

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

RARE MEDIUM GROUP INC  
Form 10-Q  
November 13, 2002

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

FORM 10-Q

/x/ Quarterly report pursuant to Section 13 or 15(d) of the Securities  
Exchange Act of 1934 for the period ended September 30, 2002, or  
  
/ / Transition report pursuant to Section 13 or 15(d) of the Securities  
Exchange Act of 1934

Commission file number 0-13865

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

Delaware 23-2368845  
(State or other jurisdiction (I.R.S. Employer  
of incorporation or organization) Identification Number)

44 West 18th Street, 6th Floor 10011  
New York, New York (Zip Code)  
(Address of principal executive offices)

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

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

Yes /x/ No / /

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

Number of shares outstanding of the issuer's common stock, as of November  
8, 2002:

Voting Common Stock, par value \$0.01 per share Class	6,682,615 Number of shares outstanding
Non-Voting Common Stock, par value \$0.01 per share Class	8,990,212 Number of shares outstanding

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(Unaudited)

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

December  
2001  
-----

Current assets:

Assets

Cash and cash equivalents  
Short-term investments

\$  
-----

Total cash, cash equivalents and short-term investments  
Investment in XM Satellite Radio  
Prepaid expenses and other current assets

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Total current assets	1
Property and equipment, net	
Note receivable from the Mobile Satellite Venture, L.P.	
Note receivable from Motient Corporation, net	
Investments in affiliates	
Other assets	
Total assets	\$ 1
Liabilities and Stockholders' Equity	
Current liabilities:	
Accounts payable	\$
Accrued liabilities	
Other current liabilities	
Total current liabilities	
Other noncurrent liabilities	
Total liabilities	
Series A Convertible Preferred Stock, \$.01 par value, net of unamortized discount of \$45,768 and \$42,472, respectively	
Minority interest	
Stockholders' equity:	
Preferred stock, \$.01 par value. Authorized 10,000,000 shares; issued 1,053,259 shares as Series A Convertible Preferred Stock at December 31, 2001 and 1,105,830 shares at September 30, 2002	
Common stock, \$.01 par value. Authorized 200,000,000 shares; issued and outstanding 6,532,496 shares at December 31, 2001 and 6,682,615 shares at September 30, 2002	
Non-voting common stock, \$.01 par value. Authorized 100,000,000 shares; issued and outstanding nil shares at December 31, 2001 and 8,990,212 shares at September 30, 2002	
Additional paid-in capital	5
Accumulated other comprehensive income	
Accumulated deficit	(5)
Treasury stock, at cost, 6,622 shares	
Total stockholders' equity	
Total liabilities and stockholders' equity	\$ 1

See accompanying notes to unaudited consolidated financial statements

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

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	Three Months Ended September 30,		Nine Months Ended September 30, 2001
	2001	2002	
Revenues	\$ 25	\$ --	\$ 1,8
Cost of revenues	2	--	1,3
Gross profit	23	--	5
Expenses:			
Sales and marketing	28	--	1,2
General and administrative	2,737	1,266	14,2
Depreciation and amortization	398	28	2,9
Restructuring charges	125	--	1,0
Total expenses	3,288	1,294	19,5
Loss from operations	(3,265)	(1,294)	(18,9
Interest income, net	3,010	1,418	7,4
Loss on investments in affiliates	(18,212)	(171)	(41,8
Other expense, net	(14,821)	(14,813)	(6
Minority interest	--	(258)	
Loss before taxes and discontinued operations	(33,288)	(15,118)	(54,0
Income tax benefit	--	--	
Loss before discontinued operations	(33,288)	(15,118)	(54,0
Discontinued operations:			
Loss from discontinued operations	(50,677)	--	(117,6
(Loss) gain from wind-down of discontinued operations	(3,073)	413	(3,0
(Loss) gain from discontinued operations	(53,750)	413	(120,7
Net loss	(87,038)	(14,705)	(174,7
Cumulative dividends and accretion of convertible preferred stock to liquidation value	(3,001)	(2,370)	(8,9
Net loss attributable to common stockholders	\$ (90,039)	\$ (17,075)	\$ (183,6
Basic and diluted (loss) earnings per share:			
Continuing operations	\$ (5.72)	\$ (1.18)	\$ (9.
Discontinued operations	(8.48)	0.03	(19.
Net loss per share	\$ (14.20)	\$ (1.15)	\$ (28.
Weighted average common shares outstanding	6,341,683	14,800,273	6,341,7

See accompanying notes to unaudited consolidated financial statements

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

Nine Months

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	----- 2001 -----
Cash flows from operating activities:	
Net loss	\$ (174,761)
Adjustments to reconcile net loss to net cash used in operating activities:	
Loss (gain) from discontinued operations	120,720
Depreciation and amortization	2,981
Loss on investments in affiliates	41,844
Unrealized loss on derivative instrument	1,511
Loss on XM Satellite Radio common stock	--
Non-cash restructuring charges	689
Non-cash interest, net	(1,511)
Non-cash compensation benefit	--
Changes in assets and liabilities, net of sale of businesses:	
Prepaid expenses and other assets	(1,256)
Deferred revenue	666
Accounts payable, accrued and other liabilities	728
	-----
Net cash used in continuing operations	(8,389)
Net cash used in discontinued operations	(26,996)
	-----
Net cash used in operating activities	(35,385)
Cash flows from investing activities:	
Cash paid for investments in affiliates	(6,199)
Cash received from investment in affiliates	3,556
Cash received from sale of XM Satellite Radio common stock	--
Purchase of notes receivable	(50,000)
Purchases of property and equipment	(95)
Purchases of short-term investments	(72,860)
Sales of short-term investments	83,587
	-----
Net cash (used in) provided by continuing operations	(42,011)
Net cash (used in) provided by discontinued operations	(3,592)
	-----
Net cash (used in) provided by investing activities	(45,603)
Cash flows from financing activities:	
Proceeds from issuance of common stock, net of costs	--
Contribution from minority interest of consolidated subsidiary	--
Proceeds from issuance of common stock in connection with the exercise of warrants and options	22
	-----
Net cash provided by financing activities	22
	-----
Net (decrease) increase in cash and cash equivalents	(80,966)
Cash and cash equivalents, beginning of period	113,018
	-----
Cash and cash equivalents, end of period	\$ 32,052
	=====

See accompanying notes to unaudited consolidated financial statements

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### (1) Description of the Business

Rare Medium Group, Inc. (the "Company") historically has conducted its business through its subsidiaries. From 1998 through the third quarter of 2001, its principal business was conducted through Rare Medium, Inc., which developed Internet e-commerce strategies, business processes, marketing communications, branding strategies and interactive content using Internet-based technologies and solutions. As a result of the weakening of general economic conditions which caused many companies to reduce spending on Internet-focused business solutions, a decision to discontinue Rare Medium, Inc.'s operations, along with those of its LiveMarket, Inc. subsidiary ("LiveMarket"), was made at the end of the third quarter of 2001 (see Note 4).

From 1999 through the first quarter of 2001, the Company made venture investments by taking strategic minority equity positions in other independently managed companies. Additionally, in the past, the Company has developed, managed and operated companies in selected Internet-focused market segments ("Start-up Companies"). During the first quarter of 2001, the Company reduced its focus on these businesses and substantially ceased providing funding to its Start-up Companies. Additionally, the Company sold a majority of its equity interest in the operations of three of its Start-up Companies: ChangeMusic Network ("ChangeMusic") and ePrize in April 2001 and Regards.com in December 2001.

In November 2001, through its 80% owned MSV Investors, LLC subsidiary ("MSV Investors Subsidiary"), the Company became a participant in the Mobile Satellite Venture, L.P. joint venture ("MSV Joint Venture"), a joint venture that includes TMI Communications, Inc., Motient Corporation ("Motient"), and certain other investors (collectively, the "Other MSV Investors"). The MSV Joint Venture is currently a provider of mobile digital voice and data communications services via satellite in North America. The Company expects to become an increasingly active participant in the MSV Joint Venture and has designated three members of the 12-member board of directors of the MSV Joint Venture's corporate general partner. In addition, in May 2002, the Company became affiliated with Miraxis, LLC ("Miraxis"), a development stage company having access to a series of licenses with which it intends to provide satellite based multi-channel, broadband data and video services in North America (see Note 7).

In addition to winding down Rare Medium, Inc., the Company's current operations consist of actively managing its interest in the MSV Joint Venture, significantly influencing the operations of Miraxis and seeking other complementary operational opportunities. As of November 8, 2002, the Company's principal assets consist of its interest in the MSV Joint Venture, a promissory note from Motient (see Note 3), its interest in Miraxis, its remaining investments in its venture portfolio companies and cash, cash equivalents and short-term investments.

As a result of the decision to discontinue the operations of Rare Medium, Inc. and LiveMarket, the operating results reported in our statements of operations as continuing operations include the consolidated results of the Company, its MSV Investors Subsidiary, and its Start-up Companies through their respective dates of sale or shutdown. The results of Rare Medium, Inc. and LiveMarket are reflected as discontinued operations.

The Company is headquartered in New York, New York.

### (2) Basis of Presentation

The accompanying unaudited consolidated financial statements have

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been prepared by the Company in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting only of those of a normal recurring nature, necessary for a fair presentation of the Company's financial position, results of operations and cash flows at the dates and for the periods indicated. While the Company believes that disclosures presented are adequate to make the information not misleading, these unaudited consolidated financial statements should be read in conjunction with the audited financial statements and related notes for the year ended December 31, 2001 which are contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission. The results of the three months and nine months ended September 30, 2002 are not necessarily indicative of the results to be expected for the full year. Certain prior year amounts in the consolidated financial statements have been reclassified to conform to the current year's presentation. In addition, all share data, including per share amounts, have been restated to give effect to the ten for one reverse stock split completed on July 18, 2002.

### RARE MEDIUM GROUP, INC. NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

#### (3) Notes Receivable from Motient

On April 2, 2001, the Company agreed to purchase from Motient 12.5% secured promissory notes, issuable in two tranches, each in the principal amount of \$25.0 million. The notes were collateralized by five million shares of XM Satellite Radio common stock owned by Motient. The first tranche was purchased on April 4, 2001, and the second tranche was purchased on July 16, 2001. The principal of and accrued interest on the notes were payable on October 1, 2001 in either cash, shares of XM Satellite Radio, or any combination thereof at Motient's option, as set forth in the agreement. At the option of the Company, the notes were exchangeable for a number of XM Satellite Radio shares based on a formula, as set forth in the agreement.

On October 1, 2001, and again on October 8, 2001, the Company extended the maturity date of the notes. On October 12, 2001, in accordance with the terms of the notes, the Company received five million shares of XM Satellite Radio as payment for \$26.2 million of the notes and accrued interest. The maturity date for the remaining balance of the Motient Notes in the principal amount of approximately \$26.2 million, and interest thereon, was extended for 60 days. On January 10, 2002, Motient and its subsidiaries filed for protection under Chapter 11 of the United States Bankruptcy Code. As part of its filing, Motient indicated that it would likely challenge the Company's right to the \$26.2 million outstanding principal balance and accrued interest thereon, as well as the delivery of the shares of XM Satellite Radio common stock as partial repayment of the aggregate \$50.0 million principal amount of the notes. As a result of uncertainty with respect to the ultimate collection on the notes, a reserve was recognized for the entire amount.

On May 1, 2002, to mitigate the risk, uncertainties and expenses associated with Motient's plan of reorganization, the Company cancelled the outstanding amounts due under the notes and accepted a new note in the principal amount of \$19.0 million that was issued by a new wholly-owned subsidiary of Motient that owns 100% of Motient's interests in the MSV

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Joint Venture. The new note is due in three years and bears interest at a rate of 9% per annum. As a result of the uncertainty with respect to the ultimate collection on the new note, a reserve continues to be maintained for the entire amount of the note.

### (4) Discontinued Operations

At the end of the third quarter of 2001, a decision to discontinue the operations of Rare Medium, Inc. and the LiveMarket subsidiary was made in light of their performance and prospects. The wind-down of these businesses is expected to be substantially completed during 2002. As of September 30, 2002, the remaining assets of Rare Medium, Inc. and LiveMarket totaled approximately \$0.7 million, consisting of cash (including cash collateralizing a letter of credit) and other assets. The liabilities of these subsidiaries totaled approximately \$5.3 million, consisting of accounts payable, accrued expenses and other current liabilities. For the three and nine months ended September 30, 2002, the Company recognized a gain of \$0.4 million and \$11.9 million, respectively, as a result of the settlement of Rare Medium, Inc. liabilities at amounts less than their recorded amounts.

### (5) Stockholders' Equity

#### Common Stock Transactions

In connection with the settlement of a purported class action lawsuit (as described in Note 8), the Company distributed to each holder of record of its common stock, warrants and preferred stock, as of the close of business on May 16, 2002, one non-transferable right to purchase one additional share of its common stock, for each share held, at a purchase price of \$2.01 per share. On July 11, 2002, the rights offering was approved by the Company's stockholders and was concluded on July 16, 2002, with 9,138,105 shares of common stock purchased for gross proceeds of \$18.4 million. Included in the rights offering is the advance purchase by the Company's preferred stockholders of 3,876,584 shares of non-voting common stock in April 2002 for total gross proceeds of \$7.8 million as described in Note 8 and an additional 5,113,628 shares of non-voting common stock purchased by the Company's preferred stockholders pursuant to their over subscription privilege.

### (6) Investment in XM Satellite Radio

The Company classifies its investment in XM Satellite Radio common stock as an available-for-sale, marketable security and reports such investment at fair value with net unrealized gains and losses recorded in stockholders' equity. Gains and losses are recognized in the accompanying consolidated statements of operations when realized or when a decline in value is considered to be other than temporary. During the three months ended September 30, 2002, the Company sold an aggregate of 970,000 shares of XM Satellite Radio common stock at an average price of \$4.10 per share, resulting in net proceeds of \$3.9 million. These sales resulted in a loss of approximately \$2.2 million which is included in "Other Expense, Net" on the accompanying consolidated statements of operations. Subsequent to September 30, 2002, the Company sold its remaining 4,030,000 shares of the stock at an average price of \$3.18 per share, resulting in net proceeds of \$12.7 million (see Note 9). The Company recognized an additional loss of approximately \$12.7 million for the other than temporary impairment in the value of these shares sold subsequent to September 30, 2002. At September 30, 2002, the reported value of the shares in the accompanying consolidated balance sheet was approximately \$12.7 million, representing the net value received from the sale of the stock after September 30, 2002.



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### (7) Business Transaction

On May 28, 2002, the Company acquired Series B Preferred Shares and a warrant from Miraxis for approximately \$0.4 million, representing an ownership on a fully diluted basis of approximately 30%. Miraxis is a development stage, privately held telecommunications company having access to a series of licenses with which it intends to provide satellite based multi-channel, broadband data and video services in North America. Additionally, the Company entered into a management support agreement with Miraxis whereby the Company's President and Chief Operating Officer will provide certain services to Miraxis through February 2003 in exchange for additional Series B Preferred Shares and warrants. This investment is included in "Investments in Affiliates" on the accompanying consolidated balance sheets and is being accounted for under the equity method with the Company's share of Miraxis' loss being recorded in "Loss on Investments in Affiliates" on the accompanying consolidated statements of operations.

### (8) Contingencies

#### Motient Notes

On May 1, 2002, to mitigate the risk, uncertainties and expenses associated with Motient's plan of reorganization, the Company cancelled the outstanding amounts due under the Motient promissory notes and accepted a new note in the principal amount of \$19.0 million that was issued by a new wholly-owned subsidiary of Motient that owns 100% of Motient's interests in the MSV Joint Venture. As a result of uncertainty with respect to the ultimate collection on the new note, the Company continues to maintain its reserve for the entire amount of the note. If the Company recovers any amount on the new note, adjustments to the reserve would be reflected as other income in the accompanying consolidated statements of operations.

#### Settlement of Purported Class Action Lawsuit

A number of purported class action lawsuits were filed by the holders of the Company's common stock in the Court of Chancery of the State of Delaware challenging the plan of merger with Motient Corporation that was ultimately terminated on October 1, 2001. All of the complaints name the Company and members of the Company's board of directors as defendants. Most of the complaints name the holders of the Company's preferred stock, and certain of their affiliates, as defendants, and some of the complaints name Motient as a defendant. On June 22, 2001, the Delaware court entered an order to consolidate all of the Delaware lawsuits for all purposes into a single purported class action, In re Rare Medium Group, Inc. Shareholders Litigation, C.A. No. 18879-NC. On August 7, 2001, a Consolidated Amended Class Action Complaint was filed in Delaware Chancery Court. The Delaware Chancery Court has not yet certified the consolidated lawsuit as a class action. The lawsuit alleges that the defendants breached duties allegedly owed to the holders of the Company's common stock in connection with the merger agreement and sought to stop the merger and/or obtain monetary damages.

On April 2, 2002, the Company and its preferred stockholders entered into a Stipulation of Settlement (the "Settlement") with the plaintiffs relating to the purported class action lawsuit, which is subject to a court hearing on December 2, 2002. In connection with the Settlement, the Company agreed to effect a one for ten reverse stock split, to commence a rights offering and to take certain other corporate actions. Also in connection with the Settlement, the Company entered into an investment agreement with its preferred stockholders who agreed to purchase in advance

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of the rights offering 3,876,584 of shares of the Company's non-voting common stock. This purchase equaled the number of shares of voting common stock that they would otherwise have been entitled to purchase in the rights offering, after giving effect to the cancellation of 20% of the outstanding warrants in connection with the Settlement. An affiliate of the preferred stockholders also commenced a cash tender offer for up to 1,500,291 shares of the Company's common stock on April 9, 2002.

Reverse Split of our Common Stock. As part of the Settlement, the Company agreed to effect a one for ten reverse stock split in order to assist the Company in meeting the Nasdaq National Market's minimum closing bid price requirement of \$1.00 per share. The one for ten reverse stock split was approved by the Company's stockholders on July 11, 2002 and became effective on July 18, 2002.

Rights Offering. In the rights offering, the Company distributed to each holder of record of common stock, warrants and preferred stock, as of the close of business on May 16, 2002, one non-transferable right to purchase one additional share of the Company's common stock, for each share held, at a purchase price of \$2.01 per share. The rights offering was concluded on July 16, 2002, with 9,138,105 shares of common stock purchased for total gross proceeds of \$18.4 million. Included in the rights offering is the advance purchase by the Company's preferred stockholders of 3,876,584 shares of non-voting common stock in April 2002 as described below and an additional 5,113,628 shares of non-voting common stock purchased by the Company's preferred stockholders pursuant to their over subscription privilege.

Advance Purchase by the Preferred Stockholders. Under an investment agreement made in connection with the Settlement, the Company's preferred stockholders purchased 3,876,584 shares of the Company's non-voting common stock. This purchase equaled the number of shares of voting common stock that the preferred stockholders would otherwise have been entitled to purchase in the rights offering, after giving effect to the cancellation of 20% of the outstanding warrants in connection with the Settlement. In connection with the advance purchase, the preferred stockholders paid \$2.01 per share for an aggregate gross purchase price of approximately \$7.8 million.

Stipulation of Settlement. The Company and its preferred stockholders have also agreed, among other things:

- o that, in connection with the rights offering, the preferred stockholders will waive anti-dilution rights in their preferred stock and warrants with respect to the non-voting common stock acquired by the preferred stockholders in the advance purchase or their over-subscription privilege in the rights offering;
- o subject to the final court approval of the Settlement, that 20% of the warrants held by the preferred stockholders to acquire shares of common stock will be cancelled; and
- o subject to the final court approval of the Settlement, that the preferred stockholders will elect to receive dividends on their shares of preferred stock in the form of additional shares of preferred stock, in lieu of cash dividends, for any dividend payment date occurring after June 30, 2002 and on or prior to June 30, 2004.

Tender Offer. As part of the Settlement, on April 9, 2002, an affiliate of the preferred stockholders commenced a cash tender offer at a

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price of \$2.80 per share for up to 1,500,291 shares, or approximately 23% of the Company's outstanding common stock. In accordance with the Settlement, the \$2.80 per share tender offer price equaled 105% of the average closing prices of the common stock for the five trading days prior to April 9, 2002. The tender offer expired on May 10, 2002. The preferred stockholders agreed that so long as any tendered shares are held by them or any of their affiliates, the preferred stockholders and their affiliates will cause all such shares held by them, which would otherwise entitle the preferred stockholders and their affiliates, collectively, to cast more than 29.9% of voting power of our outstanding capital stock, to be voted pro-rata with all other votes cast by holders of common stock. The tender offer was intended to provide additional liquidity for the Company's common stockholders and, thereby, provide near term support for the market price of the Company's common stock in light of the one for ten reverse stock split.

Payment of Attorneys Fees and Expenses. As part of the Settlement, the Company agreed to issue 357,142 shares of the Company's common stock (worth \$1.0 million based on the tender offer price of \$2.80 per share) to the plaintiff's counsel as attorney's fees and to pay them \$0.1 million for expenses. A reserve for the full amount of these fees and expenses is included in accrued liabilities.

### Litigation

On May 16, 2001, plaintiffs Jay M. Wolff, David Bliss, Tim Barber and Steve O'Brien filed suit against Rare Medium, Inc., Rare Medium Group, Inc., and Rare Medium Texas I, Inc. in the United States District Court for the Southern District of New York, Wolff, et al. v. Rare Medium, Inc., et al., CV No 01-4279. The plaintiffs asserted claims for breach of contract, tortious interference with contractual relations, tortious interference with prospective advantage, and breach of implied obligation of good faith, arising out of the plaintiffs' alleged attempt to engage in transactions involving some or all of the approximately 1,200,000 shares of the Company's common stock (prior to the reverse stock split) that the plaintiffs obtained in the Company's acquisition of Big Hand, Inc. The plaintiffs sought unspecified compensatory and punitive damages, interest, attorneys' fees and costs. On October 31, 2001, the Court dismissed the case without prejudice.

The plaintiffs filed an amended complaint on December 7, 2001 based on substantially the same alleged facts. The amended complaint asserts the following causes of action: (1) breach of contract; (2) tortious interference with contract; and, (3) tortious interference with prospective business advantage. The amended complaint also sought an unspecified amount of actual damages, punitive damages, interest, and costs. On June 27, 2002, the Court dismissed the case with prejudice. On July 16, 2002, the plaintiffs filed a notice of appeal. On October 31, 2002, the plaintiffs filed their brief in support of their appeal. The Company intends to dispute this appeal vigorously.

On November 19, 2001, five of the Company's shareholders filed a complaint against the Company, certain of its subsidiaries and certain of their current and former officers and directors in the United States District Court for the Southern District of New York, Dovitz v. Rare Medium Group, Inc. et al., No. 01 Civ. 10196. Plaintiffs became owners of restricted Company stock when they sold the company that they owned to the Company. Plaintiffs assert the following four claims against defendants: (1) common-law fraud; (2) violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder; (3) violation

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of the Michigan Securities Act; and (4) breach of fiduciary duty. These claims arise out of alleged representations by defendants to induce plaintiffs to enter into the transaction. The complaint seeks compensatory damages of approximately \$5.6 million, exemplary and/or punitive damages in the same amount, as well as attorney fees. On January 25, 2002, the Company filed a motion to dismiss the complaint in its entirety. On June 3, 2002, the Court dismissed the matter without prejudice. On or about July 17, 2002, the plaintiffs filed an amended complaint asserting similar causes of action to those asserted in the original complaint. On September 12, 2002, the Company filed a motion to dismiss on behalf of itself and its current and former officers and directors. On November 5, 2002, the plaintiffs filed a brief in opposition to the motion to dismiss. The Company intends to continue to dispute this matter vigorously.

The Company and certain of its subsidiaries (along with the Engelhard Corporation) are parties to an arbitration relating to certain agreements that existed between or among the claimant and ICC Technologies, Inc., the Company's former name, and the Engelhard/ICC ("E/ICC") joint venture arising from the desiccant air conditioning business that the Company and its subsidiaries sold in 1998. The claimant has sought \$8.5 million for (1) its alleged out of pocket losses in investing in the E/ICC's technology; (2) unjust enrichment resulting from the reorganization of E/ICC in 1998; and (3) lost profits arising from the fact that it was allegedly forced to leave the air conditioning business when the E/ICC joint venture was dissolved. The Company intends to vigorously dispute this action.

On July 26, 2002, plaintiffs James D. Loeffelbein, Terrie L. Pham and certain related parties filed suit against the lead plaintiff's counsel in the purported class action lawsuit, the Company, certain of its current and former officers, its former investor relations firm and a former employee of plaintiff Loeffelbein in the District Court of Johnson County, Kansas, Loeffelbein v. Milberg Weiss Bershad Hynes & Lerach, LLP, et al., 02 CV 04867. The plaintiffs assert claims for fraud, negligence and breach of fiduciary duty against all of the Company and certain of its current and former officers in connection with allegedly false statements purportedly made to the plaintiffs. The plaintiffs have sought unspecified damages from the defendants. On September 11, 2002, the matter was removed to the United States District Court for the District of Kansas. On October 11, 2002, the plaintiffs sought to have the matter remanded to state court. The Company intends to oppose this motion and to dispute this matter vigorously.

Though it intends to continue to vigorously contest each of the aforementioned cases, the Company is unable to predict their respective outcomes, or reasonably estimate a range of possible losses, if any, given the current status of these cases. Additionally, from time to time, the Company is subject to litigation in the normal course of business. The Company is of the opinion that, based on information presently available, the resolution of any such additional legal matters will not have a material adverse effect on the Company's financial position or results of its operations.

### (9) Subsequent Events

#### Listing under the Nasdaq National Market

By letter dated May 16, 2002, Nasdaq notified the Company that the closing bid price of our common stock had not exceeded the \$1.00 minimum, and accordingly, its common stock would be delisted from the Nasdaq National Market for failure to satisfy the minimum bid price requirement.

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On May 17, 2002, the Company requested a hearing before the Nasdaq Listing Qualification Panel (the "Panel"). On June 20, 2002, the hearing was held in which the Company presented its case for maintaining the listing of its common stock on the Nasdaq National Market. At the hearing and in communication prior to the hearing, the Company explained to Nasdaq that in order to regain compliance with the requirements for continued listing on the Nasdaq National Market, its board of directors had approved a one for ten reverse stock split, subject to stockholder approval. On July 11, 2002, the Company's stockholders approved the reverse stock split which became effective on July 18, 2002.

On August 19, 2002, the Panel notified the Company that it had determined to permit the Company to maintain its listing on the Nasdaq National Market, subject to the Company providing certain information, including this Form 10-Q, on or before November 14, 2002. On October 3, 2002, the Nasdaq Listing and Hearing Council (the "Council") called for the review of the Panel's determination to permit the Company to remain listed on the Nasdaq National Market, expressing concern that the Company's current business operations may not be adequate to avoid raising public policy concerns with respect to its continued listing. The Company intends to present its case to the Council in the form of a written submission on or before November 12, 2002. In addition, on November 14, 2002, in accordance with the Panel's determination, the Company will update the Panel on the Company's compliance with all Nasdaq requirements, including stockholders' equity of at least \$10.0 million and the Company's activities with respect to the MSV Joint Venture, the status of the FCC's review of the request allowing for an ancillary terrestrial component and Miraxis. Should the Council or the Panel determine that for public policy reasons the Company should no longer be listed on Nasdaq, the Company expects that it would seek listing of its common stock on the OTC Bulletin Board. However, there can be no assurance that such transfer would be granted and the Company could be forced to trade in the "pink sheets." Trading on either the OTC Bulletin or in the "pink sheets" would likely result in a reduction in the liquidity and the trading volume of the Company's common stock. This lack of liquidity would also make it difficult for the Company to raise additional capital, if necessary. In addition, the delisting of its common stock from the Nasdaq National Market would result in an event of non-compliance under the provisions of the Company's preferred stock. If the Company is unable to obtain a waiver of this event of non-compliance, the preferred stockholders would be entitled to elect a majority of the members of the board of directors which would provide them with the ability to control the Company's management and policies.

### Sale of XM Satellite Radio Common Stock

Subsequent to September 30, 2002, the Company sold its remaining 4,030,000 shares of the stock at an average price of \$3.18 per share, resulting in net proceeds of \$12.7 million. The Company recognized a loss during the three months ended September 30, 2002 of approximately \$12.7 million relating to the other than temporary impairment in the value of these shares.

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that involve risks and uncertainties, including statements regarding our capital needs, business strategy, expectations and intentions. We urge you to consider that statements that

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

### Overview

From 1998 through the third quarter of 2001, our principal business was conducted through our subsidiary Rare Medium, Inc., which developed Internet e-commerce strategies, business processes, marketing communications, branding strategies and interactive content using Internet-based technologies and solutions. As a result of the weakening of general economic conditions which caused many companies to reduce spending on Internet-focused business solutions, a decision to discontinue Rare Medium, Inc.'s operations, along with those of its LiveMarket, Inc. subsidiary, was made at the end of the third quarter of 2001.

From 1999 through the first quarter of 2001, we made venture investments by taking strategic minority equity positions in other independently managed companies. Additionally, in the past, we have developed, managed and operated our Start-up Companies. During the first quarter of 2001, we reduced our focus on these businesses and substantially ceased providing funding to our Start-up Companies. Additionally, we sold a majority of our equity interest in the operations of three of our Start-up Companies: ChangeMusic and ePrize in April 2001 and Regards.com in December 2001.

In November 2001, through our MSV Investors Subsidiary, we became a participant in the MSV Joint Venture, a joint venture which includes TMI Communications, Inc., Motient and the Other MSV Investors. The MSV Joint Venture is currently a provider of mobile digital voice and data communications services via satellite in North America. We expect to become an increasingly active participant in the MSV Joint Venture and have designated three members of the 12-member board of directors of the MSV Joint Venture's corporate general partner. In addition, in May 2002, we became affiliated with Miraxis, a development stage company having access to a series of licenses with which it intends to provide satellite based multi-channel, broadband data and video services in North America.

In addition to winding down Rare Medium, Inc., our current operations consist of actively managing our interest in the MSV Joint Venture, significantly influencing the operations of Miraxis and seeking other complementary operational opportunities. Our principal assets consist of our interest in the MSV Joint Venture, a promissory note from Motient Corporation, our interest in Miraxis, our remaining investments in our venture portfolio companies and cash, cash equivalents and short-term investments. As a result of uncertainty with respect to the ultimate collection on the Motient notes, we recognized a reserve for the entire amount of these notes. See "Liquidity and Capital Resources" under this Item 2.

As a result of the decision to discontinue the operations of Rare

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Medium, Inc. and LiveMarket, the operating results reported in our statements of operations as continuing operations include the consolidated results of Rare Medium Group, Inc., our MSV Investors Subsidiary, and our Start-up Companies, through their respective dates of sale or shutdown. The results of Rare Medium, Inc. and LiveMarket are reflected as discontinued operations.

Results of Operations for the Three Months Ended September 30, 2002 Compared to the Three Months Ended September 30, 2001

### Revenues

Revenues for the three months ended September 30, 2002 decreased to nil from approximately \$25,000 for the three months ended September 30, 2001, a decrease of approximately \$25,000. The decrease is the result of the sale of our majority interest in the operations of three Start-up Companies in 2001.

### Cost of Revenues

Cost of revenues includes salaries, payroll taxes and related benefits and other direct costs associated with the generation of revenues. Cost of revenues for the three months ended September 30, 2002 decreased to nil from approximately \$2,000 for the three months ended September 30, 2001, a decrease of approximately \$2,000. The decrease is the result of the sale of our majority interest in the operations of three Start-up Companies in 2001.

### Sales and Marketing Expense

Sales and marketing expense primarily includes the costs associated with the respective sales force of each Start-up Company, marketing and advertising. Sales and marketing expense for the three months ended September 30, 2002 decreased to nil from approximately \$28,000 for the three months ended September 30, 2001, a decrease of approximately \$28,000. The decrease is primarily the result of the sale of our majority interest in the operations of three Start-up Companies in 2001.

### General and Administrative Expense

General and administrative expense includes facilities costs, finance, legal and other corporate costs, as well as the salaries and related employee benefits for those employees that support such functions. General and administrative expense for the three months ended September 30, 2002 decreased to \$1.3 million from \$2.7 million for the three months ended September 30, 2001, a decrease of \$1.4 million. This decrease was primarily related to the reduced infrastructure needed to manage our continuing operations and the sale of our majority interest in the operations of three Start-up Companies in 2001. We currently expect our general and administrative expense, as it relates to our existing operations, to remain at this level in future periods.

### Depreciation and Amortization Expense

Depreciation and amortization expense substantially consists of the depreciation of property and equipment and amortization of intangible assets as a result of the acquisitions of our Start-up Companies. Depreciation and amortization expense for the three months ended September 30, 2002 decreased to approximately \$27,000 from \$0.4 million for the three months ended September 30, 2001, a decrease of approximately \$0.4 million. This decrease is primarily the result of the sale or shutdown of the

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operations of our Start-up Companies in 2001 and the disposal of property and equipment associated with our restructuring activities. As we have reduced our capital expenditures and have written off all remaining goodwill, we currently expect depreciation expense, as it relates to our existing operations, to remain at this level in future periods.

### Restructuring Charges

For the three months ended September 30, 2002, we did not record any restructuring charges. For the three months ended September 30, 2001, we recorded restructuring charges of approximately \$0.1 primarily relating to the disposition of property and equipment. These restructuring charges were the result of the reduction of our infrastructure needed to manage our continuing operations.

### Interest Income, Net

Interest income, net for the three months ended September 30, 2002 is mainly comprised of the interest earned on our cash, cash equivalents, and short-term investments and on our convertible notes receivable from the MSV Joint Venture.

### Loss on Investment in Affiliates

For the three months ended September 30, 2002, we recorded a loss on investments in affiliates of approximately \$0.2 million, consisting of our proportionate share of affiliates' operating losses and amortization of our net excess investment over our equity in an affiliate's net assets accounted for under the equity method. For the three months ended September 30, 2001, we recorded a loss on investments in affiliates of \$18.2 million, consisting primarily of \$16.2 million for the impairment to the carrying value of certain affiliates accounted for under the cost method, \$0.1 million for the realized loss on the sale of publicly traded securities, \$0.5 million for our proportionate share of affiliates' operating losses and amortization of our net excess investment over our equity in each affiliate's net assets for those affiliates accounted for under the equity method and \$1.4 million related to our Start-Up Companies. We will continue to monitor the carrying value our remaining investments in affiliates for further impairment.

### Minority Interest

We received \$10.2 million from unaffiliated persons as an investment into our MSV Investors Subsidiary. Minority interest relates to the equity in earnings, primarily the interest income earned on the convertible notes from the MSV Joint Venture, which is attributable to those unaffiliated investors.

### Other Expense, Net

For the three months ended September 30, 2002, we recorded other expense, net of approximately \$14.8 million, consisting primarily of \$2.2 million for the realized loss on the sale of XM Satellite Radio common stock and \$12.7 million for the other than temporary impairment in the value of the XM Satellite Radio common stock sold subsequent to September 30, 2002. For the three months ended September 30, 2001, we recorded other expense, net of approximately \$14.8 million, consisting primarily of \$15.3 million for the unrealized loss relating to the exchange feature allowing us to convert the Motient promissory notes to shares of XM Satellite Radio common stock then held by Motient. The decrease in the value of the exchange feature was due to the decrease in the value of XM Satellite Radio



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common stock from June 30, 2001 to September 30, 2001.

### (Loss) Gain from Discontinued Operations

At the end of the third quarter of 2001, a decision to discontinue the operations of Rare Medium, Inc. and its LiveMarket subsidiary was made in light of their performance and prospects. The wind-down of these businesses is expected to be completed during 2002. For the three months ended September 30, 2002, we recognized a gain of \$0.4 million as a result of the settlement of Rare Medium, Inc. liabilities at amounts less than their recorded amounts. For the three months ended September 30, 2001, we recognized a loss from operations of \$50.7 million relating to these businesses and \$3.1 million relating to the wind down of these businesses.

### Net Loss

For the three months ended September 30, 2002, we recorded a net loss of \$14.7 million. The net loss was primarily due to the factors described in "General and Administrative Expense," "Depreciation and Amortization Expense," "Interest Income, Net," "Minority Interest," "Other Expense, Net" and "(Loss) Gain from Discontinued Operations."

Included in net loss attributable to common shareholders of \$17.1 million was \$2.4 million of non-cash deemed dividends and accretion related to the issuance of our convertible preferred stock. Dividends were accrued related to the pay-in-kind dividends payable quarterly on convertible preferred stock and to the accretion of the carrying amount of the convertible preferred stock up to its \$100 per share face redemption amount over 13 years.

Results of Operations for the Nine Months Ended September 30, 2002 Compared to the Nine Months Ended September 30, 2001

### Revenues

Revenues for the nine months ended September 30, 2002 decreased to nil from approximately \$1.9 million for the nine months ended September 30, 2001, a decrease of approximately \$1.9 million. The decrease is the result of the sale of our majority interest in the operations of three Start-up Companies in 2001.

### Cost of Revenues

Cost of revenues includes salaries, payroll taxes and related benefits and other direct costs associated with the generation of revenues. Cost of revenues for the nine months ended September 30, 2002 decreased to nil from approximately \$1.3 million for the nine months ended September 30, 2001, a decrease of approximately \$1.3 million. The decrease is the result of the sale of our majority interest in the operations of three Start-up Companies in 2001.

### Sales and Marketing Expense

Sales and marketing expense primarily includes the costs associated with the respective sales force of each Start-up Company, marketing and advertising. Sales and marketing expense for the nine months ended September 30, 2002 decreased to nil from approximately \$1.3 million for the nine months ended September 30, 2001, a decrease of approximately \$1.3 million. The decrease is primarily the result of the sale of our majority interest in the operations of three Start-up Companies in 2001.

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### General and Administrative Expense

General and administrative expense includes facilities costs, finance, legal and other corporate costs, as well as the salaries and related employee benefits for those employees that support such functions. General and administrative expense for the nine months ended September 30, 2002 decreased to \$4.9 million from \$14.2 million for the nine months ended September 30, 2001, a decrease of \$9.3 million. This decrease was primarily related to the reduced infrastructure needed to manage our continuing operations and the sale of our majority interest in the operations of three Start-up Companies in 2001, partially offset by the legal and advisory costs associated with our negotiations and settlement with the plaintiffs in the purported class action lawsuit. We currently expect our general and administrative expense, as it relates to our existing operations, to remain at this level in future periods.

### Depreciation and Amortization Expense

Depreciation and amortization expense substantially consists of the depreciation of property and equipment and amortization of intangible assets as a result of the acquisitions of our Start-up Companies. Depreciation and amortization expense for the nine months ended September 30, 2002 decreased to approximately \$0.1 million from \$3.0 million for the nine months ended September 30, 2001, a decrease of approximately \$2.9 million. This decrease is primarily the result of the sale or shutdown of the operations of our Start-up Companies in 2001 and the disposal of property and equipment associated with our restructuring activities. As we have reduced our capital expenditures and have written off all remaining goodwill, we currently expect depreciation expense, as it relates to our existing operations, to remain at this level in future periods.

### Restructuring Charges

For the nine months ended September 30, 2002, we did not record any restructuring charges. For the nine months ended September 30, 2001, we recorded restructuring charges of approximately \$1.1 million primarily relating to the disposition of property and equipment. These restructuring charges were the result of the reduction of our infrastructure needed to manage our continuing operations.

### Interest Income, Net

Interest income, net for the nine months ended September 30, 2002 is mainly comprised of the interest earned on our cash, cash equivalents, and short-term investments and on our convertible notes receivable from the MSV Joint Venture.

### Loss on Investment in Affiliates

For the nine months ended September 30, 2002, we recorded a loss on investments in affiliates of approximately \$0.2 million, consisting of our proportionate share of affiliates' operating losses and amortization of our net excess investment over our equity in an affiliate's net assets accounted for under the equity method. For the nine months ended September 30, 2001, we recorded a loss on investments in affiliates of \$41.8 million, \$31.8 million for the impairment to the carrying value of certain affiliates accounted for under the cost method, \$3.2 million for the realized loss on the sale of publicly traded securities, \$2.7 million for our proportionate share of affiliates' operating losses and amortization of our net excess investment over its equity in each affiliate's net assets for those affiliates accounted for under the equity method, and \$4.1

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million related to our Start-Up Companies. We will continue to monitor the carrying value our remaining investments in affiliates for further impairment.

### Other Expense, Net

For the nine months ended September 30, 2002, we recorded other expense, net of approximately \$14.8 million, consisting primarily of \$2.2 million for the realized loss on the sale of XM Satellite Radio common stock and \$12.7 million for the other than temporary impairment in the value of the XM Satellite Radio common stock sold subsequent to September 30, 2002. For the nine months ended September 30, 2001, we recorded other expense, net of approximately \$0.7 million, consisting primarily of \$1.5 million for the unrealized loss relating to the exchange feature allowing us to convert the Motient promissory notes to shares of XM Satellite Radio common stock then held by Motient. The decrease in the value of the exchange feature was due to the decrease in the value of XM Satellite Radio common stock from the time we purchased the Motient promissory notes to September 30, 2001.

### Minority Interest

We received \$10.2 million from unaffiliated persons as an investment into our MSV Investors Subsidiary. Minority interest relates to the equity in earnings, primarily the interest income earned on the convertible notes from the MSV Joint Venture, which is attributable to those unaffiliated investors.

### (Loss) Gain from Discontinued Operations

At the end of the third quarter of 2001, a decision to discontinue the operations of Rare Medium, Inc. and its LiveMarket subsidiary was made in light of their performance and prospects. The wind-down of these businesses is expected to be completed during 2002. For the nine months ended September 30, 2002, we recognized a gain of \$11.9 million as a result of the settlement of Rare Medium, Inc. liabilities at amounts less than their recorded amounts. For the nine months ended September 30, 2001, we recognized a loss from operations of \$117.6 million relating to these businesses and \$3.1 million relating to the wind down of these businesses.

### Net Income

For the nine months ended September 30, 2002, we recorded a net loss of \$4.4 million. The net income was primarily due to the factors described in "General and Administrative Expense," "Depreciation and Amortization Expense," "Interest Income, Net," "Minority Interest," "Other Expense, Net" and "(Loss) Gain from Discontinued Operations."

Included in net loss attributable to common shareholders of \$13.0 million was \$8.6 million of non-cash deemed dividends and accretion related to the issuance of our convertible preferred stock. Dividends were accrued related to the pay-in-kind dividends payable quarterly on convertible preferred stock and to the accretion of the carrying amount of the convertible preferred stock up to its \$100 per share face redemption amount over 13 years.

### Liquidity and Capital Resources

We had \$31.7 million in cash, cash equivalents and short-term investments as of September 30, 2002. Cash used in operating activities

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from continuing operations was \$4.6 million for the nine months ended September 30, 2002 and resulted primarily from cash used for general corporate overhead including professional fees associated with the settlement of certain litigation matters. Cash used in operating activities from discontinued operations was \$1.5 million for the nine months ended September 30, 2002 which primarily relates to settlements of existing liabilities and, to a lesser extent, legal fees associated with the wind down of Rare Medium, Inc. and other businesses. We expect cash used in continuing operations, as it relates to our existing operations, to remain at approximately this level in future periods.

Cash provided by investing activities from continuing operations was \$2.7 million, excluding the \$6.2 million resulting from the net sale of short-term investments, for the nine months ended September 30, 2002, which primarily consists of \$3.9 million of cash received from the sale of 970,000 shares of XM Satellite Radio common stock and \$0.3 million of cash received from an investment in an affiliate with whom we had a dispute, partially offset by the \$1.1 million used by our MSV Investors Subsidiary to purchase, in connection with the MSV Joint Venture rights offering, a newly issued convertible note with terms similar to the convertible note already held by the MSV Investors Subsidiary and \$0.4 million used to purchase an investment in Miraxis, LLC. We do not have any future funding commitments with respect to any of our investments. However, we expect that the MSV Joint Venture will require additional funding from time to time, and we may choose to exercise our preemptive rights to provide our pro rata share of such funding, subject to our liquidity and capital resources at the time. Subsequent to September 30, 2002, we sold our remaining 4,030,000 shares of XM Satellite Radio common stock for net proceeds of \$12.7 million.

Cash provided by financing activities was \$18.3 million for the nine months ended September 30, 2002, which primarily consists of the proceeds from the sale of 147,893 shares of voting common stock and 8,990,212 shares of non-voting common stock in connection with the rights offering and advance purchase, partially offset by the costs of the rights offering.

### Motient Promissory Note

On May 1, 2002, to mitigate the risk, uncertainties and expenses associated with Motient's plan of reorganization, we cancelled the outstanding promissory notes with an aggregate principal amount of \$26.2 million and accepted a new note in the principal amount of \$19.0 million that was issued by a new wholly-owned subsidiary of Motient that owns 100% of Motient's interests in the MSV Joint Venture. The new note is due in three years and bears interest at a rate of 9% per annum. As a result of uncertainty with respect to the ultimate collection on the new note, we continue to maintain a reserve for the entire amount of the note. If we recover any amount on the new note, adjustments to the reserve would be reflected as other income in the accompanying consolidated statements of operations.

### MSV Joint Venture Convertible Notes Receivable

Through our 80% owned MSV Investors Subsidiary, we are an active participant in the MSV Joint Venture, a joint venture that includes TMI Communications, Inc., Motient, and the Other MSV Investors. The MSV Joint Venture is currently a provider of mobile digital voice and data communications services via satellite in North America. On November 26, 2001, through our MSV Investors Subsidiary, we purchased a \$50.0 million interest in the MSV Joint Venture in the form of a convertible note (the

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"MSV Note"). Immediately prior to the purchase of the convertible note, Rare Medium Group contributed \$40.0 million to the MSV Investors Subsidiary and a group of unrelated third parties contributed \$10.0 million. The MSV Note bears interest at a rate of 10% per year, has a maturity date of November 26, 2006, and is convertible at any time at the option of our MSV Investors Subsidiary into equity interests in the MSV Joint Venture. The MSV Note automatically converts into equity interests upon the MSV Joint Venture obtaining certain approvals from the FCC and its Canadian equivalent, Industry Canada. Upon conversion, our MSV Investors Subsidiary would own approximately 30.8% of the equity interests in the MSV Joint Venture. However, in the event that the MSV Joint Venture receives approval from the FCC by March 31, 2003 with regard to its plans for a next-generation satellite system complemented by ancillary terrestrial base stations, certain other investors in MSV are obligated to invest an additional \$50.0 million in the MSV Joint Venture and, thereafter, our MSV Investors Subsidiary would own approximately 23.6% of the equity interests in the MSV Joint Venture. The fair value of the MSV Note approximates book value based on the equity value of the MSV Joint Venture's recent funding transactions assuming conversion of such note.

On August 13, 2002, the MSV Joint Venture held a rights offering allowing its investors to purchase their pro rata share of an aggregate \$3.0 million worth of newly issued convertible notes with terms similar to the convertible note already held by our MSV Investors Subsidiary. The MSV Investors Subsidiary exercised its basic and over subscription rights and purchased approximately \$1.1 million of the convertible notes.

### Rights Offering and Advance Purchase

In connection with the settlement of the purported class action lawsuit, we distributed to each holder of record of our common stock, warrants and preferred stock, as of the close of business on May 16, 2002, one non-transferable right to purchase one additional share of our common stock, for each share held, at a purchase price of \$2.01 per share. On July 11, 2002, the rights offering was approved by our stockholders and was concluded on July 16, 2002, with 9,138,105 shares of our common stock purchased for total gross proceeds of approximately \$18.4 million. Included in the rights offering is the advance purchase by our preferred stockholders of 3,876,584 shares of non-voting common stock in April 2002 for total gross proceeds of approximately \$7.8 million and an additional 5,113,628 shares of non-voting common stock purchased by our preferred stockholders pursuant to their over subscription privilege.

### Listing under the Nasdaq National Market

By letter dated May 16, 2002, Nasdaq notified us that the closing bid price of our common stock had not exceeded the \$1.00 minimum, and accordingly, our common stock would be delisted from the Nasdaq National Market for failure to satisfy the minimum bid price requirement. On May 17, 2002, we requested a hearing before the Nasdaq Listing Qualification Panel. On June 20, 2002, the hearing was held in which we presented our case for maintaining the listing of our common stock on the Nasdaq National Market. At the hearing and in communication prior to the hearing, we explained to Nasdaq that in order to regain compliance with the requirements for continued listing on the Nasdaq National Market, our board of directors had approved a one for ten reverse stock split, subject to stockholder approval. On July 11, 2002, our stockholders approved the reverse stock split which became effective on July 18, 2002.

On August 19, 2002, the Panel notified us that it had determined

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to permit us to maintain our listing on the Nasdaq National Market, subject to us providing certain information, including this Form 10-Q, on or before November 14, 2002. On October 3, 2002, the Nasdaq Listing and Hearing Council called for the review of the Panel's determination to permit us to remain listed on the Nasdaq National Market, expressing concern that our current business operations may not be adequate to avoid raising public policy concerns with respect to our continued listing. We intend to present our case to the Council in the form of a written submission on or before November 12, 2002. In addition, on November 14, 2002, in accordance with the Panel's determination, we will update the Panel on our compliance with all Nasdaq requirements, including stockholders' equity of at least \$10.0 million and our activities with respect to the MSV Joint Venture, the status of the FCC's review of the request allowing for an ancillary terrestrial component and Miraxis. Should the Council or the Panel determine that for public policy reasons we should no longer be listed on Nasdaq, we expect that we would seek listing of our common stock on the OTC Bulletin Board. However, there can be no assurance that such transfer would be granted, and we could be forced to trade in the "pink sheets." Trading on either the OTC Bulletin or in the "pink sheets" would likely result in a reduction in the liquidity and the trading volume of our common stock. This lack of liquidity would also make it difficult for us to raise capital. Furthermore, there can be no assurance that we would be permitted to trade on the OTC Bulletin Board. In addition, the delisting of our common stock from the Nasdaq National Market would result in an event of non-compliance under the provisions of our preferred stock. If we are unable to obtain a waiver of this event of non-compliance, the preferred stockholders would be entitled to elect a majority of the members of our board of directors which would provide them with the ability to control our management and policies.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to certain market risks from changes in the price of the XM Satellite Radio publicly traded common stock. We account for our investment in XM Satellite Radio common stock as an available-for-sale, marketable security and report such investment at fair value with net unrealized gains and losses recorded in stockholders' equity. Gains and losses are recognized in our consolidated statements of operations when realized or when a decline in value is considered to be other than temporary. During the three months ended September 30, 2002, we sold an aggregate of 970,000 shares of XM Satellite Radio common stock at an average price of \$4.10 per share, resulting in net proceeds of \$3.9 million. These sales resulted in a loss of approximately \$2.2 million, which is included in "Other Expense, Net" in our consolidated statements of operations. Subsequent to September 30, 2002, we sold our remaining 4,030,000 shares of the stock at an average price of \$3.18 per share, resulting in net proceeds of \$12.7 million. We recognized an additional loss of approximately \$12.7 million for the other than temporary impairment in the value of the shares sold subsequent to September 30, 2002. At September 30, 2002, the reported value of our remaining shares of XM Satellite Radio common stock in our consolidated balance sheet was approximately \$12.7 million, representing the net value received from the sale of the stock after September 30, 2002.

### Item 4. Controls and Procedures

Within 90 days prior to the date of this report, we carried out an evaluation, under the supervision and with the participation of our chief executive officer, principal accounting officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our chief executive officer, principal accounting officer and principal financial officer concluded that our disclosure controls and procedures, as of the date of the evaluation, are effective in timely alerting them to material

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information required to be included in our periodic SEC reports. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

In addition, we reviewed our internal controls, and there have been no significant changes in those controls or in other factors that could significantly affect those controls subsequent to the date of their last evaluation.

### PART II OTHER INFORMATION

#### Item 1. Legal Proceedings

A number of purported class action lawsuits were filed by the holders of the Company's common stock in the Court of Chancery of the State of Delaware challenging the plan of merger with Motient Corporation that was ultimately terminated on October 1, 2001. All of the complaints name the Company and members of the Company's board of directors as defendants. Most of the complaints name the holders of the Company's preferred stock, and certain of their affiliates, as defendants, and some of the complaints name Motient as a defendant. On June 22, 2001, the Delaware court entered an order to consolidate all of the Delaware lawsuits for all purposes into a single purported class action, *In re Rare Medium Group, Inc. Shareholders Litigation*, C.A. No. 18879-NC. On August 7, 2001, a Consolidated Amended Class Action Complaint was filed in Delaware Chancery Court. The Delaware Chancery Court has not yet certified the consolidated lawsuit as a class action. The lawsuit alleges that the defendants breached duties allegedly owed to the holders of the Company's common stock in connection with the merger agreement and sought to stop the merger and/or obtain monetary damages. On April 2, 2002, the Company entered into a Stipulation of Settlement, subject to court approval, in which it agreed to effectuate a reverse stock split, commence a rights offering and take certain other corporate actions. In connection with the settlement, the Company agreed to issue 357,142 shares of the Company's common stock (worth \$1.0 million based on the tender offer price of \$2.80 per share) to the plaintiff's counsel as attorney's fees and pay the plaintiff's counsel \$0.1 million for expenses.

On May 16, 2001, plaintiffs Jay M. Wolff, David Bliss, Tim Barber and Steve O'Brien filed suit against Rare Medium, Inc., Rare Medium Group, Inc., and Rare Medium Texas I, Inc. in the United States District Court for the Southern District of New York, *Wolff, et al. v. Rare Medium, Inc., et al.*, CV No 01-4279. The plaintiffs asserted claims for breach of contract, tortious interference with contractual relations, tortious interference with prospective advantage, and breach of implied obligation of good faith, arising out of the plaintiffs' alleged attempt to engage in transactions involving some or all of the approximately 1,200,000 shares of the Company's common stock (prior to the reverse stock split) that the plaintiffs obtained in the Company's acquisition of Big Hand, Inc. The plaintiffs sought unspecified compensatory and punitive damages, interest, attorneys' fees and costs. On October 31, 2001, the Court dismissed the case without prejudice.

The plaintiffs filed an amended complaint on December 7, 2001 based on substantially the same alleged facts. The amended complaint asserts the following causes of action: (1) breach of contract; (2) tortious interference with contract; and, (3) tortious interference with

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prospective business advantage. The amended complaint also sought an unspecified amount of actual damages, punitive damages, interest, and costs. On June 27, 2002, the Court dismissed the case with prejudice. On July 16, 2002, the plaintiffs filed a notice of appeal. On October 31, 2002, plaintiffs filed their brief in support of their appeal. The Company intends to dispute this appeal vigorously.

On November 19, 2001, five of the Company's shareholders filed a complaint against the Company, certain of its subsidiaries and certain of their current and former officers and directors in the United States District Court for the Southern District of New York, *Dovitz v. Rare Medium Group, Inc. et al.*, No. 01 Civ. 10196. Plaintiffs became owners of restricted Company stock when they sold the company that they owned to the Company. Plaintiffs assert the following four claims against defendants: (1) common-law fraud; (2) violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder; (3) violation of the Michigan Securities Act; and (4) breach of fiduciary duty. These claims arise out of alleged representations by defendants to induce plaintiffs to enter into the transaction. The complaint seeks compensatory damages of approximately \$5.6 million, exemplary and/or punitive damages in the same amount, as well as attorney fees. On January 25, 2002, the Company filed a motion to dismiss the complaint in its entirety. On June 3, 2002, the Court dismissed the matter without prejudice. On or about July 17, 2002, the plaintiffs filed an amended complaint asserting similar causes of action to those asserted in the original complaint. On September 12, 2002, the Company filed a motion to dismiss on behalf of itself and its current and former officers and directors. On November 5, 2002, the plaintiffs filed a brief in opposition to the motion to dismiss. The Company intends to continue to dispute this matter vigorously.

The Company and certain of its subsidiaries (along with the Engelhard Corporation) are parties to an arbitration relating to certain agreements that existed between or among the claimant and ICC Technologies, Inc., the Company's former name, and the Engelhard/ICC ("E/ICC") joint venture arising from the desiccant air conditioning business that the Company and its subsidiaries sold in 1998. The claimant has sought \$8.5 million for (a) its alleged out of pocket losses in investing in the E/ICC's technology, (b) unjust enrichment resulting from the reorganization of E/ICC in 1998, and (c) lost profits arising from the fact that it was allegedly forced to leave the air conditioning business when the E/ICC joint venture was dissolved. The Company intends to vigorously dispute this action.

On July 26, 2002, plaintiffs James D. Loeffelbein, Terrie L. Pham and certain related parties filed suit against the lead plaintiff's counsel in the purported class action lawsuit, the Company, certain of its current and former officers, its former investor relations firm and a former employee of plaintiff Loeffelbein in the District Court of Johnson County, Kansas, *Loeffelbein v. Milberg Weiss Bershad Hynes & Lerach, LLP, et al.*, 02 CV 04867. The plaintiffs assert claims for fraud, negligence and breach of fiduciary duty against all of the Company and certain of its current and former officers in connection with allegedly false statements purportedly made to the plaintiffs. The plaintiffs have sought unspecified damages from the defendants. On September 11, 2002, the matter was removed to the United States District Court for the District of Kansas. On October 11, 2002, the plaintiffs sought to have the matter remanded to state court. The Company intends to oppose this motion and to dispute this matter vigorously.

Item 2. Changes in Securities



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- (a) Not applicable
- (b) Not applicable
- (c) On July 16, 2002, the Company sold 5,113,628 shares of its non-voting common stock, par value \$0.01 per share, for cash proceeds of \$10.3 million in a private placement under Section 4(2) of the Securities Act. The private placement was made to the holder of all of our preferred stock (the "Apollo Stockholders") pursuant to its over subscription privilege in the rights offering. The net proceeds from this offering will be used to supplement our cash resources, to satisfy our ongoing cash requirements, including general and administrative expenses, and to take advantage of business opportunities, including maintaining or increasing our stake in the MSV Joint Venture.

Pursuant to the Investment Agreement, and as approved by the Company's stockholders on July 11, 2002, the Apollo Stockholders are permitted to exchange their shares of non-voting common stock for shares of voting common stock only in the following two circumstances: (1) as part of a transfer of the Apollo Stockholders' holdings to a person not affiliated with the Apollo Stockholders, in an amount not to exceed 10% of our voting power, and such transferee, to the knowledge of the Apollo Stockholders, will not, as a result of the transfer, hold more than 15% of our voting power; and (2) at any time, so long as the voting power of the Apollo Stockholders, after giving effect to any such exchange, does not exceed 29.9% of the outstanding voting power which is the percentage of the outstanding voting power which the Apollo Stockholders were entitled to cast prior to the April 2, 2002 advance purchase.

- (d) Not applicable

### Item 3. Defaults Upon Senior Securities

Not applicable

### Item 4. Submissions of Matters to a Vote of Security Holders

The Company held a special meeting of stockholders on July 11, 2002. Proxies for the meeting were solicited by the Company pursuant to Regulation 14A under the Exchange Act. The Company's stockholders voted on the following proposals with the following results:

The adoption of an amendment to the Company's Restated Certificate of Incorporation to effect a one for ten reverse stock split.

	For	Against	Abstain	Broker Non-Votes
Preferred Stock	1,073,007	0	0	0
Common Stock	54,443,496	1,726,903	371,470	0

The authorization to issue up to 91,381,315 shares of the Company's common stock, prior to the one for ten reverse split, in connection with a rights offering.

Broker

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	For	Against	Abstain	Non-Votes
Preferred Stock	1,073,007	0	0	0
Common Stock	18,570,446	2,043,245	439,518	34,590,195

The authorization for the Apollo Stockholders to exchange, from time to time, non-voting common stock for voting common stock under certain circumstances.

	For	Against	Abstain	Broker Non-Votes
Preferred Stock	1,073,007	0	0	0
Common Stock	18,317,179	2,050,283	441,032	34,590,195

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

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

Exhibit Number	Description
99.1	- Certification Pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

On July 18, 2002, the Company filed a report on Form 8-K (i) announcing the completion of the rights offering, (ii) announcing the hiring of Jeffrey A. Leddy as Senior Vice President of Operations and (iii) announcing the one for ten reverse stock split would become effective on July 18, 2002.

On August 21, 2002, the Company filed a report on Form 8-K announcing that it received notice from the Nasdaq Listing Qualifications Panel indicating that the Company's common stock will continued to be listed on the Nasdaq National Market pursuant to certain conditions.

SIGNATURES

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

Date: November 12, 2002

By: /s/ GLENN S. MEYERS

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Glenn S. Meyers  
Chief Executive Officer

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Date: November 12, 2002

By: /s/ CRAIG C. CHESSER

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

Date: November 12, 2002

By: /s/ MICHAEL A. HULTBERG

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

CERTIFICATIONS

I, Glenn S. Meyers, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Rare Medium Group, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

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- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 12, 2002

By: /s/ GLENN S. MEYERS

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Glenn S. Meyers  
Chief Executive Officer

### CERTIFICATIONS

I, Michael A. Hultberg, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Rare Medium Group, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

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- c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 12, 2002

By: /s/ MICHAEL A. HULTBERG

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

CERTIFICATIONS

I, Craig C. Chesser, certify that:

- 1. I have reviewed this quarterly report on Form 10-Q of Rare Medium Group, Inc.;
- 2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
- 3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
- 4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14)

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for the registrant and we have:

- a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 12, 2002

By: /s/ CRAIG C. CHESSER

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

Exhibit 99.1

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Rare Medium Group, Inc. (the "Company") for the quarterly period ended September 30, 2002 as filed with the Securities and Exchange Commission on the date

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hereof (the "Report"), Glenn S. Meyers as Chief Executive Officer of the Company, Michael A. Hultberg as Principal Accounting Officer, and Craig C. Chesser as Principal Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ GLENN S. MEYERS

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Name: Glenn S. Meyers  
Title: Chief Executive Officer  
Date: November 12, 2002

By: /s/ MICHAEL A. HULTBERG

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Name: Michael A. Hultberg  
Title: Principal Accounting Officer  
Date: November 12, 2002

By: /s/ CRAIG C. CHESSE

-----  
Name: Craig C. Chesser  
Title: Principal Financial Officer  
Date: November 12, 2002

This certification accompanies the Report pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of ss.18 of the Securities Exchange Act of 1934, as amended.