preferred Stock."	Under certain limited circumstances as provided in McLeodUSA's certificate of incorporation. See "Description of Capital Stock Common Stock."
Voting Rights	Except as required by law, the holders of the Series A preferred stock are not entitled to any voting rights unless payments of dividends on the Series A preferred stock are in arrears and unpaid for an aggregate of six or more quarterly dividend payments. In such an event, the holders of the Series A preferred stock (together with holders of other series of preferred stock having similar rights) are entitled to elect the lesser of two directors to the board of directors or that number of directors constituting at least 25% of the board of directors, until such time as all dividend arrearages have been paid.	One vote on all matters on which stockholders are entitled to vote, including the election of the board of directors.
Ranking	With respect to dividends and upon liquidation, dissolution or winding-up: junior to all existing and future debt obligations, junior to each class of capital stock or series of preferred stock, the	Upon liquidation or dissolution, subject to the preferences that may be applicable to any outstanding shares of preferred stock, the holders of Class A common stock are entitled to share

	terms of which expressly provide that it ranks senior to the Series A preferred stock, on a parity with each class of capital stock or series of preferred stock, the terms of which expressly provide that it ranks on a parity with the Series A preferred stock, senior to all classes of common stock and each other class of capital stock or series of preferred stock, the terms of which do not expressly provide that it ranks senior to or on a parity with the Series A preferred stock. See "Description of Capital Stock Ranking."	ratably in all assets available for distribution to stockholders.

	Series D and Series E Preferred Stock	**Class A Common Stock**
Dividends	If at any time prior to October 1, 2006, McLeodUSA pays a dividend in cash or property other than in shares of capital stock on the Class A common stock, each share of Series D and Series E preferred stock will participate in such dividend pursuant to a formula specified in the certificates of designations for such preferred stock. See "Description of Capital Stock Dividends."	When and as declared by the board of directors.
Liquidation Preference	$2500.	None.
Conversion into Class A Common Stock	Series D preferred stock is generally, convertible at any time. Upon any such conversion, a proportional amount of the Series E preferred stock also automatically converts. If, at any time on or after September 30, 2006, the average market price of Class A common stock is equal to or greater than the product of (x) 1.01 and (y) the Conversion Price (as defined below), then McLeodUSA will have the right to declare that all outstanding shares of Series D preferred stock will be automatically converted into Class A common stock. Upon such a conversion all shares of Series E preferred stock will also convert to Class A common stock. Upon conversion, the outstanding shares of Series D and Series E preferred stock taken together will be convertible into a number of shares of Class A common stock determined pursuant to a formula specified in the certificate of designations which utilizes a conversion price of $6.10, subject to adjustment (the "Conversion Price"). See "Description of Capital Stock Conversion."	Not applicable.
Redemption	To the extent McLeodUSA has funds legally available, during the 180-day period commencing on September 30, 2009, the holders of the Series D preferred stock will have the right to cause McLeodUSA to redeem the outstanding shares of Series D preferred stock. Upon any such redemption McLeodUSA will be required to redeem a proportional amount of the Series E preferred stock. The holders of shares of Series D and Series E preferred being redeemed, taken together, will be entitled to receive an amount in cash determined pursuant to a formula specified in the certificates of designations. See	Under certain limited circumstances as provided in McLeodUSA's certificate of incorporation. See "Description of Capital Stock Common Stock."

"Description of Capital Stock Redemption."

Voting Rights	So long as at least 110,000 shares of Series D preferred stock remain outstanding, the holders of the Series D preferred stock are entitled to collectively elect two directors to the board of directors; so long as at least 55,000 but less than 110,000 shares remain outstanding, the holders are entitled to collectively elect one director to the board of directors and to designate a person as a non-voting observer to attend all meetings of the board of directors; and so long as 55,000 or less (but at least one) of the shares remain outstanding, the holders are entitled to designate two non-voting observers. The holders of Series E preferred stock are entitled to designate one non-voting observer. If McLeodUSA fails to discharge its mandatory redemption obligations or if it issues securities senior to the Series D and Series E preferred stock without the requisite consent of the holders of Series D and Series E preferred stock, the total number of directors then constituting the whole board automatically will be increased and the holders of outstanding shares of Series D and Series E preferred stock, each voting separately as a single series, will each be entitled to elect one additional director to serve on the board. See "Description of Capital Stock Voting Rights."	One vote on all matters on which stockholders are entitled to vote, including the election of directors.
Ranking	With respect to dividends and upon liquidation, dissolution or winding-up: junior to all existing and future debt obligations, junior to each class of capital stock or series of preferred stock, the terms of which expressly provide that it ranks senior to the Series D and Series E preferred stock, on a parity with each class of capital stock or series of preferred stock, the terms of which expressly provide that it ranks on a parity with the Series D and Series E preferred stock, senior to all classes of common stock and each other class of capital stock or series of preferred stock, the terms of which do not expressly provide that it ranks senior to or on a parity with the Series D and Series E preferred stock. See"Description of Capital Stock Ranking."	Upon liquidation or dissolution, subject to the preferences of that may be applicable to any outstanding shares of preferred stock, the holders of Class A common stock are entitled to share ratably in all assets available for distribution to stockholders.

TERMS AND CONDITIONS OF THE EXCHANGE OFFER AND CONSENT SOLICITATION

The Exchange Offer

McLeodUSA has launched an exchange offer for all of its outstanding senior notes (the "Exchange Offer"). Pursuant to the Exchange Offer, McLeodUSA has offered an aggregate of:

$560 million in cash; and

56,813,984 shares of Class A common stock, representing approximately 15% of the Class A common stock to be outstanding as of the closing of the Exchange Offer (subject to dilution),

for the entire principal amount of the following outstanding debt obligations of McLeodUSA:

the $10^{1}/_{2}$% Senior Discount Notes due March 1, 2007 (the "$10^{1}/_{2}$% Notes");

the $9^{1}/_{4}$% Senior Notes due July 15, 2007 (the "$9^{1}/_{4}$% Notes");

the $8^{3}/_{8}$% Senior Notes due March 15, 2008 (the "$8^{3}/_{8}$% Notes");

the $9^{1}/_{2}$% Senior Notes due November 1, 2008 (the "$9^{1}/_{2}$% Notes");

the $8^{1}/_{8}$% Senior Notes due February 15, 2009 (the "$8^{1}/_{8}$% Notes");

the 12% Senior Notes due July 15, 2008 (the "12% Notes");

the $11^{1}/_{2}$% Senior Notes due May 1, 2009 (the "$11^{1}/_{2}$% Notes"); and

the $11^{3}/_{8}$% Senior Notes due January 1, 2009 (the "$11^{3}/_{8}$% Notes").

The $10^{1}/_{2}$% Notes, the $9^{1}/_{4}$% Notes, the $8^{3}/_{8}$% Notes, the $9^{1}/_{2}$% Notes, the $8^{1}/_{8}$% Notes, the 12% Notes, the $11^{1}/_{2}$% Notes and the $11^{3}/_{8}$% Notes are collectively referred to herein as the "Notes."

Subject to the terms and conditions of the Exchange Offer, each holder of Notes ("Noteholder") who validly tenders, and does not withdraw, its Notes, all as further described herein, shall receive its pro rata portion of $560 million in cash and 56,813,984 shares of Class A common stock based upon the ratio of (x) the principal and accreted amount of the Notes tendered by such Noteholder plus all accrued and unpaid interest thereon as of the day immediately preceding the closing of the Exchange Offer to (y) the principal and accreted amount of all Notes plus all accrued and unpaid interest thereon outstanding as of the day immediately preceding the closing of the Exchange Offer, an estimate of which is set forth in the table below, for each $1,000 face amount so tendered (the

"Exchange Offer Consideration"). Notes that are exchanged as part of the Exchange Offer will be cancelled.

		Distribution of Cash and Stock per $1,000 Face:	
Issue	**Estimated Principal and Accrued Interest or Accreted Amount as of January 31, 2002**	**Cash(1)**	**Class A Shares(1)**
$10^{1}/_{2}$% Notes	$ 495,850,024	$ 182.51	18.52
12% Notes	159,750,000	$ 196.00	19.88
$11^{1}/_{2}$% Notes	216,037,500	$ 189.33	19.21
$9^{1}/_{4}$% Notes	236,273,437	$ 193.26	19.61
$8^{3}/_{8}$% Notes	309,421,875	$ 189.82	19.26
$9^{1}/_{2}$% Notes	307,125,000	$ 188.41	19.11
$11^{3}/_{8}$% Notes	799,765,625	$ 196.25	19.91

		Distribution of Cash and Stock per $1,000 Face:	
8 1/8% Notes	518,619,792	$ 190.89	19.37
	$ 3,042,843,253		

(1) The table was prepared assuming that the Exchange Offer is consummated on February 1, 2002 and 100% of the Notes are tendered. Any different date will result in differing amounts of accrued interest and therefore different amounts of cash and Class A common stock payable for each $1,000 face amount of Notes tendered.

The Consent Solicitation

As a condition to the acceptance of the Exchange Offer, each Noteholder must consent to the amendments to the respective indentures pursuant to which the Notes were issued (the "Indentures") described below (the "Indenture Amendments"). The Bank of New York, as successor trustee to The United States Trust Company of New York under each such Indenture, is referred to herein as the "Notes Trustee."

The Indenture Amendments constitute a single proposal and a tendering or consenting Noteholder must consent to the Indenture Amendments as an entirety and may not consent selectively with respect to certain of the Indenture Amendments. The primary purpose of the Indenture Amendments is to eliminate substantially all of the restrictive covenants in each of the Indentures and to modify certain of the event of default provisions and certain other provisions in each of the Indentures.

Pursuant to the terms of the Indentures, the Indenture Amendments require the written consent of the Noteholders of at least a majority in principal amount of the Notes outstanding under the applicable Indenture. The summaries of provisions of the Indentures set forth below are qualified in their entirety by reference to the full and complete terms contained in the Indentures. Capitalized terms used in this section "The Consent Solicitation" without definition shall have the meanings set forth in each of the Indentures.

Deletion of Covenants. The Indenture Amendments would delete in their entireties certain provisions, including the provisions summarized below, from each of the Indentures (or any existing supplements thereto, except with respect to the 11 3/8% Indenture as indicated below):

Repurchase at the Option of Noteholders upon a Change of Control. This provision currently requires McLeodUSA, upon a Change of Control, to repurchase, at the option of a Noteholder, the Noteholder's Notes. The Indenture Amendments would not delete this provision from the 11 3/8% Indenture.

Limitation on Asset Sales. This provision currently restricts McLeodUSA's ability to sell its assets, the shares of stock of any Restricted Subsidiary or the assets of any Restricted Subsidiary outside the ordinary course of business. The Indenture Amendments would not delete this provision from the 11 3/8% Indenture.

Limitation on Consolidated Indebtedness. This provision currently restricts the ability of McLeodUSA and its Restricted Subsidiaries to incur indebtedness.

Limitation on Indebtedness and Preferred Stock of Restricted Subsidiaries. This provision currently restricts the ability of any Restricted Subsidiary of McLeodUSA to incur indebtedness or issue preferred stock.

Limitation on Restricted Payments. This provision currently restricts the ability of McLeodUSA and its Restricted Subsidiaries to make specified restricted payments, including restrictions on the payment of dividends, the redemption of capital stock, the redemption of obligations subordinate to the Notes and the making of investments.

Limitation on Liens. This provision restricts the ability of McLeodUSA and its Restricted Subsidiaries to create or permit to exist certain Liens on their assets and properties.

Limitation on Sale and Leaseback Transactions. This provision currently restricts the ability of McLeodUSA and its Restricted Subsidiaries from entering into certain Sale-Leaseback Transactions with respect to their assets and property.

Limitation on Issuance and Sale of Capital Stock of Restricted Subsidiaries. This provision currently restricts the ability of McLeodUSA and the Restricted Subsidiaries to issue any capital stock of any Restricted Subsidiary.

Transactions with Affiliates. This provision currently restricts the ability of McLeodUSA and its Restricted Subsidiaries to engage in transactions with shareholders and affiliates of McLeodUSA.

In addition, with respect to the $9^1/_4$% Indenture, the Indenture Amendments would delete in its entirety the provision "Repurchase at the Option of Holders upon Failure to Consummate the CCI Transaction." Such provision became moot in September of 1997.

Modification of Covenants/Events of Default. The Indenture Amendments would modify the provisions summarized below:

Restricted and Unrestricted Subsidiaries. This provision would be modified by amending and restating the covenant as follows:

"(a) McLeodUSA may designate any Subsidiary (including a newly formed or newly acquired Subsidiary) of McLeodUSA or any of its Restricted Subsidiaries as either a Restricted Subsidiary or an Unrestricted Subsidiary.

"(b) The designation of a Subsidiary as a Restricted Subsidiary or an Unrestricted Subsidiary shall be made by the Board of Directors pursuant to a Board Resolution delivered to the Trustee and shall be effective as of the date specified in such Board Resolution, which shall not be prior to the date such Board Resolution is delivered to the Trustee."

Merger, Consolidation or Sale of Assets. This provision would be modified by:

- removing the restrictions on incurring additional indebtedness in connection with a merger, consolidation or sale of assets;
- removing the requirement to secure the Notes in connection with a merger, consolidation or sale of assets that involves the creation of a lien; and
- removing the obligation to deliver an officer's certificate and opinion of counsel in connection with a merger, consolidation or sale of assets.

Events of Default. This provision would be modified by eliminating as an event of default under the Indentures:

- any default in the performance, or breach, of covenants relating to (i) mandatory repurchase of the Notes at the option of the Noteholders in the event of a change of control of McLeodUSA, (ii) limitations on the ability of McLeodUSA and its subsidiaries to engage in any asset sales and (iii) a consolidation, merger, conveyance, lease or transfer involving McLeodUSA or its subsidiaries;
- any default under any bond, debenture, note or other evidence of indebtedness of McLeodUSA or its subsidiaries (or under any mortgage, indenture or instrument under which there may be issued, or by which there may be secured or evidences any indebtedness of McLeodUSA or its subsidiaries);

any final judgment for the payment of money is entered against McLeodUSA or any of its subsidiaries;

the entry by a court of any order or judgement of bankruptcy or insolvency relating to any "Restricted Subsidiaries" of McLeodUSA; and

the commencement of a voluntary case or proceeding under the Bankruptcy Code by any "Restricted Subsidiaries" of McLeodUSA.

Conditions to the Exchange Offer

Notwithstanding any other provisions of the Exchange Offer and in addition to (and not in limitation of) McLeodUSA's right to extend, amend or terminate the Exchange Offer at any time in its sole discretion, McLeodUSA's obligation to accept for exchange Notes validly tendered pursuant to the Exchange Offer is conditioned upon, among other things:

(a) receipt by McLeodUSA of valid unrevoked tenders of at least 95% of the aggregate principal and accreted amount of the Notes;

(b) receipt by McLeodUSA of consents from Noteholders of a majority of the principal amount of each series of Notes outstanding (the "Requisite Consents") to, and execution by McLeodUSA and the Notes Trustee of the Supplemental Indentures providing for, the Indenture Amendments;

(c) the restructuring proposals are approved at the Special Meeting;

(d) the purchase by Forstmann Little of the New Preferred Stock and the New Warrants (each as defined herein);

(e) the consummation of the sale of Pubco to Forstmann Little or another buyer submitting a higher offer;

(f) resolution of all tax matters related to the restructuring in a manner satisfactory to McLeodUSA; and

(g) the general conditions to the Exchange Offer, which shall be deemed to have been satisfied unless any of the following conditions shall occur on or after the date of this Proxy/Disclosure Statement and prior to the acceptance for exchange of any Notes tendered pursuant to the Exchange Offer:

(i) there shall have occurred (A) any general suspension of, or limitation on prices for, trading in securities in the United States securities or financial markets, (B) a material impairment in the trading market for debt securities, (C) a declaration of a banking moratorium or any suspension of payments in respect of banks in the United States (whether

or not mandatory), (D) any limitation (whether or not mandatory) by any governmental authority on, or other event having a reasonable likelihood of affecting, the extension of credit by banks or other lending institutions in the United States, (E) a commencement of a war, armed hostilities or other national or international crisis involving the United States or (F) any significant adverse change in the United States securities or financial markets generally or in the case of any of the foregoing existing on the date hereof, a material acceleration or worsening thereof;

(ii) there exists an order, statute, rule, regulation, executive order, stay, decree, judgment or injunction that shall have been enacted, entered, issued, promulgated, enforced or deemed applicable by any court or governmental, regulatory or administrative agency or instrumentality that, in the reasonable judgment of McLeodUSA, would or would be reasonably likely to prohibit, prevent or materially restrict or delay consummation of the Exchange Offer or the solicitations or that is, or is reasonably likely to be, materially adverse to the business, operations, properties, condition (financial or otherwise), assets, liabilities or prospects of McLeodUSA or its subsidiaries;

(iii) there shall have been instituted or be pending any action or proceeding before or by any court or governmental, regulatory or administrative agency or instrumentality, or by any other person, which challenges the making of the Exchange Offer or the solicitations or the Indenture Amendments or is reasonably likely to directly or indirectly prohibit, prevent, restrict or delay the consummation of the Exchange Offer or the solicitations or the Indenture Amendments or otherwise

adversely affect in any material manner the Exchange Offer, the solicitations or the Indenture Amendments;

(iv) there exists, in McLeodUSA's sole judgment, any other actual or threatened legal impediment to the exchange of the Notes or the issuance of the Class A common stock or the New Preferred Stock (as defined herein) or payment of cash pursuant to the Exchange Offer or any other circumstances that would materially adversely affect the transactions contemplated by the Exchange Offer or the contemplated benefits of the Exchange Offer to McLeodUSA;

(v) there shall have occurred or be likely to occur an event or events which, in McLeodUSA's sole judgment, would or might prohibit, restrict or delay the consummation of the Exchange Offer or materially impair the contemplated benefits of the Exchange Offer to McLeodUSA or otherwise result in the consummation of the Exchange Offer not being in McLeodUSA's best interests; or

(vi) the Notes Trustee under the Indentures shall have objected in any respect to, or taken any action that would be reasonably likely to materially and adversely affect the consummation of the Exchange Offer or the solicitations or McLeodUSA's ability to effect the Indenture Amendments, or shall have taken any action that challenges the validity or effectiveness of the procedures used by McLeodUSA in soliciting the consents (including the form thereof) or in the making of the Exchange Offer or the acceptance of the Notes or the consents or the issuance of Class A common stock and cash consideration in exchange for Notes.

The foregoing conditions are for the sole benefit of McLeodUSA and may be asserted by McLeodUSA regardless of the circumstances giving rise to any such condition (including any action or inaction by McLeodUSA) and may be waived by McLeodUSA, in whole or in part, at any time and from time to time. The failure by McLeodUSA at any time to exercise any of the foregoing rights will not be deemed a waiver of any other right and each right will be deemed an ongoing right which may be asserted at any time and from time to time.

Termination

McLeodUSA may terminate the Exchange Offer and the restructuring, in the sole discretion of McLeodUSA, at any time and for any reason without accepting any of the tendered Notes or exchanging or reclassifying the common or preferred stock.

The foregoing right of termination is for the sole benefit of McLeodUSA and may be asserted by McLeodUSA regardless of the circumstances giving rise to such decision at any time.

Expiration Date

The Exchange Offer will expire at 5:00 p.m., New York City time, on January 15, 2002 unless extended (such time and date as the same may be extended, the "Expiration Date"). In order to receive the Exchange Offer Consideration pursuant to the Exchange Offer, Noteholders must tender their Notes prior to the Expiration Date.

Exchange Offer Closing Date

Subject to the satisfaction or waiver by McLeodUSA of the conditions to the Exchange Offer described in this Proxy/Disclosure Statement, consummation of the Exchange Offer will occur as soon as reasonably practicable following the Expiration Date.

BACKGROUND

Background of the Restructuring

Prior to 2000, McLeodUSA grew rapidly utilizing a voice-centric strategy focused on gaining market share within a core region of 21 Midwest, Northwest and Rocky Mountain states. In the first quarter of 2000, McLeodUSA added to its voice offering a more data-centric, national-based strategy with the acquisition of Splitrock Services, Inc. ("Splitrock"), a facilities-based provider of data communications services. McLeodUSA undertook a number of additional steps as a result of this shift in strategy, announcing plans to build a national data network

including assets from Splitrock and significantly increasing its personnel levels, capital expenditures and suite of available products. In the fourth quarter of 2000, McLeodUSA increased its core footprint from 21 states to 25 states with the acquisition of CapRock Communications Corp., which operated a competitive local exchange, or CLEC, business in Texas, Arkansas, Oklahoma and Louisiana, among others.

Earlier this year, it became clear that, due to certain factors, including but not limited to complications related to McLeodUSA's rapid growth and a downturn in economic conditions generally and the competitive telecommunications sector in particular, McLeodUSA was not meeting internal expectations in terms of profitability and cash flow. As a result, on August 1, 2001, McLeodUSA announced a series of steps to strengthen its senior management and position McLeodUSA for future growth. These steps included:

- the addition of Chris A. Davis as Chief Operating and Financial Officer. Ms. Davis had most recently been Executive Vice President, Chief Financial and Administrative Officer for ONI Systems. From 1993 to 2000, she had been Executive Vice President, Chief Financial and Administrative Officer at Gulfstream Aerospace, the world's leading business jet aviation manufacturer;
- the appointment of Theodore J. Forstmann as Chairman of the Executive Committee of the board of directors. Mr. Forstmann is the Founding Partner of Forstmann Little, a significant investor in McLeodUSA;
- the addition of four current or former CEOs to the board of directors; and
- the exchange of Forstmann Little's convertible preferred stock, which carried annual cash dividends of $35 million and a conversion price of $12.17, for new convertible preferred stock with no dividends and a conversion price of $6.10.

Upon joining McLeodUSA, Ms. Davis initiated a 90-day planning process to evaluate the strategic direction of McLeodUSA. Specifically, McLeodUSA:

- evaluated McLeodUSA's strengths and available capital in order to focus its strategic direction;
- initiated an analysis of McLeodUSA's business units for profitability and synergy with a potential revised strategic plan;
- performed a complete organizational assessment to identify redundancies and operational inefficiencies;
- conducted a zero-based review of all positions in McLeodUSA in order to properly staff McLeodUSA; and
- conducted a review of the assets and the liabilities of McLeodUSA, including a detailed review of the balance sheet.

As a result of these steps, in September 2001, McLeodUSA's board of directors approved its corporate strategy to focus on voice and data services for small and medium-sized business and

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residential customers within its 25-state footprint. In support of this strategy, McLeodUSA announced plans to take the following actions:

- abandon the development of its national network and place the associated assets for sale;
- sell other non-core assets and excess inventory;

- de-emphasize certain unprofitable wholesale services;
- reduce employment by approximately 15%;
- consolidate 11 facilities into 3;
- reduce planned capital expenditures from $400 million to $350 million for 2002; and
- take a one-time charge in the third quarter of approximately $2.9 billion. Of this, $2.1 billion was associated with goodwill and other intangible assets which originated from numerous acquisitions, most notably Splitrock. In addition, McLeodUSA reduced long-lived assets and construction work-in-progress associated with Splitrock by approximately $260 million to appropriately mark those assets to fair value.

As part of the 90-day planning process, McLeodUSA also recognized that, as a result of its ambitious growth strategy of prior years, it had not implemented sufficient processes and discipline to effectively execute and manage the business. As a result, McLeodUSA implemented five Business Process Teams to improve processes in an organized fashion. These teams are focused on improving five key areas:

- sales efficiency;
- provisioning of services and customer installation;
- customer billing and revenue assurance;
- cash management; and
- business forecasting and planning.

The significant strategic and operational steps taken since August 2001 have repositioned McLeodUSA for the future. At the same time, however, the evaluation process has highlighted the difficulty of implementing McLeodUSA's plans with its current capital structure. Key challenges include:

- the slowing economy, which has adversely affected demand for telecommunications services;
- implementing the revised strategy, which requires numerous significant improvements in business processes and discipline;
- recruiting and retaining quality management to execute the revised strategy;
- improving key operations of the core retail CLEC, which is currently unprofitable. These include
  - completing McLeodUSA's in-region network and deploying over $1 billion of network assets currently not in service,
  - activating over 30 local/long distance switches in order to carry long distance traffic over McLeodUSA's network,

migrating customers from the MegaBells' networks and switches to those of McLeodUSA and

simplifying products.

improving core business processes based on the work of the Business Process Teams.

These operational initiatives present substantial challenges and will require significant management time and resources to implement. While the time required to achieve the benefits, if any, of these initiatives is uncertain, it is expected to be substantial. Upon review of this difficult operating environment, the many business practices to be improved, McLeodUSA's highly leveraged capital structure and expected future operating losses, the board of directors began considering capital structure alternatives. Beginning in mid-October of 2001, McLeodUSA began discussions with Forstmann Little regarding the restructuring of McLeodUSA's capital structure. McLeodUSA then formed a special committee of its board of directors, comprised of persons not affiliated with Forstmann Little and not members of McLeodUSA's management, and retained Houlihan Lokey Howard & Zukin Capital ("Houlihan") and Skadden, Arps, Slate, Meagher & Flom (Illinois) as outside advisors to assist in exploring alternatives for the restructuring.

After the Restructuring

Upon consummation of the restructuring and giving effect to the sale of non-core businesses set forth in McLeodUSA's strategic restructuring plan and as contemplated by the Third Amendment (as defined herein) to the Credit Agreement (as defined herein), McLeodUSA's operations will consist primarily of its core retail CLEC business. To date, the core retail CLEC operations of McLeodUSA have not generated positive cash flow in any quarterly period. In addition, the preponderance of historical EBITDA of McLeodUSA has been attributable to Pubco, ICTC and other non-core assets that McLeodUSA plans to sell. While the initiatives set forth in the strategic restructuring plan are designed to result in the core retail CLEC business eventually operating profitably, there can be no assurance that these steps will be successful in the time and magnitude expected. Moreover, the remaining operations are expected to continue generating negative cash from operations until fiscal 2005, even if McLeodUSA achieves its targeted level of EBITDA, as a result of capital expenditures and projected interest on the remaining amounts due under the Credit Agreement. Completion of asset sales within a time frame and for aggregate amounts described in McLeodUSA's business plan and retention of access to the amounts that remain available to borrow under the Credit Agreement are critical in funding McLeodUSA's operations.

Agreement with Senior Secured Lenders

Concurrently with the negotiations with Forstmann Little regarding a possible restructuring, McLeodUSA and Forstmann Little began discussions with representatives of McLeodUSA's senior secured lenders for support of a Forstmann Little sponsored restructuring involving a significant cash payment to Noteholders. Any restructuring involving a payment to Noteholders, other than regularly scheduled payments of principal and interest, requires majority consent under McLeodUSA's Credit Agreement dated May 31, 2001 between McLeodUSA and certain lenders (as amended, the "Credit Agreement"). After substantial negotiations, McLeodUSA and its senior secured lenders agreed to amend the Credit Agreement to permit the restructuring (the "Third Amendment"). The key elements of the restructuring that induced McLeodUSA's senior secured lenders to allow the sale of Pubco and the use of the proceeds therefrom to make a payment to the Noteholders were (1) the additional $100 million Forstmann Little investment, with $35 million of the net proceeds from such investment applied to prepay term loans under the Credit Agreement, (2) Forstmann Little's commitment to purchase Pubco for $535 million, subject only to completion of the restructuring and other customary closing conditions, (3) Forstmann Little's substantial continued involvement in the operations and corporate governance of McLeodUSA, (4) McLeodUSA's commitment to sell ICTC and use the first $225 million in net proceeds to prepay the term loans under the Credit Agreement, (5) McLeodUSA's commitment to use the first $25 million of any additional net proceeds from the sale of Pubco to prepay term loans under the Credit Agreement, (6) a permanent reduction of $140 million of revolving credit commitments under the Credit Agreement upon

completion of the restructuring, and (7) a 1% increase in interest rates, (8) amendment and arranger fees and (9) modification of financial and restrictive covenants under the Credit Agreement.

Any changes to the terms of the restructuring that are materially inconsistent with the plan approved by the senior secured lenders, or that have an adverse effect on the senior secured lenders, would require the majority consent of McLeodUSA's senior secured lenders. Specifically, the Third Amendment requires that Forstmann Little have approximately a 40% ownership stake in McLeodUSA upon consummation of the restructuring. McLeodUSA does not believe that its senior secured lenders would consent to any restructuring involving a payment to the Noteholders without the substantial commitments provided by Forstmann Little and Forstmann Little's continued involvement in the operations of McLeodUSA. In addition, there can be no assurance that Forstmann Little would invest $100 million in McLeodUSA unless the restructuring were consummated on substantially the same terms as those described in this Proxy/Disclosure Statement.

Many of the amendments and waivers contained in the Third Amendment will terminate if McLeodUSA fails to satisfy certain "progress conditions" on a timely basis. One important progress condition is that the restructuring be completed on or before August 1, 2002. The complete list of progress conditions is set forth in the Third Amendment which we filed as an exhibit to our Current Report on Form 8-K on December 7, 2001.

McLeodUSA expects to obtain an interim debtor-in-possession financing facility of up to $50 million in the event McLeodUSA pursues the restructuring through a Chapter 11 case. In addition, McLeodUSA expects to obtain an exit financing facility upon the consummation of a plan of reorganization under a Chapter 11 proceeding in an amount up to $160 million. Such exit financing facility would be used to provide working capital for its future operations and to repay any amounts outstanding under any debtor-in-possession financing facility. While McLeodUSA has not yet obtained firm commitments for such facilities, it expects to obtain such commitments prior to filing a Chapter 11 case.

RESTRUCTURING

The Financial Restructuring

Together with its outside advisors, McLeodUSA considered a number of strategic alternatives with respect to a financial restructuring. Management and the special committee engaged in extensive negotiations with Forstmann Little to sponsor a comprehensive transaction that would result in a substantial deleveraging of McLeodUSA. The proposed transaction will result in the elimination of $2.9 billion of note indebtedness, provide a substantial cash payment to Noteholders, require a $100 million new money investment from Forstmann Little and contemplate a substantial on-going involvement of Forstmann Little in the operations of McLeodUSA. Concurrently with such negotiations, McLeodUSA and Forstmann Little engaged in extensive negotiations with McLeodUSA's bank group under the Credit Agreement to obtain the Third Amendment to permit the restructuring.

The material elements of the restructuring are as follows:

Treatment of Preferred Stock

McLeodUSA's outstanding Series A, Series D and Series E preferred stock will be reclassified into 196,399,008 shares of Class A common stock, representing approximately 51.9% of the Class A common stock expected to be outstanding upon consummation of the restructuring, subject to dilution. The pro rata distribution of this Class A common stock will be based on the relative liquidation preferences of and accrued dividends on, each of the series of outstanding preferred stock, resulting in the following distribution:

- holders of the Series A preferred stock will receive their pro rata share of 44,883,856 shares of Class A common stock, representing approximately 11.9% of the Class A common stock expected to be outstanding upon consummation of the restructuring, subject to dilution;

- holders of the Series D preferred stock will receive their pro rata share of 104,166,667 shares of Class A common stock, representing approximately 27.5% of the Class A common stock expected to be outstanding upon consummation of the restructuring, subject to dilution; and

- holders of the Series E preferred stock will receive their pro rata share of 47,348,485 shares of Class A common stock, representing approximately 12.5% of the Class A common stock expected to be outstanding upon consummation of the restructuring, subject to dilution.

Common Stock

On the effective date of the restructuring, existing holders of the Class A common stock will have approximately 33.1% of the Class A common stock expected to be outstanding upon consummation of the restructuring, subject to dilution.

Treatment of Notes

In full and complete satisfaction of McLeodUSA's obligations under the Notes, Noteholders will receive:

$560 million in cash, available from the sale of Pubco ($535 million) and a portion of Forstmann Little's new money investment ($25 million) which will be applied to the Notes, plus

56,813,984 shares of the Class A common stock, representing approximately 15% of the Class A common stock as of the closing of the Exchange Offer, subject to dilution.

Upon consummation of the Exchange Offer, each Noteholder that validly tenders, and does not withdraw, Notes will receive a pro rata portion of $560 million of cash and 56,813,984 shares of Class A common stock based upon the ratio of (x) the principal and accreted amount of the Notes

tendered by such Noteholder plus all accrued and unpaid interest thereon as of the day immediately preceding the closing of the exchange offer, to (y) the principal and accreted amount of all outstanding Notes plus all accrued and unpaid interest thereon as of the day immediately preceding the closing of the Exchange Offer.

Summary of Restructuring Plan

Consideration

	Cash	Estimated Number of Shares and % of Class A Common Stock Ownership			
		Before Dilution		After Dilution(1)	
Noteholders	$ 560,000,000	56,813,984	15.0%	56,813,984	13.7%
Series A Preferred Stock		44,883,856	11.9%	44,883,856	10.8%
Series D Preferred Stock		104,166,667	27.5%	104,166,667	25.1%
Series E Preferred Stock		47,348,485	12.5%	47,348,485	11.4%
Class A Common Stock		125,546,898	33.1%	125,546,898	30.2%
New Preferred Stock		NA	NA	36,433,233	8.8%
		378,759,890	100.0%	415,193,123	100.0%

Sources and Uses of Cash
($ in millions)

Sources		
Sale of Pubco	$	535
Forstmann Little Investment		100
Working Capital/Available Cash		25
	$	660
Uses		
Cash Payment to Noteholders	$	560

Mandatory Pre-Payment on Term Loans		35
Fees and Expenses		65
	$	660

(1) Estimated common stock ownership after giving effect to the mandatory conversion of the new convertible preferred stock to be issued to Forstmann Little at an assumed price per share equal to the reorganization equity value per share of $2.74 prior to dilution for warrants and the management incentive plan. See "Valuation Analysis."

While McLeodUSA believes the percentage estimates set forth above and referenced to elsewhere in this Proxy/Disclosure Statement are helpful in describing the allocation of Class A common stock among the Noteholders, preferred stockholders and current Class A common stockholders, there can be no assurance that actual allocations will correspond exactly to these estimated percentages.

Agreements with Forstmann Little

In order to raise the funds required to implement the restructuring, McLeodUSA has entered into three agreements with Forstmann Little.

Stock Purchase Agreement

McLeodUSA Holdings, Inc. has entered into a Stock Purchase Agreement, dated as of December 3, 2001 (the "Stock Purchase Agreement"), which provides for the sale of Pubco to Pubco Acquisition Corp., an affiliate of Forstmann Little ("Pubco Acquisition"), for $535 million in cash. A copy of the Stock Purchase Agreement is filed as an exhibit to McLeodUSA's Current Report on Form 8-K filed with the SEC on December 7, 2001. The following summary of the Stock Purchase Agreement is qualified in its entirety by reference to the Stock Purchase Agreement.

The Stock Purchase Agreement contains customary representations, warranties, covenants, agreements and indemnities.

The Stock Purchase Agreement also provides McLeodUSA with the right to terminate the Stock Purchase Agreement to enter into an alternative agreement with a third party that provides for the sale of Pubco at a higher price, subject to certain conditions including the requirement that the

consummation of the alternative transaction be conditioned upon the consummation of a capital restructuring that does not materially deviate from the terms of the restructuring described in this Proxy/Disclosure Statement. No termination fees or other expenses are payable to Forstmann Little in connection with such a termination. McLeodUSA has retained a nationally recognized investment banking firm to commence a marketing process in an effort to obtain a higher price.

The Stock Purchase Agreement provides McLeodUSA with certain rights relating to future dispositions of Pubco. For two years after the consummation of the Stock Purchase Agreement, McLeodUSA has a right of first offer to purchase Pubco. Generally, this right of first offer requires Pubco Acquisition to offer to sell Pubco to McLeodUSA prior to selling it to a third party. The Stock Purchase Agreement also provides that if Pubco Acquisition sells Pubco during the one year period after the consummation of the Stock Purchase Agreement, Pubco Acquisition will pay McLeodUSA 50% of the sales proceeds in excess of the price Pubco Acquisition paid for Pubco in the Stock Purchase Agreement, subject to certain adjustments.

The Stock Purchase Agreement also provides that Pubco Acquisition will enter into a Publishing, Branding and Operating Agreement, which provides for the continued publication of telephone directories for an initial term of five years following the consummation of the Stock Purchase Agreement.

The consummation of the Stock Purchase Agreement is subject to the following conditions:

no statute, rule, regulation, executive order, decree, or injunction shall have been enacted, entered, promulgated or enforced by any court or governmental entity which prohibits or restricts the consummation of the stock purchase;

all required consents, approvals, orders and permits of, and registrations, declarations and filings with, any governmental authority shall have been made or obtained, and any waiting period under the Hart-Scott-Rodino Anti-Trust Improvements Act of 1974, as amended, shall have terminated or expired;

all conditions precedent to the consummation of the restructuring shall have been satisfied and the restructuring shall be occurring simultaneously;

the representations and warranties of the other party are true and correct as of the closing date as if made at and as of such date, except where the failure of such representations and warranties to be so true and accurate (without giving effect to any limitation as to "materiality" or "material adverse effect" set forth therein) would not, individually or in the aggregate, have a material adverse effect; and

the other party performed and complied in all material respects with all agreements, obligations, covenants and conditions contained in the Stock Purchase Agreement.

Publishing, Branding and Operating Agreement

One of the conditions to closing of the Stock Purchase Agreement is that McLeodUSA Publishing Company (the "Publisher"), McLeodUSA, McLeodUSA Telecommunications Services Inc., and Pubco Acquisition enter into a Publishing, Branding and Operating Agreement (the "Operating Agreement") in the form attached as an exhibit to the Stock Purchase Agreement. The following summary of the Operating Agreement is qualified in its entirety by reference to the form of Operating Agreement attached to the Stock Purchase Agreement which is filed as an exhibit to McLeodUSA's Current Report on Form 8-K filed with the SEC on December 7, 2001.

The Operating Agreement provides for the continued publication of telephone directories by the Publisher following the consummation of the Stock Purchase Agreement and in many ways documents the existing practices of the Publisher with respect to the publication of McLeod-branded telephone

directories. The term of the Operating Agreement is five years (unless terminated earlier for cause, change of control, or by mutual agreement) with automatic one-year renewals thereafter unless a party elects not to renew and provides one years' notice.

The Operating Agreement grants the Publisher a license to use the principal McLeodUSA trademarks to publish telephone directories. It also requires the Publisher to publish certain telephone directories using those trademarks. Following the termination of the Operating Agreement, the Publisher will continue to own the right to publish a directory that looks like the directories it currently publishes (although it may not continue to use the McLeodUSA star).

The Operating Agreement prohibits McLeodUSA from competing with Pubco Acquisition and its subsidiaries during the term in its core businesses, and similarly prohibits Pubco Acquisition and its subsidiaries from competing with McLeodUSA during the term in its core businesses.

Preferred Stock and Warrant Purchase Agreement

McLeodUSA has entered into a Preferred Stock and Warrant Purchase Agreement, dated as of December 3, 2001 (the "Purchase Agreement"), which provides for the sale of preferred stock and warrants to Forstmann Little, for $100 million in cash. A copy of the Purchase Agreement is filed as an exhibit to McLeodUSA's Current Report on Form 8-K filed with the SEC on December 7, 2001. The following summary of the Purchase Agreement is qualified in its entirety by reference to the Purchase Agreement.

The Purchase Agreement provides for the issuance of Series F and Series G preferred stock (collectively, the "New Preferred Stock"). The Series F preferred stock is mandatorily convertible into shares of Class A common stock on the 60th day following the effective date of the

restructuring in an amount equal to (x) $10.00 divided by the average share price of Class A common stock calculated as the mathematical average of the closing price per share of Class A common stock on 10 randomly selected trading days during the 60-day period following the effective date of the restructuring (excluding the 2 high and 2 low prices and taking an average of the remaining 6) multiplied by (y) 10 million shares. The Series G preferred stock provides Forstmann Little with the right to designate members of the board of directors and/or a non-voting observer to the board of directors as follows:

If Forstmann Little owns at least 40% of the shares of Class A common stock it will own upon consummation of the restructuring, Forstmann Little will have the right to designate 2 members of the board of directors.

If Forstmann Little owns less than 40%, but more than 20%, of such shares, Forstmann Little will have the right to designate 1 member of the board of directors and 1 non-voting observer to the board of directors.

If Forstmann Little owns 20% or less, but at least 10%, of such shares, Forstmann Little will have the right to designate 1 non-voting observer to the board of directors.

If Forstmann Little owns less than 10% of such shares, Forstmann Little will have no rights to designate either members of the board of directors or non-voting observers to the board of directors.

The Series G preferred stock will not otherwise provide for any dividend, liquidation or other preferences.

The Purchase Agreement also provides for the sale of approximately 18.9 million new warrants (the "New Warrants") to Forstmann Little. Each New Warrant entitles the holder to purchase one share of Class A common stock at an exercise price equal to 150% of the average share price of the Class A common stock, calculated as the mathematical average of the closing price per share of

Class A common stock on 10 randomly selected trading days during the 60-day period following the effective date of the restructuring (excluding the 2 high and 2 low prices and taking an average of the remaining 6) pursuant to a formula contained in the related warrant agreement. Pursuant to their terms, the New Warrants expire on the fifth anniversary of the consummation of the restructuring.

Assuming that the average price of Class A common stock is equal to the reorganization equity value per share upon the date of conversion of the New Preferred Stock, Forstmann Little would receive approximately 36.4 million shares of Class A common stock representing roughly 8.8% of all such stock outstanding prior to consideration of any management options.

The Purchase Agreement also provides Forstmann Little with the right to designate observers to the board of directors in connection with maintaining the venture capital operating company status of Forstmann Little's investment in McLeodUSA.

In addition to similar conditions as those contained in the Stock Purchase Agreement described above, the consummation is subject to certain additional conditions, including the condition that McLeodUSA's certificate of incorporation be amended to provide that McLeodUSA will not be governed by Section 203 of the DGCL.

Upon the consummation of the Purchase Agreement, the existing transfer restrictions applicable to Forstmann Little's Series D and E preferred stock will terminate. Following the consummation of the Purchase Agreement, Forstmann Little may transfer shares of Class A common stock, preferred stock and warrants; provided that prior to the Standstill Termination Date (as defined below), Forstmann Little may not make any transfers (other than transfers to affiliates) to any person or group which is, or which Forstmann Little believes or should reasonably believe will seek to become, the beneficial owner of more than 50% of McLeodUSA's voting securities (a "Disqualified Transaction") without the consent of the board of directors of McLeodUSA, unless Forstmann Little provides McLeodUSA with a notice of setting forth the minimum cash price at which Forstmann Little would be prepared to sell the securities. McLeodUSA then has 45 days to purchase or cause a designee to purchase the securities. If no agreement providing for the purchase of the securities is entered into within 45 days, Forstmann Little has the right for 180 days to sell the securities to any person at a price no less than the price specified in the notice.

The "Standstill Termination Date" means the earlier of the third anniversary of the closing of the Purchase Agreement or the date Theodore J. Forstmann is removed, without his consent, as the Chairman of the Executive Committee of the board of directors.

During the period of time from the closing of the Purchase Agreement until the Standstill Termination Date, except as specifically approved in writing in advance by the board of directors, Forstmann Little shall not directly or indirectly:

- acquire, or offer or agree to acquire, or become the beneficial owner of or obtain any rights in respect of, any capital stock of McLeodUSA;
- solicit or participate in the solicitation of any person to acquire, offer to acquire or agree to acquire, by merger, tender offer, purchase or otherwise, McLeodUSA or initiate or become a participant in any stockholder proposal or election contest or induce others to initiate the same, or otherwise seek to advise or influence any person with respect to the voting of any voting securities of McLeodUSA; or
- solicit or participate in the solicitation of any person to acquire, offer to acquire or agree to acquire, by merger, tender offer, purchase or otherwise, McLeodUSA or a substantial portion of its assets or more than 50% of its outstanding capital stock; provided, that, these restrictions do not apply to actions taken by Forstmann Little in connection with the sale of any of its own securities.

During the period from the closing of the Purchase Agreement until the Standstill Termination Date, Forstmann Little agrees to be present, in person or by proxy at all meetings of stockholders of McLeodUSA so that all of its voting securities are counted for purposes of determining the presence of a quorum at such meetings. During such period, Forstmann Little agrees to vote its securities in all elections of directors such that (i) at least five members of the board of directors are qualified as "independent directors" and (ii) the Chairman, the Chief Executive Officer, and the Chief Financial Officer of McLeodUSA are elected as members to the board of directors.

The Purchase Agreement also prohibits McLeodUSA from adopting or implementing any stockholders rights plan or "poison pill" as long as Forstmann Little holds 60% of the McLeodUSA securities (on a fully converted basis) it owned at the consummation of the Purchase Agreement. If Forstmann Little owns less than 60% of such securities or sells its securities in a Disqualified Transaction, McLeodUSA may adopt a rights plan subject to certain restrictions.

Credit Agreement Amendment

On May 31, 2000, the Company entered into $1.3 billion of Senior Secured Credit Facilities with a syndicate of financial institutions. In order to facilitate the restructuring, McLeodUSA has entered into the Third Amendment. The following summary of the Third Amendment is qualified in its entirety by reference to the Third Amendment.

Under the Third Amendment, the lenders waived:

- any bankruptcy and payment cross-defaults with respect to the Notes that may arise in connection with the restructuring;
- covenants respecting sales of assets in order to allow the sale of Pubco to proceed pursuant to the restructuring and the use of $535 million of the proceeds therefrom to make a payment to the Noteholders; and
- certain other covenants and other provisions of the Credit Agreement that would have restricted McLeodUSA's ability to enter into various transactions necessary to consummate the restructuring.

In return for the lenders' consent to the Third Amendment, McLeodUSA agreed that the following amounts will be paid on a current basis during the restructuring:

- all interest, commitment fees, letter of credit participation fees and fronting fees when due pursuant to the terms of the Credit Agreement;

- all fees and expenses payable to the agent under any debtor-in-possession facility, including the reasonable fees and disbursements of counsel; and

- an amendment fee payable upon consummation of the restructuring to each lender that agreed to the Third Amendment equal to 1.00% of the aggregate amount of each consenting lender's exposure under the Credit Agreement.

McLeodUSA also agreed to limit any additional borrowings under the Credit Agreement to $50 million until the restructuring is completed pursuant to the out-of-court restructuring discussed below, McLeodUSA files for Chapter 11 protection or McLeodUSA advises the lenders that it is no longer pursuing the restructuring.

The waivers and modifications to the Credit Agreement described above will remain in effect so long as McLeodUSA is pursuing the restructuring as outlined in this Proxy/Disclosure Statement unless McLeodUSA fails to satisfy any "progress condition" on a timely basis. The progress conditions include a requirement that the restructuring be consummated on or before August 1, 2002. The progress conditions also require McLeodUSA to continue in good faith to seek consummation of the

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restructuring prior to such date in the event bankruptcy proceedings are commenced with respect to McLeodUSA or any of its subsidiaries. Also if bankruptcy proceedings are commenced in connection with the restructuring, orders respecting use of the lenders' cash collateral and approving any debtor-in-possession financing must be in the forms attached to the Third Amendment or otherwise in accordance with terms agreeable to the lenders.

McLeodUSA will be deemed to have breached a progress condition if any bankruptcy proceedings shall have been dismissed or converted to liquidation proceedings under Chapter 7 of the Bankruptcy Code, a trustee shall have been appointed, or the exclusive period during which McLeodUSA may file and propose a plan is not in full force and effect. McLeodUSA is restricted, during the course of any bankruptcy proceeding, from challenging the lenders' liens, and any such challenge raised by a third party must be dismissed before the effective date of the restructuring or August 1, 2002 without adverse consequence to the lenders. Finally, no event shall have occurred in any such proceedings that would constitute an event of default under the Credit Agreement (other than those events of default waived in order to permit the restructuring).

If the restructuring is consummated pursuant to the Plan through Chapter 11 proceedings, the Plan must provide that the liens and claims of the lenders under the Credit Agreement will be unimpaired. The Third Amendment also contains certain modifications to the Credit Agreement that will become effective only upon consummation of the restructuring, including:

- an agreement to use $35 million of Forstmann Little's new $100 million investment to prepay the term loans under the Credit Agreement;

- an agreement that requires McLeodUSA to sell, or have entered into a contract to sell (which may be subject to regulatory approval and certain other customary closing conditions) Illinois Consolidated Telephone Company (or substantially all of its assets) within 14 months of the consummation of the restructuring and to apply the first $225 million in proceeds from such sale to reduce McLeodUSA's outstanding obligations under the Credit Agreement. McLeodUSA is permitted to retain proceeds in excess of $225 million from such sale for working capital and general corporate purposes. If McLeodUSA does not complete the Illinois Consolidated Telephone Company sale within two years of the consummation of the restructuring, $225 million of term loans under the credit agreement will be subject to additional interest of 1.50% per annum until such sale is completed;

- an agreement to allow McLeodUSA to retain the proceeds of certain non-core asset sales;

- the modification of various financial covenants and the addition of a capital expenditure limitation;

- a 1% increase in the applicable rates of interest on the borrowings under the Credit Agreement and the establishment of certain prepayment premiums applicable to the Credit Agreement term loan repayments made in the first three years following the restructuring;

an agreement that McLeodUSA may enter into an exit financing facility upon consummation of the restructuring in an amount not to exceed $160 million, secured by liens on and security interests in the assets of McLeodUSA and its domestic subsidiaries superior to the liens securing the existing obligations under the Credit Agreement; and

additional limitations on the ability of McLeodUSA and its subsidiaries to incur third-party indebtedness and make additional investments.

If the restructuring is consummated pursuant to the Out-of-Court Restructuring discussed below, the revolving loan commitment of the lenders under the Credit Agreement will be reduced by $140 million, which will reduce the current revolving credit commitment of the lenders to $310 million.

Finally, whether or not the restructuring is consummated, McLeodUSA agreed in the Third Amendment to additional restrictions relating to the incurrence of third-party indebtedness and making of additional investments.

While the Third Amendment permits both a $50 million debtor-in-possession financing facility and a $160 million exit financing facility, McLeodUSA has not yet obtained firm commitments for such facilities. McLeodUSA expects to have such commitments prior to filing any case under Chapter 11 of the Bankruptcy Code.

Alternative Means for Implementing the Restructuring

McLeodUSA is simultaneously pursuing the restructuring via two alternative mechanisms: (1) the out-of-court alternative and (2) the in-court alternative. Each of these alternatives is described in detail in this Proxy/Disclosure Statement. Noteholders are being requested to take action on *both* mechanisms.

Out-of-Court Alternative

The out-of-court restructuring (the "Out-of-Court Restructuring") is comprised of the following elements:

Special Meeting of Stockholders. The restructuring proposals in connection with the Out-of-Court Restructuring require the approval of McLeodUSA's preferred and common stockholders. The purpose of the Special Meeting is to consider the Restructuring and to vote on the restructuring proposals. See "Discussion of Restructuring Proposals."

Exchange Offer and Consent Solicitation. Pursuant to the Exchange Offer, McLeodUSA is:

offering to exchange the Notes for each Noteholder's pro rata share of (i) $560 million in cash plus (ii) 56,813,984 shares of Class A common stock, representing approximately 15% of the Class A common stock expected to be outstanding upon consummation of the Exchange Offer, subject to dilution; and

seeking the approval of Noteholders to certain amendments to the Indentures.

The terms of the Exchange Offer and consent solicitation are described in more detail in this Proxy/Disclosure Statement.

The consummation of the Out-of-Court Restructuring is conditioned upon the consummation of the Exchange Offer, as well as the approval of each of the restructuring proposals by the requisite vote of McLeodUSA's stockholders.

In-Court Alternative

If McLeodUSA concludes that it would be more advantageous or expeditious, McLeodUSA may elect to effectuate the restructuring by filing a voluntary petition for relief under Chapter 11 of the Bankruptcy Code and seeking court approval of the restructuring.

To facilitate court approval of the in-court restructuring (the "In-Court Restructuring"), McLeodUSA is soliciting acceptances of the Plan, a copy of which is attached hereto as Appendix I. The Plan contains the terms of the restructuring as described in this Proxy/Disclosure Statement, which will, if approved, result in the same distributions as would be effectuated through the Out-of-Court Restructuring.

Support for the Restructuring

Forstmann Little, as the holder of 100% of the Series D and Series E preferred stock with an aggregate liquidation preference of $1 billion, supports the restructuring and has executed a Lock-Up and Voting Agreement requiring Forstmann Little to vote in favor of the restructuring proposals and the Plan.

McLeodUSA's executive officers and directors, as a group, beneficially own approximately 67,311,394 shares of Class A common stock, excluding option shares. Such officers and directors have advised McLeodUSA that they intend to vote in favor of the restructuring proposals and the Plan. See "Security Ownership of Certain Beneficial Owners and Management."

Recommendation of the Restructuring

The special committee considered a number of alternatives with respect to restructuring McLeodUSA's capital structure, held numerous lengthy meetings, discussed the restructuring with its advisors, and engaged in extensive negotiations with representatives of Forstmann Little regarding the sale of Pubco and the restructuring. In addition, the special committee, through senior management, was involved in negotiations with representatives of McLeodUSA's senior secured lenders regarding

amendments to the Credit Agreement. After considering alternatives, and in light of these extensive negotiations, the special committee recommended the restructuring to McLeodUSA's board of directors.

The disinterested members of McLeodUSA's board of directors have unanimously approved the restructuring proposals, including the terms of the Series A reclassification proposal, the Series D reclassification proposal, the Series E reclassification proposal, the reverse stock split proposal, the Section 203 proposal, the issuance proposal and the management incentive plan proposal discussed in this Proxy/Disclosure Statement, upon the recommendation of the special committee. However, McLeodUSA's board of directors has not at this time taken any corporate action approving a bankruptcy filing or in furtherance thereof.

Estimated Fees and Expenses

McLeodUSA estimates that fees and expenses incurred in connection with the Restructuring will be approximately $65 million, consisting of:

- $31.6 million of legal and financial advisors fees;
- $28 million of arranger and amendment fees; and
- $5.4 million of other fees and expenses.

McLeodUSA will also pay brokerage houses and other custodians, nominees and fiduciaries the reasonable out-of-pocket expenses incurred by them in forwarding copies of the Proxy/Disclosure Statement and related documents to the beneficial owners of the common and preferred stock and in handling or forwarding tenders of their customers.

McLeodUSA anticipates that a substantial portion of the fees referenced above will be paid at the consummation of the restructuring, which is estimated to be on or before March 31, 2002.

VALUATION ANALYSIS

McLeodUSA has been advised by Houlihan with respect to the reorganization equity value of reorganized McLeodUSA. The reorganization equity value, which includes McLeodUSA's operating business, the expected present value of certain non-core assets and takes into account the estimated debt balances at and beyond the Effective Date (as defined herein), was estimated by Houlihan to be approximately $1.15 billion as of an assumed Effective Date of March 31, 2002 and giving effect to the divestiture of Pubco on the assumed Effective Date and to the divestiture of (1) ICTC and (2) McLeodUSA's South Dakota ILEC, CLEC and cable assets (collectively "DTG"), both of which are assumed to occur within 14 months of the Effective Date. The foregoing reorganization equity value (ascribed as of the date of this Proxy/Disclosure Statement) reflects, among other things, factors discussed below, current financial market conditions and the inherent uncertainty as to the achievement of the projections discussed elsewhere in this Proxy/Disclosure Statement.

Based on the assumed reorganization equity value set forth above, the value of the 378.8 million shares of Class A common stock to be outstanding is estimated to be approximately $2.74 per share, after giving effect to the potentially dilutive impact of the New Warrants, New Preferred Stock and the Management Incentive Plan. The foregoing valuation also reflects a number of assumptions, including a successful reorganization of McLeodUSA's business and finances in a timely manner, the amount of available cash, market conditions, and the restructuring becoming effective in accordance with its terms on a basis consistent with the estimates and other assumptions discussed herein.

In preparing the estimated reorganization equity value, Houlihan: (a) reviewed certain historical financial information of McLeodUSA for recent years and interim periods; (b) reviewed certain internal financial and operating data of McLeodUSA and assisted in developing financial projections relating to its businesses and prospects; (c) met with certain members of senior management of McLeodUSA to discuss McLeodUSA's operations and future prospects; (d) reviewed publicly available financial data and considered the market values of public companies that Houlihan deemed generally comparable to the operating businesses of McLeodUSA; (e) reviewed the financial terms, to the extent publicly available, of certain acquisitions of companies that Houlihan believes were comparable to the operating businesses of McLeodUSA; (f) considered certain economic and industry information relevant to McLeodUSA's operating business; (g) visited certain of McLeodUSA's facilities; and (h) conducted such other analyses as Houlihan deemed appropriate under the circumstances. Although Houlihan conducted a review and analysis of McLeodUSA's business, operating assets and liabilities and business plans, Houlihan assumed and relied on the accuracy and completeness of all financial and other information furnished to it by McLeodUSA. No independent evaluations or appraisals of McLeodUSA's assets were sought or were obtained in connection therewith.

Estimates of reorganization equity value do not purport to be appraisals, nor do they necessarily reflect the values that might be realized if assets were sold. The estimates of reorganization equity value prepared by Houlihan assume that reorganized McLeodUSA continues as the owner and operator of its businesses and assets (other than Pubco, ICTC, DTG and other non-core assets assumed to be divested). Such estimates were developed solely for purposes of formulation of the restructuring and the analysis of implied relative recoveries to creditors thereunder. Such estimates reflect computations of the estimated reorganization equity value of reorganized McLeodUSA through the application of various valuation techniques and do not purport to reflect or constitute appraisals, liquidation values or estimates of the actual market values that may be realized through the sale of any securities to be issued pursuant to the restructuring, which may be significantly different from the amounts set forth herein. The value of an operating business is subject to uncertainties and contingencies that are difficult to predict and will fluctuate with changes in factors affecting the financial conditions and prospects of such a business. As a result, the estimate of reorganization equity value set forth herein is not necessarily indicative of actual outcomes, which may be significantly more or less favorable than those set forth herein. Depending on the results of McLeodUSA's operations or

changes in the financial markets, Houlihan's valuation analysis as of the effective date may differ from that disclosed herein.

In addition, the valuation of newly-issued securities is subject to additional uncertainties and contingencies, all of which are difficult to predict. Actual market prices of such securities at issuance will depend upon, among other things, prevailing interest rates; conditions in the financial markets; the anticipated initial securities holdings of prepetition creditors, some of which may prefer to liquidate their investment rather than hold it on a long-term basis; and other factors that generally influence the prices of securities. Actual market prices of such securities also may be affected by other factors not possible to predict. Accordingly, the reorganization equity value estimated by Houlihan does not necessarily reflect, and should not be construed as reflecting, values that will be attained in the public or private markets. The equity value ascribed in the analysis does not purport to be an estimate of the post-reorganization market trading value. Such trading value may be materially different from the reorganization equity value ranges associated with Houlihan's valuation analysis.

SUMMARY UNAUDITED HISTORICAL AND PRO FORMA CAPITALIZATION

The following table sets forth the unaudited capitalization of McLeodUSA as of September 30, 2001, and as adjusted to give effect to the Out-of-Court Restructuring and the Splitrock Disposition as though they had become effective on September 30, 2001. The adjustments giving effect to the restructuring assume 100% of the Notes are exchanged. If less than 95% of the Notes are tendered and McLeodUSA elects to waive the minimum tender condition and accept the tendered Notes for exchange, such acceptance would have a material effect upon the information presented below. The information presented below should be read in conjunction with the Consolidated Financial Statements, Unaudited Pro Forma Financial Information and related notes appearing elsewhere herein.

	September 30, 2001		
(In millions, except shares)		**Historical**	**Total Pro Forma**
		(unaudited)	**(unaudited)**
Long-term debt (excludes current maturities)		3,694.0	747.9 (1)(2)
Redeemable convertible preferred stock			
Preferred, Series B, redeemable, convertible, $.01 par value, authorized, issued and outstanding historical none; pro forma none			
Preferred, Series C, redeemable, convertible, $.01 par value, authorized, issued and outstanding historical none; pro forma none			
Preferred, Series D, redeemable, convertible, $.01 par value, authorized, issued and outstanding historical 275,000; pro forma none		104.0	
Preferred, Series E, redeemable, convertible, $.01 par value, authorized, issued and outstanding historical 125,000; pro forma none		43.0	
Total redeemable convertible preferred stock		147.0	
Stockholders' Equity			
Capital Stock:			
Preferred, Series A, $.01 par value: authorized, issued and outstanding historical 1,149,375 shares; pro forma none			
Common, Class A, $.01 par value; authorized 2,000,000,000 shares; issued and outstanding historical 626,950,228 shares; pro forma 415,036,271 shares		6.3	4.1
Common, Class B, convertible, $.01 par value; authorized 22,000,000 shares; issued and outstanding historical and pro forma none			
Additional paid-in capital		3,843.2	4,092.9
Accumulated deficit		(3,621.1)	(1,295.5)
Accumulated other comprehensive income		(2.0)	(2.0)
Total stockholders' equity		226.4	2,799.5 (1)
Total capitalization and pro forma capitalization	$	4,067.4	3,547.4 (1)

(1) If the Out-of-Court Restructuring is consummated at the 95% acceptance level by the Noteholders, pro forma long-term debt (excluding current maturities), total pro forma stockholders' equity and total pro forma capitalization would be $893.1 million, $2,681.7 million and $3,574.8 million, respectively.

(2) McLeodUSA borrowed an additional $250 million under its Credit Agreement subsequent to September 30, 2001. As a result, pro forma long-term debt (excluding current maturities) upon consummation of the restructuring would be $997.9 million (assuming 100% tender by the Noteholders) and $1,143.1 million (assuming a 95% tender by the Noteholders).

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UNAUDITED PRO FORMA FINANCIAL INFORMATION

The Unaudited Pro Forma Condensed Consolidated Balance Sheet as of September 30, 2001 and the Unaudited Pro Forma Condensed Consolidated Statement of Operations for the year ended December 31, 2000 and nine months ended September 30, 2001 have been prepared to give effect to the Out-of-Court Restructuring and the Splitrock Disposition for $55 million.

The Out-of-Court Restructuring includes:

- A 5-to-1 reverse stock split;
- the sale of Pubco for cash proceeds of $535 million;
- the issuance of New Preferred Stock and 18.9 million New Warrants to Forstmann Little in exchange for $100 million;
- the conversion of the New Preferred Stock into shares of Class A common stock;
- the elimination of all Notes for $560 million in cash and 15% of McLeodUSA's Class A common stock (subject to dilution); and
- A $35 million prepayment of Term Loans A and B under the Credit Agreement.

The Splitrock Disposition relates to an agreement to sell certain of its internet/data assets (formerly part of Splitrock Services, Inc.) and wholesale dial-up Internet Service Provider (ISP) customer base to Level 3 Communications, Inc. for $55 million plus the assumption of certain operating liabilities. The Splitrock Disposition is subject to customary closing conditions, and is expected to close prior to May 1, 2002.

The Unaudited Pro Forma Condensed Consolidated Balance Sheet as of September 30, 2001 was prepared as if the Out-of-Court Restructuring and the Splitrock Disposition had been consummated as of September 30, 2001. The Unaudited Pro Forma Condensed Consolidated Statements of Operations for the year ended December 30, 2000 and for the nine months ended September 30, 2001 were prepared as if the Out-of-Court Restructuring and the Splitrock Disposition had been consummated by January 1, 2000.

The pro forma adjustments are based on available information and upon certain assumptions McLeodUSA believes are reasonable under the circumstances. The unaudited pro forma condensed consolidated financial statements should be read in conjunction with "Selected Financial Data" and "Management's Discussion and Analysis of Results of Operations and Financial Condition" and McLeodUSA's consolidated financial statements and related notes thereto contained elsewhere in this document.

THESE UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS ARE PROVIDED FOR INFORMATIONAL PURPOSES ONLY AND SHOULD NOT BE CONSTRUED TO BE INDICATIVE OF THE FINANCIAL CONDITIONS OR RESULTS OF OPERATIONS OF MCLEODUSA HAD THE OUT-OF-COURT RESTRUCTURING DESCRIBED HEREIN BEEN CONSUMMATED ON THE RESPECTIVE DATES INDICATED AND ARE NOT INTENDED TO BE PREDICTIVE OF THE FINANCIAL CONDITION OR RESULTS OF OPERATIONS OF MCLEODUSA AT ANY FUTURE DATE OR FOR ANY FUTURE PERIOD.

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McLEODUSA INCORPORATED AND SUBSIDIARIES
UNAUDITED PRO FORMA CONDENSED CONSOLIDATED BALANCE SHEET

(In millions except per share information)

	As of September 30, 2001				
	Historical McLeodUSA	Adjustments for the Out-of-Court Restructuring	Pro Forma for the Out-of-Court Restructuring(9)	Adjustments for Splitrock Disposition(10)	Total Pro Forma
ASSETS					
Current Assets:					
Cash and cash equivalents	$ 67.0	$ (26.6)(1)	$ 40.4	$ 55.0	$ 95.4 (11)
Other current assets	400.2	(148.0)(2)	252.2	(.2)	252.0
Total Current Assets	467.2	(174.6)	292.6	54.8	347.4
Property and equipment, net	2,680.5	(36.8)(2)	2,643.7	(70.8)	2,572.9
Intangible assets	1,491.2	(328.9)(2)	1,162.3		1,162.3
Other assets	153.7	(46.9)(3)	106.8	(1.4)	105.4
Total Assets	$ 4,792.6	$ (587.2)	$ 4,205.4	$ (17.4)	$ 4,188.0
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current Liabilities	$ 692.7	$ (69.2)(4)(8)	$ 623.5	$ (15.4)	$ 608.1
Long-term debt, less current maturities	3,694.0	(2,944.1)(5)	749.9	(2.0)	747.9 (11)
Other long-term liabilities	32.5		32.5		32.5
Total Liabilities	4,419.2	(3,013.3)	1,405.9	(17.4)	1,388.5
Redeemable convertible preferred stock	147.0	(147.0)(6)			
Stockholders' Equity:					
Preferred stock (Series A)					
Common stock	6.3	(2.2)(7)	4.1		4.1
Additional paid-in capital	3,843.2	249.7 (7)	4,092.9		4,092.9
Retained earnings (deficit)	(3,621.1)	2,325.6 (7)(8)	(1,295.5)		(1,295.5)
Accumulated other comprehensive income	(2.0)		(2.0)		(2.0)
Total Stockholders' Equity	226.4	2,573.1	2,799.5		2,799.5
Total Liabilities and Stockholders' Equity	$ 4,792.6	$ (587.2)	$ 4,205.4	$ (17.4)	$ 4,188.0

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

McLEODUSA INCORPORATED AND SUBSIDIARIES
UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions except per share information)

Year Ended December 31, 2000

	Historical McLeodUSA	Adjustments for the Out-of-Court Restructuring	Pro Forma for the Out-of-Court Restructuring	Adjustments for Splitrock Disposition(9)	Total Pro Forma
Operations Statement Data:					
Revenue	$ 1,396.7	$ (253.9)(1)	$ 1,142.8	$ (102.3)	$ 1,040.5
Operating expenses					
Cost of service (exclusive of depreciation shown separately below)	772.8	(88.8)(1)	684.0	(103.0)	581.0
Selling, general and administrative	563.2	(122.0)(1)	441.2	(19.4)	421.8
Depreciation and amortization	409.6	(32.4)(1)	377.2	(121.9)	255.3
Other					
Total operating expenses	1,745.6	(243.2)	1,502.4	(244.3)	1,258.1
Operating loss	(348.9)	(10.7)	(359.6)	142.0	(217.6)
Interest income	47.8	(47.8)(2)			
Interest expense	(151.4)	151.4 (3)(8)		(10)	(12)
Other nonoperating expense	(0.4)		(0.4)	0.3	(0.1)
Income taxes					
Net income (loss)	(452.9)	92.9	(360.0)	142.3	(217.7)
Extraordinary charge for early retirement of debt	(24.4)	24.4 (4)			
Net income (loss)	(477.3)	117.3	(360.0)	142.3	(217.7)
Preferred stock dividends	(54.4)	54.4 (6)			
Earnings applicable to common stock	$ (531.7)	$ 171.7	$ (360.0)	$ 142.3	$ (217.7)
Loss per common and common equivalent share	$ (0.95)		$ (0.90)		$ (0.54)
Weighted average common and common equivalent shares outstanding	558.4	(157.1)(7)	401.3		401.3

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

McLEODUSA INCORPORATED AND SUBSIDIARIES
UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions except per share information)

	Nine Months Ended September 30, 2001				
	Historical McLeodUSA	**Adjustments for the Out-of-Court Restructuring**	**Pro Forma for the Out-of-Court Restructuring**	**Adjustments for Splitrock Disposition(9)**	**Total Pro Forma**
Operations Statement Data:					
Revenue	$ 1,357.1	$ (225.1)(1)	$ 1,132.0	$ (61.8)	$ 1,070.2
Operating expenses					
Cost of service (exclusive of depreciation shown separately below)	791.5	(84.9)(1)	706.6	(59.5)	647.1
Selling, general and administrative	517.4	(99.8)(1)	417.6	(3.0)	414.6
Depreciation and amortization	471.4	(26.9)(1)	444.5	(102.7)	341.8
Other	2,935.4		2,935.4	(2,020.3)(11)	915.1
Total operating expenses	4,715.7	(211.6)	4,504.1	(2,185.5)	2,318.6
Operating loss	(3,358.6)	(13.5)	(3,372.1)	2,123.7	(1,248.4)
Interest income	9.7	(9.7)(2)			
Interest expense	(180.8)	180.8 (3)(8)		(10)	(12)
Other non-operating income	116.5	0.4 (1)	116.9	2.6	119.5
Income taxes					
Net income (loss)	(3,413.2)	158.0	(3,255.2)	2,126.3	(1,128.9)
Gain on exchange of preferred stock	851.2	(851.2)(5)			
Preferred stock dividends	(32.0)	32.0 (6)			
Earnings applicable to common stock	$ (2,594.0)	$ (661.2)	$ (3,255.2)	$ 2,126.3	$ (1,128.9)
Loss per common and common equivalent share	$ (4.20)		$ (7.88)		$ (2.73)
Weighted average common and common equivalent shares outstanding	617.8	(204.6)(7)	413.2		413.2

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

NOTES TO UNAUDITED PRO FORMA
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

General

The pro forma adjustments assume that the Out-of-Court Restructuring will be accomplished as outlined in this document and that the Splitrock Disposition will be consummated for $55 million in cash. The pro forma adjustments relating to the Out-of-Court Restructuring and the Splitrock Disposition are summarized in the following notes.

The Out-of-Court Restructuring assumes that the transaction will be consummated outside of a Chapter 11 case, which is contingent upon a number of conditions as outlined in this document. However, if the Out-of-Court Restructuring is not consummated, McLeodUSA may effect the transaction via the Plan for the reorganization of McLeodUSA under Chapter 11 of the Bankruptcy Code. If the Plan is used, McLeodUSA would implement the provisions of SOP 90-7, "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code." Under SOP 90-7, if the reorganization value of McLeodUSA is less than the amount of allowed claims and post petition liabilities and if holders of existing voting shares immediately before confirmation receive less than fifty percent of the voting shares of the emerging entity, fresh start accounting would apply. McLeodUSA believes that it would be required to adopt fresh start accounting upon an emergence from bankruptcy. The provisions of fresh start accounting would require that McLeodUSA revalue its assets and liabilities at fair value, reset its stockholders' equity using the reorganization value established in the bankruptcy, and record any applicable reorganization value in excess of amounts allocable to identifiable assets. In the event the Plan is used to affect the transaction, the amounts in the accompanying pro forma condensed consolidated financial statements would change materially to comply with SOP 90-7.

Unaudited Pro Forma Condensed Consolidated Balance Sheet

The Unaudited Pro Forma Condensed Consolidated Balance Sheet includes estimated pro forma adjustments necessary to give effect to the Out-of-Court Restructuring as if it had occurred on September 30, 2001. The pro forma adjustments have been prepared on the basis that the Out-of-Court Restructuring will be accomplished outside of Chapter 11 proceedings. In the event the Plan is used to affect the transaction, the amounts in the accompanying pro forma condensed consolidated financial statements would change materially to comply with SOP 90-7. The assets of McLeodUSA would equal the enterprise value of the remaining businesses of McLeodUSA at emergence from Chapter 11 proceedings. McLeodUSA currently estimates that enterprise value would be approximately $2.65 billion and a leveraged net equity balance of approximately $1.15 billion. Any difference in enterprise value and pro forma assets would cause a change to the accompanying Unaudited Pro Forma Condensed Consolidated Balance Sheet by increasing or decreasing the extraordinary gain (retained earnings) with a corresponding offset to the value assigned to the common stock.

During the third quarter ended September 30, 2001, McLeodUSA wrote down all of the assets directly related to Splitrock to fair value as a result of an impairment analysis performed which was triggered by McLeodUSA's operational restructuring. The negotiated sales price for the Splitrock Disposition is $55 million which approximates the fair value of those net assets at September 30, 2001. As such, no gain or loss is expected on this transaction.

The pro forma adjustments to the Unaudited Pro Forma Condensed Consolidated Balance Sheet are described as follows:

1. To reflect the cash proceeds of (a) $535 million and $100 million from the sale of Pubco and the issuance of new preferred stock and warrants, less (b) $560 million paid as partial consideration for the elimination of the Notes, $35 million to prepay Term Loans A and B

under the Credit Agreement, $65 million in transaction costs and $1.6 million of cash and cash equivalents at Pubco which are assumed to be retained by the buyer of Pubco.

2. To reflect the sale of Pubco and the elimination of its assets and liabilities.

3.

To write-off the remaining unamortized financing fees related to the Notes resulting from the retirement of the Notes through the Out-of-Court Restructuring.

4. To reflect the elimination of the accrued interest on the Notes ($57.5 million) and Pubco's current liabilities ($57.7 million) and to reflect an estimated current tax liability of $46.0 million (see note 8 below).

5. To reflect the elimination of the Notes ($2,906.1 million), a prepayment of Term Loans A and B under the Credit Agreement ($35.0 million) and the elimination of Pubco's long-term debt ($3.0 million.)

6. To reflect the conversion of the Preferred Stock to Class A common stock.

7. To reflect the extraordinary gain on the extinguishment of indebtedness as a result of the retirement of the Notes and forgiveness of accrued interest in the Out-of-Court Restructuring, the gain on the sale of Pubco, the 5-to-1 reverse stock split, and the conversion of the Preferred Stock, Notes and New Preferred Stock to 196.4 million, 56.8 million and 36.4 million shares, respectively of Class A common stock.

8. The unaudited pro forma information has been prepared based upon certain assumptions, estimates and positions taken with respect to taxes. It is possible that taxing authorities could disagree. If such authorities were to ultimately prevail, the amounts involved could be material.

9. In the event that the Out-of-Court Restructuring is effected through the tender of 95% of the principal amount of the Notes, the Pro Forma Cash, Long-term debt (excluding current maturities), Total Assets and Total Stockholders' Equity would be $68.4 million, $895.2 million, $4,235.7 million and $2,681.7 million respectively.

10. To reflect the Splitrock Disposition for $55 million in cash and the elimination of the associated assets and liabilities. See "Recent Developments."

11. McLeodUSA borrowed an additional $250 million under its Credit Agreement subsequent to September 30, 2001. As a result total pro forma cash would be $345.4 million and total pro forma long term debt (less current maturities) would be $997.9 million (assuming 100% tender) and $1,143.1 million (assuming a 95% tender).

Unaudited Pro Forma Condensed Consolidated Statements of Operations

The Unaudited Pro Forma Condensed Consolidated Statements of Operations include adjustments necessary to give effect to the Out-of-Court Restructuring and the Splitrock Disposition as if the transactions had been consummated by January 1, 2000.

The pro forma adjustments for the year ended December 31, 2000 and the nine months ended September 30, 2001 are summarized as follows:

1. To eliminate the operations of Pubco sold as part of the Out-of-Court Restructuring.

2. To eliminate all interest income on cash and cash equivalents held during each of the periods under the assumption that all interest income was originally derived from cash proceeds provided by the Notes.

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3. To reflect the elimination of interest expense not capitalized and amortization of deferred financing fees and discounts of the Notes. All pro forma interest for the periods ending December 31, 2000 and September 30, 2001 of $57.4 million and $55.6 million, respectively, related to remaining debt is assumed capitalized and does not result in a charge to earnings.

4. To eliminate the extraordinary charge for the early retirement of debt.

5. To eliminate the gain on exchange of Preferred Stock for the nine months ended September 30, 2001 that was generated by the Exchange of Series B and Series C Preferred Shares for Series D and Series E Preferred Shares.

6. To reflect the elimination of preferred share dividends related to the preferred stock.

7. Reflects a 5-to-1 reverse stock split and the issuance of new shares as described in the Proxy/Disclosure Statement.

8. In the event that the Out-of-Court Restructuring is effected through the tender of 95% of the principal amount of Notes, the additional interest expense would be $14.3 million and $10.9 million for the periods ended December 31, 2000 and September 30, 2001, respectively, of which $7.7 million and $10.9 million may be capitalized.

9. To eliminate the operations of Splitrock.

10. Splitrock's interest expense of $9.4 million and $.2 million for the periods ending December 31, 2000 and September 30, 2001, respectively, would have been capitalized and the elimination does not result in a reduction of interest expense.

11. To eliminate the portion of the restructure charge taken during September 2001 which specifically related to the write down of Splitrock's assets (including intangibles) which are currently being sold and associated goodwill.

12. McLeodUSA borrowed an additional $250 million under its Credit Agreement subsequent to September 30, 2001. The additional pro forma interest from the borrowings would be $26.6 million and $15.3 million for the periods ended December 31, 2000 and September 30, 2001 respectively, of which $17.1 million and $15.3 million may be capitalized.

SELECTED FINANCIAL DATA

The following selected consolidated financial and operating data should be read in conjunction with "Business," "Unaudited Historical and Pro Forma Capitalization," "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the Consolidated Financial Statements and related notes contained herein. The statement of operations and balance sheet data herein is derived from the audited financial statements of McLeodUSA.

Selected Consolidated Financial Data of McLeodUSA
(In millions, except per share data)

	For the Year Ended December 31,						For the Nine-month Period Ending September 30, 2001	
	1996	1997	1998	1999	2000	Total Pro Forma 2000	Historical	Total Pro Forma
						(unaudited)	(unaudited)	(unaudited)
Operations Statement:								

	For the Year Ended December 31,						For the Nine-month Period Ending September 30, 2001	
Revenue	$ 81.3	$ 267.9	$ 604.1	$ 908.8	$ 1,396.7	$ 1,040.5	$ 1,357.1	$ 1,070.2
Operating Expenses:								
Cost of service (exclusive of depreciation expense shown separately below)	52.6	151.2	323.2	457.1	772.8	581.0	791.5	647.1
Selling, general and administrative	46.0	148.2	260.9	392.7	563.2	421.8	517.4	414.6
Depreciation and amortization	8.5	33.3	89.1	190.7	409.6	255.3	471.4	341.8
Restructuring and other	2.4	4.6	5.6				2,935.4	915.1
Total operating expenses	109.5	337.3	678.8	1,040.5	1,745.6	1,258.1	4,715.7	2,318.6
Operating loss	(28.2)	(69.4)	(74.7)	(131.7)	(348.9)	(217.6)	(3,358.6)	(1,248,4)
Interest income (expense), net	5.4	(12.0)	(52.2)	(94.2)	(103.6)		(171.1)	
Other income (expense)	0.5	1.5	2.0	5.6	(0.4)	(0.1)	116.5	119.5
Income taxes								
Net loss before extraordinary charge	(22.3)	(79.9)	(124.9)	(220.3)	(452.9)	(217.7)	(3,413.2)	(1,128.9)
Extraordinary charge for early extinguishment of debt					(24.4)			
Net loss	(22.3)	(79.9)	(124.9)	(220.3)	(477.3)	(217.7)	(3,413.2)	(1,128.9)
Gain on exchange of Preferred Stock							851.2	
Preferred stock dividends				(17.7)	(54.4)		(32.0)	