

VOIP INC  
Form 10-K  
April 02, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2006

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

For the transition period \_\_\_\_\_ to \_\_\_\_\_  
*Commission file number 000-28985*

**VOIP, INC.**

(Exact name of registrant as specified in its charter)

Texas  
(State or other jurisdiction of incorporation or organization)

75-2785941  
(I.R.S. Employer Identification No.)

151 South Wymore Road, Suite 3000  
Altamonte Springs, Florida  
(Address of principal executive offices)

32714  
(ZIP Code)

Issuer's telephone number, including area code: (407) 389-3232

**Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$0.001.**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES  NO

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES  NO

Issuer’s revenues for its most recent fiscal year were \$14,676,948.

At June 30, 2006, the last business day of the registrant’s most recently completed second fiscal quarter, there were 70,509,102 shares of registrant’s common stock outstanding, and the aggregate market value of such shares held by non-affiliates of the registrant (based upon the closing sale price of such shares on the Over-The-Counter Bulletin Board on June 30, 2006) was approximately \$38,722,066. Shares of the registrant’s common stock held by each executive officer and director and by each entity or person that, to the registrant’s knowledge, owned 5% or more of the registrant’s outstanding common stock as of June 30, 2006, have been excluded in that such persons may be deemed to be affiliates of the registrant. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

At March 28, 2007, the registrant had outstanding 98,609,701 and no shares of par value \$0.001 common stock and par value \$0.001 preferred stock, respectively.

Company Symbol-VOII

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**VOIP, INC.**

**PART I**

**Item 1. Business**

**Caution Regarding Forward-Looking Statements**

This annual report contains forward-looking statements relating to events anticipated to happen in the future. These forward-looking statements are based on the beliefs of our management, as well as assumptions made by and information currently available to our management. Forward-looking statements also may be included in other written and oral statements made or released by us. You can identify forward-looking statements by the fact that they do not relate strictly to historical or current facts. The words "believe," "anticipate," "intend," "expect," "estimate," "project," "may," "could" and similar expressions are intended to identify forward-looking statements. Forward-looking statements describe our expectations today of what we believe is most likely to occur or may be reasonably achievable in the future, but they do not predict or assure any future occurrence and may turn out to be wrong. Forward-looking statements are subject to both known and unknown risks and uncertainties and can be affected by inaccurate assumptions we might make. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially. We do not undertake any obligation to publicly update any forward-looking statements to reflect new information or future events or occurrences. These statements reflect our current views with respect to future events and are subject to risks and uncertainties about us, including, among other things:

- Our ability to market our services successfully to new customers;
  - Our ability to retain a high percentage of our customers;
- The possibility of unforeseen capital expenditures and other upfront investments required to deploy new technologies or to effect new business initiatives;
  - Our ability to raise capital;
  - Network development and operations;
- Our expansion, including consumer acceptance of new price plans and bundled offerings;
  - Additions or departures of key personnel;
  - Competition, including the introduction of new products or services by our competitors;
- Existing and future laws or regulations affecting our business and our ability to comply with these laws or regulations;
  - Our reliance on the systems and provisioning processes of regional Bell operating companies;
    - Technological innovations
  - The outcome of legal and regulatory proceedings;
- General economic and business conditions, both nationally and in the regions in which we operate; and
- Other factors described in this document, including those described in more detail in PART I, Item 1A. "Risk Factors."

**DESCRIPTION OF BUSINESS**

**General Development**

We were incorporated under the laws of the State of Texas on August 3, 1998, under our original name of Millennia Tea Masters. In February 2004 we exchanged 12,500,000 shares for the assets of two start-up telecommunication businesses, eGlobalphone, Inc. and VoIP Solutions, Inc. We changed our name to VoIP, Inc., in April 2004. We consummated the acquisitions of DTNet Technologies, a hardware supplier, and VoIP Americas, an interconnected Voice-over-Internet-Protocol ("VoIP") related company, in June and September, respectively, of 2004. We decided to exit our former tea business in December 2004, and focus our efforts and resources in the VoIP telecommunications

industry. In May 2005 we completed the acquisition of Caerus, a VoIP carrier and service provider, and in October 2005 we purchased substantially all of the VoIP related assets of WQN, Inc. ("WQN"). In April 2006, we sold DTNet Technologies to our former Chief Operating Officer.

We are an emerging global provider of wholesale long-distance and local telephone services through our VoIP network (called the VoiceOne Network). VoIP is the real time transmission of voice communications in the form of digitized "packets" of information over the public Internet or our own private network, similar to the way in which e-mail and other data is transmitted. Our services allow customers to communicate at significantly reduced costs compared to traditional telephony networks, using our softswitches that connect calls over different phone lines entirely by software run on a computer system. We are a certified Competitive Local Exchange Carrier ("CLEC") and InterExchange Carrier ("IXC").

Since 2004 we have developed our business through strategic acquisitions, as noted in the second preceding paragraph. These acquisitions, and our subsequent VoIP-related technological enhancements, have provided us with important technology, intellectual capital and VoIP expertise, trade names, domain names, VoIP enhanced service applications, key business relationships and revenues. We own our network and technology, and provide a portfolio of advanced telecommunications technologies, enhanced service solutions, and broadband products to the VoIP industry. Our current and targeted customers include CLECs, IXC, Internet Service Providers (“ISPs”), cable operators, and VoIP service providers in the United States and various countries around the world.

Our goal is to become the premier enabler for packet communication services for carriers (portal and ISP), service providers and cable operators seeking to offer value-added voice, data and enhanced services products using VoIP technology.

### **Business Segments**

Our business was previously divided into three primary segments: (1) telecommunications, which consists of consumer and wholesale telecommunication services provided through our propriety VoIP network and technology; (2) wholesale sales of VoIP hardware and broadband components; and (3) the wholesaling of prepaid calling cards. We recently sold businesses comprising our hardware sales and prepaid calling card segments. Accordingly, separate financial statement information for the former segments is not provided.

### **Our Technology and Network**

Our proprietary softswitch technology was developed in-house using protocol agnostic architecture, enabling virtually any network protocol, from legacy switches to the latest Multi-Protocol Label Switching (“MPLS”) standards, to communicate with our softswitches. Prior to softswitches, existing legacy technology uses hardware such as physical switches to route calls. Our technology approach enables us to integrate our network directly into the public switched telephone networks, with more limited capital expenditure costs.

Based on Microsoft .NET technology, we believe that integration to the enterprise desktop will drive market acceptance and use of our advanced services. Our network currently supports its own media gateways, softswitch controller, unified messaging systems, voicemail, media trans-coding and many other integral parts of a complete solution. Using our web interfaces, our customers also have the management tools needed for provisioning and maintenance of their services.

Our network operations center (“NOC”) located in Orlando, Florida, is a fully staffed, 24x7x365 operation. From the NOC we monitor all aspects of the technical environment, from our nationwide OC-12 backbone to network routers, SIP proxies and numerous routing gateways, soft switches and other aspects of our VoIP infrastructure. Fully redundant technologies are deployed in a scalable network environment that we believe will enable us to compete in the demanding IP telephony marketplace. Our network incorporates an advanced MPLS architecture which provides services to carriers and other service providers. Our network features direct interconnection facilities with multiple RBOCs, CLECs, IXCs, service providers, cable operators, wireless carriers and resellers. We also operate a smaller combination Time Division Multiplexing (“TDM”)/IP network located in Dallas, Texas.

### **Products and Services**

Our telecommunications products and service offerings target VoIP wholesale customers, CLECs, IXCs, ISPs, cable operators and other providers of telephony services in the United States and various countries around the world. We also sell VoIP products such as EasyTalk and Rocket VoIP that are targeted at individual consumers.

#### *Call Termination*

We charge our wholesale customers minute-based fees to terminate calls on our network. We pay termination fees when it is necessary to route calls from our network to other networks for termination. Our revenues and profit margins on those revenues are a function of the number and duration of calls handled by our network and what we charge and pay to handle this traffic.

U.S. call termination takes place either on our network or that of one of our network partners to which we route traffic. Our international termination product features direct routes and connections established to many international voice carriers worldwide. Carriers use complex least-cost-routing algorithms that direct traffic to the lowest cost carrier. We are attempting to establish a competitive cost structure through the efficiencies of our network design, the completion and implementation of our own least-cost routing algorithms, and through current and future partnerships with key off-net and niche providers. Revenues generated from these services for the year ended December 31, 2006, substantially all of which were derived from one customer, amounted to \$5.7 million or 39% of our consolidated revenues during this period.



### *VoiceOne Carrier Direct*

We are in the early stages of implementing our VoiceOne Carrier Direct program which we believe will enable us to develop a significant facilities-based, carrier customer base. We believe that carriers that want to offer VoIP services have essentially three options: create their own internal VoIP capabilities, acquire a VoIP carrier, or partner with a VoIP carrier. The first two of these options are typically expensive and time consuming, both initially and with respect to ongoing system maintenance. With respect to the third option, our VoiceOne Carrier Direct is a partner program for carriers that provide them with our technology to IP-enable their TDM networks. With this program the carriers receive our equipment and expertise, enabling them to rapidly enter the VoIP services market without making significant capital expenditures. Because our technology is protocol agnostic, by implementing the VoiceOne Carrier Direct program we believe our customers can avoid modifications to their TDM networks and the operability issues that can plague the interface of legacy systems with IP technology. We interface our customers' TDM systems to our VoIP network. We do not charge the carriers for equipment that includes softswitch technology, a media gateway, a service creation environment, a multi-protocol label switching network and access to our products and services. In return for our equipment and expertise, the facilities based carrier pays us fees to terminate calls on our network and for other services such as Hosted IP Centrex and local inbound. We anticipate that this strategy will be attractive to the carriers since it provides them with a new group of customers and revenue sources without requiring them to modify their legacy systems or expend capital. Once the carriers are part of our Carrier Direct Program, we can obtain revenues from calls the carriers terminate on our network, and can terminate calls on their network. Through December 31, 2006 we had not generated any significant revenues from our VoiceOne Carrier Direct program.

### *Click-to-Call*

In November 2006 we introduced Click-to-Call, which involves initiating phone calls from computers without dialing. This technology is currently used as a sales lead generator in online ads. From a web site, users type in the desired service (flowers, pizza, etc.) along with their zip code. Once a service provider is located and selected, the user then enters their phone number, clicks "call" on the web site, and their phone will ring connecting them to the service provider. We receive minute-based revenue for each call carried on our network. Through December 31, 2006 we had not generated significant revenues from our Click-to-Call program.

### *EasyTalk*

EasyTalk, our automated number identification ("ANI") retail product, marketed through our website, is a long distance service with "ease of use" features for consumers. We believe that EasyTalk is a step beyond calling cards. Our network is programmed to automatically recognize our customers' phone numbers and to provide callers from these numbers immediate access to long-distance services. No calling card or PIN number is required. Consumer features include PIN-less dialing, fast \*1 recharge of the service, speed dial, and quick query of current balance. As of December 31, 2006 we had approximately 25,000 EasyTalk customers, and revenues generated from this product offering amounted to approximately \$5.5 million for the year ended December 31, 2006.

### *Rocket VoIP*

Our Rocket VoIP retail product allows customers to use, through a media terminal adapter we provide, their high speed Internet connection to place local, long distance and international calls. As of December 31, 2006 we had approximately 3,000 Rocket VoIP customers, and revenues generated for this product offering amounted to approximately \$600,000 for the year ended December 31, 2006.

### *Other Products*

We also sell various PIN and ANI products to consumers via our website.

**Prepaid Calling Cards Segment**

We previously sold prepaid calling cards that we purchased from other carriers to private distributors located in Southern California. Unlike our other communications products, the communication traffic arising from the use of these cards to place telephone calls was handled by carriers affiliated with vendors we purchased the cards from, and not by our network. In October 2006, we terminated our Marketing and Distribution Agreement with Phone House, Inc., effectively discontinuing this business segment, and its operations are accounted for as discontinued.

**Hardware Sales Segment**

Our hardware sales subsidiary, doing business as DTNet Technologies, operated a fulfillment center in Clearwater, Florida from which we sold a variety of VoIP hardware and broadband components to broadband service providers. These products included cable modems, DSL modems, AV power line and home plug adapters, and multimedia terminal adapters. In April 2006, we sold DTNet Technologies to our former Chief Operating Officer, and its operations have since been accounted for as discontinued.

## OUR STRATEGY

Our objective is to provide reliable, scalable, and competitively-priced worldwide VoIP communication services with unmatched quality. We plan to achieve this objective by delivering innovative technologies and services while balancing the needs of our customers with the needs of our business. We intend to bring high quality voice products and services, at an affordable price, to other communication providers, businesses and residential consumers to enhance the ways in which these customers communicate with the rest of the world. Recognizing that basic voice service is a commodity item that does not drive significant profits, we plan to provide basic services to customers that will lead into margin expansion as more advanced features are offered on our network, including initiating phone calls from computers without dialing (click-to-call technology), checking voicemail, faxes, and emails from a single computer in-box (unified messaging), providing audio and video teleconferencing, and offering VoIP services with leased lines.

Specific strategies to accomplish this objective include:

- building our carrier/service provider customer base through aggressive marketing of our VoiceOne Carrier Direct program;
- completing the expansion of our network (currently in process);
- capitalizing on our technological expertise to introduce new products, services and features;
- customizing our service offerings for the purpose of pursuing strategic partnerships with major customers and suppliers;
- offering the best possible service and support to our customers;
- developing additional distribution channels;
- expanding our market share for our retail calling services;
- increasing our customer base by introducing cost-effective solutions to interconnect with our network; and
- controlling operating expenses and capital expenditures.

## Competition

We compete primarily in the market for enhanced IP communications services. This market is highly competitive and has numerous service providers. The market for enhanced Internet and IP communications services is new and rapidly evolving. We believe that the primary competitive factors determining success in the Internet and IP communications market are:

- quality of service;
- breadth and depth of service offerings;
- ability to custom create innovative solutions;
- the ability to meet and anticipate customer needs through multiple service offerings and feature sets;
- responsive customer care services; and
- price.

Future competition could come from a variety of companies both in the Internet and telecommunications industries. These industries include major companies who have greater resources and larger customer bases than we have, and have been in operation for many years. We also compete in the growing market of discount telecommunications services including "pure play" VoIP service providers, prepaid calling cards, call-back services, dial-around or 10-10 calling and collect calling services. In addition, some Internet service providers have begun to aggressively enhance their real time interactive communications, including instant messaging, PC-to-PC and PC-to-Phone services, and broadband phone services.

Some competitors may be able to bundle services and products that are not offered by us together with enhanced Internet and IP communications services, which could place us at a significant competitive disadvantage. Many of our competitors enjoy economies of scale that can result in lower cost structure for transmission and related costs, which could cause significant pricing pressures within the industry. At the same time, we see these potential competitors as potential customers, and have organized our various reseller and service provider products and services to meet the emergent needs of these companies.

Our primary competitors include:

- carriers operating in the U.S. and abroad, including Level 3, Global Crossing, Cogent Communications Group, Inc., XO Holdings, Inc., US LEC Corporation, Pac-West Telecomm, Inc.; and
- subscriber based service provider competitors, including Vonage, Packet8, DeltaThree, SunRocket, Time Warner, Comcast and Net2phone.

## **Human Resources**

VoIP, Inc. currently employs 53 persons in the following capacities: 3 officers, 26 general and administrative employees, and 24 technology personnel. We consider our relations with our employees to be favorable. We have never had a work stoppage, and none of our employees is represented by collective bargaining agreements. We believe that our future success will depend in part on our ability to attract, integrate, retain and motivate highly qualified personnel, and upon the continued service of our senior management and key technical personnel. Our Chief Executive Officer and Chief Operating Officer are bound by employment agreements through September 2009. Competition for qualified personnel in our industry and geographical location is intense. We cannot assure you that we will be successful in attracting, integrating, retaining and motivating a sufficient number of qualified employees to conduct our business in the future.

## **Intellectual Property**

We have developed several important intellectual property features. VoiceOne has developed and the network provides an E911 solution to comply with the FCC's recent order imposing E911 requirements on VoIP service providers. VoiceOne's 911 service is known as Enhanced E911. A key feature of the E911 service is that it can route emergency calls for the customer whose location is constant as well as the customer who often moves the location of his VoIP device. Customers can update their location information in real time, so that their 911 call will be delivered to the appropriate PSAP in the new location. To further support the FCC 911 mandate, we have applied for a patent for our 911 compliant VoIP Multimedia Terminal Adaptor.

We have developed Pathfinder as a "cascading provisioning server" feature for deployment of zero-touch hardware deployment and is a new development that is exclusive to our platform. The system allows each device to auto-provision without any customer interaction even in situations where there are multiple levels of resellers to distribute the product to their customers (to any number of resale levels). This allows for installations without any customer service or technical support time spent in configuration issues.

## **REGULATION**

We are currently both a value added service provider and a provider of interconnected Voice over Internet Protocol ("VoIP") services as that term is defined under federal law. The integration and softswitch portions of our business are expected to remain unthreatened by traditional common carrier regulation in major nations in which we expect to do business. Our telecommunications service offerings may potentially experience regulatory pressures as the United States makes changes in its telecommunications law to encompass interconnected VoIP services. The imposition of government regulation on our business could adversely affect our operations by requiring additional expense to meet compliance requirements and subject us to additional fees and surcharges that are currently applicable to providers of legacy telecommunications services.

The FCC regulates interstate and international telecommunications services. The FCC imposes extensive regulations on common carriers such as ILECs that have some degree of market power. The FCC imposes less regulation on common carriers without market power, such as the Company. The FCC permits these non-dominant carriers to provide domestic interstate services (including long-distance and access services) without prior authorization; but it requires carriers to receive an authorization to construct and operate telecommunications facilities and to provide or resell telecommunications services between the United States and international points. Under the Telecommunications Act of 1996 (the "1996 Act"), any entity, including cable television companies and electric and gas utilities, may enter any telecommunications market, subject to reasonable state regulation of safety, quality and consumer protection. The 1996 Act opened the local services market by requiring ILECs to permit interconnection to their networks.

The FCC has to date treated Internet service providers (“ISPs”) as "enhanced service providers," exempt from federal and state regulations governing common carriers, including the obligation to pay access charges and contribute to the universal service fund. Nevertheless, regulations governing disclosure of confidential communications, copyright, excise tax and other requirements may apply to the provision of Internet access services.

**FCC Regulation of Interconnected VoIP Services**

There are a number of regulatory proceedings underway or being considered by federal and state authorities, including the Federal Communications Commission, or FCC, and state regulatory agencies that could potentially impact providers of interconnected VoIP services, like us. Currently, providers of interconnected VoIP services are largely unregulated in the United States particularly when compared to providers of traditional telecommunications services. On March 10, 2004, the FCC adopted a Notice of Proposed Rulemaking, which will address a variety of issues concerning the regulatory treatment of VoIP telephony. We cannot predict the outcome of this proceeding. Should the FCC adopt additional regulations that would be applicable to interconnected VoIP providers like us, our costs of doing business would likely increase and would make our services less competitive with traditional providers of telecommunications services.

In November 2004, the FCC ruled that the interconnected VoIP services of a particular company are jurisdictionally interstate and not subject to state certification, tariffing and most other state telecommunications regulations. The FCC ruling was upheld on appeal. We believe that our interconnected VoIP service is substantially similar to the one the FCC ruled on and that our service would also be considered interstate and free from state regulation.

In June 2006, the FCC determined that providers of interconnected VoIP services must contribute to the federal Universal Service Fund, or USF. For a period of at least two quarters beginning October 1, 2006, we will be required to contribute to the USF for its subscribers' retail revenues as well as through its underlying carriers' wholesale charges. The impact of this obligation is to either increase prices for our services to our customers or to reduce our profit margin. This could have a material adverse effect on our financial position, results of operations and cash flows. The FCC Order applying USF contributions to interconnected VoIP providers is currently under appeal and the FCC continues to evaluate alternative methods for assessing USF charges, including imposing an assessment on telephone numbers. The outcome of these proceedings cannot be determined at this time.

Interconnected VoIP providers, like us, are required to offer the 911 emergency calling capabilities similar to those available to subscribers of traditional switched phone lines. We were also required to distribute stickers and labels warning customers of the limitations associated with accessing emergency services through an interconnected VoIP service, as well as to notify and to obtain affirmative acknowledgement from customers that customers were aware of the differences between the emergency calling capabilities offered by interconnected VoIP providers as compared to traditional, wireline providers of telephone service. These requirements pertain to our Rocket VoIP customers described on page 6. The FCC's Enforcement Bureau released an order stating that the Enforcement Bureau will not pursue enforcement against interconnected VoIP providers that have received affirmative acknowledgement from at least 90% of their subscribers, which we have received.

Like many interconnected VoIP providers, we cannot offer VoIP E911 services that route emergency calls in a manner consistent with the FCC rules for all of its customers. We are addressing this issue with our VoIP E911 solution providers. The FCC may determine that our VoIP E911 solution for certain customers does not satisfy the requirements of the VoIP E911 order because, in some instances, Volo will not be able to connect subscribers directly to a PSAP. Volo recently received correspondence from the FCC requesting additional information about its 911 compliance. We understand that a number of interconnected VoIP providers received similar correspondence. A response is due on April 11, 2007. We cannot predict what action the FCC may take after reviewing our responses. Should the FCC engage in any type of enforcement action, such as disconnecting customers, paying monetary fines, or any other type of enforcement action, such actions could have a material adverse effect on our financial position, results of operations and cash flows.

On August 5, 2005, the FCC unanimously adopted an order requiring interconnected VoIP providers, like the Company, to comply with the Communications Assistance for Law Enforcement Act, or CALEA. CALEA requires covered providers to assist law enforcement agencies in conducting lawfully authorized electronic surveillance. Under the FCC Order, interconnected VoIP providers will be required to comply with CALEA obligations by May 14, 2007 and make certain filings prior to that date. Consistent with the relevant rules, we are working with a third-party solution provider to devise a CALEA solution. Our failure to achieve compliance with any future CALEA orders, rules, filings or standards, or any enforcement action initiated by the FCC or other agency, state or task force against us could have a material adverse effect on our financial position, results of operations or cash flows.

The effect of any future laws and regulations on our operations cannot be determined.

### **State Regulation**

The 1996 Act is intended to increase competition in the telecommunications industry, especially in the local exchange market. With respect to local services, ILECs are required to allow interconnection to their networks and to provide

unbundled access to network facilities, as well as a number of other pro-competitive measures. Because the implementation of the 1996 Act is subject to numerous state rulemaking proceedings on these issues, it is currently difficult to predict how quickly full competition for local services will develop.

**Local Regulation**

Our network is subject to numerous local regulations such as building codes and licensing. Such regulations vary on a city-by-city, county- by-county and state-by-state basis.

**Item 1A. Risk Factors**

**RISKS RELATED TO OUR COMPANY**

**We are not in compliance with the terms of our secured loan agreement, and the note holders may accelerate the amounts due at any time.**



We are not in compliance with certain covenants of the agreement for our secured loan from a lending institution, now held by a group of institutional investors (and formerly held by Cedar Boulevard Lease Funding LLC). The loan balance currently amounts to approximately \$1.9 million, and we have also not made scheduled principal and interest payments. In addition, the loan is now accruing interest at 17.5%, and is repayable through May 2007. Because the investors have a security interest in all of our assets, they may choose to accelerate the loan payments at any time, which would have a significant adverse impact on our financial condition, and could impair our ability to continue as a going concern.

**We are not in compliance with the terms of our convertible notes issued in July and October 2005, in January and February of 2006, and in October 2006, and the note holders may accelerate the amounts due at any time.**

The provisions of the convertible notes issued in July and October 2005, in January and February 2006, and in October 2006 provide that the failure to pay principal and interest timely and the failure to register the securities underlying the notes within the required time limit are events of default under the notes. We have not made scheduled payments of \$217,506 under the 2005 notes and have not made scheduled payments of \$1,286,079 under the 2006 notes. Also we have not registered all of these note shares and related warrant shares. The convertible note holders have not declared a default under the loan agreements. However, the amounts due under the notes could be accelerated and immediately due and payable, which would adversely affect our financial condition.

**Because we failed to meet our obligations to file registration statements required under the various subscription agreements related to certain of our note, warrant and common stock financings timely, we are accruing liquidated damages for breach of contract until such time as the registration statements are filed and are declared effective.**

Pursuant to the subscription agreements under which certain investors purchased notes, common stock and warrants in 2005 and 2006, we agreed to register the securities purchased for resale by those investors under the Securities Act of 1933, as amended, within a specified time. Because we failed to comply with these requirements, we currently owe liquidated damages of \$2,200,631 plus 1,535,219 shares of common stock, and will continue to incur liquidated damages amounting to \$278,432 per month until there are effective registration statements covering the notes and warrants. Because we are incurring substantial liquidated damages on a monthly basis, our failure to comply with the terms of the notes and warrants could continue to have an adverse effect on our financial position and our results of operations. We are currently contractually obligated to register approximately 269 million shares, warrants and options. There is no assurance that sufficient registration statements can be filed or declared effective by the SEC, in which case we would continue to be unable to satisfy our contractual obligations to register shares.

**Our substantial debt could adversely affect our financial position, operations and ability to grow.**

As of December 31, 2006, our total liabilities were approximately \$37.9 million, most of which are classified as current. Our substantial indebtedness could have adverse consequences in the future. For example, it could:

- Require us to dedicate a substantial portion of our cash flow from operations to payments on our debt, which would reduce amounts available for working capital, capital expenditures, research and development, and other general corporate purposes;
- Limit our flexibility in planning for, or reacting to, changes in our business and the industries in which we operate;
  - Increase our vulnerability to general adverse economic and industry conditions;
  - Place us at a disadvantage compared to our competitors that may have less debt than we do;
- Make it more difficult for us to obtain additional financing that may be necessary in connection with our business;
  - Make it more difficult for us to implement our business and growth strategies; and
  - Cause us to have to pay higher interest rates on future borrowings.

**We need immediate additional capital to continue our operations.**

Our operations currently require significant amounts of cash. We intend to continue to enhance and expand our network in order to maintain our competitive position and meet the increasing demands for service quality, capacity and competitive pricing. Also, our pursuit of new customers and the introduction of new products and/or services will require significant marketing and promotional expenses that we often incur before we begin to receive the related revenue. To date, our operations have consumed, rather than generated, cash. Our working capital and capital expenditure requirements have been met by sales of debt and equity securities. We need to raise additional capital to continue our operations. We may not be able to raise additional capital. If we are able to raise additional capital through the issuance of additional equity or debt, our current investors could experience further dilution. We need to raise additional debt or equity capital imminently to provide the funds necessary to repay or restructure our debt and continue operations. If unsuccessful, or if the note holders declare the Company's notes in default, we may not be able to continue operations.

**We have experienced significant changes in our top management.**

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On September 12, 2006, we underwent a reorganization of our executive management. Accordingly, Mr. Anthony J. Cataldo was appointed Chief Executive Officer and Chairman, replacing Mr. Gary Post, who himself replaced a former Chief Executive Officer on May 19, 2006. Mr. David Ahn, Vice President Corporate Planning, also left the Company effective September 12, 2006. On May 19, 2006, Mr. Robert V. Staats was appointed Chief Accounting Officer, and Mr. David Sasnett resigned as Chief Financial Officer. On July 28, 2006, Mr. Shawn M. Lewis was appointed Chief Operating Officer in addition to Chief Technology Officer. Although the board of directors believes that these management changes are in our best interests and that the new management will have a positive impact, significant personnel changes may have the effect of disrupting our day-to-day operations until such time as the new management is integrated and fully informed with respect to our business and operations.

**We may incur goodwill and intangible asset impairment charges.**

Our balance sheet at December 31, 2006 includes approximately \$21.2 million in goodwill and approximately \$11.5 million in other intangible assets recorded in connection with our acquisitions. We recorded significant additional amounts of goodwill and intangible assets as a result of our acquisition in October 2005 of substantially all of the assets relating to the VoIP business of WQN, and as a result of our acquisition in May 2005 of Caerus and its subsidiaries.

In accordance with SFAS 142, we test the carrying value of our goodwill and our other intangible assets for impairment at least annually by comparing the fair values of these assets to their carrying values. During the year ended December 31, 2005 we recorded an impairment charge to our operating results of approximately \$4.2 million relating to goodwill previously recorded for an acquisition. During the year ended December 31, 2006, we recorded an impairment charge to operating results of \$839,101 as a result of selling our interest in our subsidiary, DTNet Technologies, in April 2006. These charges reduced the carrying value of the subsidiary to its estimated fair value. We may be required to record additional impairment charges for these assets in the future, which could materially adversely affect our financial condition and results of operations. If the traded market price of our common stock declines, a material goodwill impairment charge in the future is possible.

**Our internal controls over financial reporting are not adequate, and our independent auditors may not be able to later certify as to their adequacy, which could have a significant and adverse effect on our business and reputation.**

Section 404 of Sarbanes-Oxley and the rules and regulations of the Securities Exchange Commission (the "Commission") associated with Sarbanes-Oxley, which we refer to as Section 404, require a reporting company to, among other things, annually review and disclose its internal controls over financial reporting, and evaluate and disclose changes in its internal controls over financial reporting quarterly. Under Section 404 a reporting company is required to document and evaluate such internal controls in order to allow its management to report on, and its independent auditors to attest to, these controls. We are required to comply with Section 404 not later than our fiscal year ending December 2007. We are currently evaluating our strategy to begin performing the system and process documentation, evaluation and testing required (and any necessary remediation) in an effort to comply with management certification and auditor attestation requirements of Section 404. As reported in Item 9A. Controls and Procedures beginning at page 31, we have concluded that our disclosure controls and procedures, and our financial reporting controls, are currently ineffective. Further, in the course of our ongoing evaluation, we may identify additional areas of our internal controls requiring improvement, and plan to design enhanced processes and controls to address issues that might be identified through this review. As a result, we expect to incur additional expenses and diversion of management's time. We cannot be certain as to the timing of completion of our documentation, evaluation, testing and remediation actions or the impact of the same on our operations, and may not be able to ensure that the process is effective or that the internal controls are or will be effective in a timely manner. If we are not able to implement the requirements of Section 404 in a timely manner or with adequate compliance, our independent auditors may not be able to certify as to the effectiveness of our internal control over financial reporting, and we may

be subject to sanctions or investigation by regulatory authorities, such as the Commission. As a result, there could be an adverse reaction in the financial markets due to a loss of confidence in the reliability of our financial statements. In addition, we may be required to incur costs in improving our internal control system and the hiring of additional personnel. Any such actions could adversely affect our results of operations, cash flows and financial condition.

**We have a history of losses and negative cash flows from operations, and we anticipate such losses and negative cash flows will continue.**

We have incurred significant losses since inception, and we anticipate continuing to incur significant losses for the foreseeable future. Our net loss for the fiscal years ended December 31, 2006 and 2005 was approximately \$41.2 million and \$28.3 million, respectively. Our net cash used for operating activities for these same periods was approximately \$12.4 million and \$20.0 million, respectively. As of December 31, 2006, our accumulated deficit was approximately \$76.0 million. Our revenues may not grow or even continue at their current level. We will need to significantly increase our revenues and gross margins to become profitable. In order to increase our revenues, we need to attract and maintain customers to increase the fees we collect for our services. If our revenues do not increase as much as we expect, we may never be profitable. Even if our revenues increase, if we are unable to generate sufficiently profitable margins on these revenues, we may never be profitable. If we become profitable, we may not be able to sustain or increase profitability.

**We have a limited operating history upon which you can evaluate us.**

We have only a limited operating history upon which you can evaluate our business and prospects. We commenced operations of our current business in 2004, and the majority of our operations are comprised of businesses we acquired in 2005. You should consider our prospects in light of the risks, expenses and difficulties we may encounter as an early stage company in the new and rapidly evolving market for Internet protocol (IP) communications services. These risks include our ability:

- To increase acceptance of our VoIP communications services, thereby increasing the number of users of our IP telephony services;
- To successfully integrate our recent acquisitions;
- To compete effectively; and
- To develop new products and keep pace with developing technology.

In addition, because we expect an increasing percentage of our revenues to be derived from our IP communications services, our past operating results may not be indicative of our future results.

**We may not be able to expand our revenue base and achieve profitability.**

Our business strategy is to expand our revenue sources by providing IP communications services to several different customer groups. We can neither assure you that we will be able to accomplish this nor that this strategy will be profitable. Approximately 39% of our consolidated revenues for the year ended December 31, 2006 were derived from one customer, and our gross margins for these revenues were negative. Currently, our revenues are generated by providing termination services for other carriers and end users, and from the sales of retail VoIP services to consumers. These services have not been profitable to date and may not be profitable in the future.

In the future, we intend to generate increased revenues from IP communications services from multiple sources, many of which are unproven. We expect that our revenues for the foreseeable future will be dependent on, among other factors:

- Acceptance and use of IP telephony;
- Growth in the number of our customers;
  - Expansion of service offerings;
  - Traffic levels on our network;
- The effect of competition, regulatory environment, international long distance rates, and access and transmission costs on our prices; and
- Continued improvement of our global network quality.

We cannot assure you that a market for our services will develop. Our market is new and rapidly evolving. Our ability to sell our services may be inhibited by, among other factors, the reluctance of some end-users to switch from traditional communications carriers to IP communications carriers and by concerns with the quality of IP telephony and the adequacy of security in the exchange of information over the Internet, and the reluctance of our resellers and service providers to utilize outsourced solutions providers.

End-users in markets serviced by recently deregulated telecommunications providers are not familiar with obtaining services from competitors of these providers and may be reluctant to use new providers such as us. We will need to devote substantial resources to educate customers and end-users about the benefits of IP communications solutions in general and our services in particular. If enterprises and their customers do not accept our enhanced IP communications services as a means of sending and receiving communications, we will not be able to increase our number of paid users or successfully generate revenues in the future.

**Potential fluctuations in our quarterly financial results may make it difficult for investors to predict our future performance.**

Our quarterly operating results may fluctuate significantly in the future as a result of a variety of factors, many of which are outside our control.

Such factors also may create other risks affecting our long-term success, as discussed in the other risk factors. We believe that quarter-to-quarter comparisons of our historical operating results may not be a good indication of our future performance, nor would our operating results for any particular quarter be indicative of our future operating results.

**Our network may not be able to accommodate our capacity needs.**

We expect the volume of traffic we carry over our network to increase significantly as we expand our operations and service offerings. Our network may not be able to accommodate this additional volume. In order to ensure that we are able to handle additional traffic, we may have to enter into long-term agreements for leased capacity. To the extent that we overestimate our capacity needs, we may be obligated to pay for more transmission capacity than we actually use, resulting in costs without corresponding revenues. Conversely, if we underestimate our capacity needs, we may be required to obtain additional transmission capacity from more expensive sources. If we are unable to maintain sufficient capacity to meet the needs of our users, our reputation could be damaged and we could lose customers and revenues.

Additionally, our success depends on our ability to handle a large number of simultaneous calls. We expect that the volume of simultaneous calls will increase significantly as we expand our operations. If this occurs, additional stress will be placed upon the network hardware and software that manages our traffic. We cannot assure stockholders of our ability to efficiently manage a large number of simultaneous calls. If we are not able to maintain an appropriate level of operating performance, or if our service is disrupted, then we may develop a negative reputation and our business, results of operations, and financial condition could be materially adversely affected.

**We may be unsuccessful selecting the most economical call routing.**

We rely on vendors to terminate calls. Vendor charges for these services vary by call route, and costs between vendors for the same routes vary. Because of the heavy volume of calls handled by our network, automation of the call routing to the “least-cost” vendor for each route is typically required to generate a positive gross margin. We are currently developing such automation, but we may not be successful in its implementation or further maintenance, which would adversely affect our financial performance.

**We face a risk of failure of computer and communications systems used in our business.**

Our business depends on the efficient and uninterrupted operation of our computer and communications systems as well as those that connect to our network. We maintain communications systems (also referred to as network access points) in facilities in Orlando, Atlanta, New York, Dallas, and Los Angeles. Our systems and those that connect to our network are subject to disruption from natural disasters or other sources such as power loss, communications failure, hardware or software malfunction, network failures, and other events both within and beyond our control. Any system interruptions that cause our services to be unavailable, including significant or lengthy telephone network failures or difficulties for users in communicating through our network or portal, could damage our reputation and result in a loss of users.

**Our computer systems and operations may be vulnerable to security breaches.**

Our computer infrastructure is potentially vulnerable to physical or electronic computer viruses, break-ins and similar disruptive problems and security breaches that could cause interruptions, delays or loss of services to our users. We believe that the secure transmission of confidential information, such as credit card numbers, over the Internet is essential in maintaining user confidence in our services. We rely on licensed encryption and authentication technology to effect secure transmission of confidential information, including credit card numbers. It is possible that advances in computer capabilities, new technologies or other developments could result in a compromise or breach of the technology we use to protect user transaction data. A party that is able to circumvent our security systems could misappropriate proprietary information or cause interruptions in our operations. Security breaches also could damage our reputation and expose us to a risk of loss or litigation and possible liability. Although we have experienced no security breaches to date of which we are aware, we cannot guarantee you that our security measures will prevent security breaches.

**Online credit card fraud can harm our business.**

The sale of our products and services over the Internet exposes us to credit card fraud risks. Some of our products and services can be ordered or established (in the case of new accounts) over the Internet using a major credit card for payment. As is prevalent in retail telecommunications and Internet services industries, we are exposed to the risk that some of these credit card accounts are stolen or otherwise fraudulently obtained. In general, we are not able to recover fraudulent credit card charges from such accounts. In addition to the loss of revenue from such fraudulent credit card use, we also remain liable to third parties whose products or services are engaged by us (such as termination fees due telecommunications providers) in connection with the services which we provide. In addition, depending upon the level of credit card fraud we experience, we may become ineligible to accept the credit cards of certain issuers. We are

currently authorized to accept American Express, Visa, MasterCard, and Discover. The loss of eligibility for acceptance of credit cards could significantly and adversely affect our business. We will attempt to manage fraud risks through our internal controls and our monitoring and blocking systems. If those efforts are not successful, fraud could cause our revenue to decline significantly and our business, financial condition and results of operations to be materially and adversely affected.

**We depend on highly qualified technical and managerial personnel.**

Our future success also depends on our continuing ability to attract, retain and motivate highly qualified technical expertise and managerial personnel necessary to operate our businesses. We may need to give retention bonuses and stock incentives to certain employees to keep them, which can be costly to us. The loss of the services of members of our management team or other key personnel could harm our business. Our future success depends to a significant extent on the continued service of key management, client service, product development, sales and technical personnel. We do not maintain key person life insurance on any of our executive officers and do not intend to purchase any in the future. Although we generally enter into non-competition agreements with our key employees, our business could be harmed if one or more of our officers or key employees decided to join a competitor or otherwise compete with us.



We may be unable to attract, assimilate or retain highly qualified technical and managerial personnel in the future. Wages for managerial and technical employees are increasing and are expected to continue to increase in the future. We may have difficulty in hiring and retaining highly skilled employees with appropriate qualifications. If we were unable to attract and retain the technical and managerial personnel necessary to support and grow our businesses, our businesses would likely be materially and adversely affected.

**International operations may expose us to additional and unpredictable risks.**

We may enter international markets such as Eastern Europe, the Middle East, Latin America, Africa and Asia and may expand our existing operations outside the United States. International operations are subject to inherent risks, including:

- Potentially weaker protection of intellectual property rights;
  - Political and economic instability;
  - Unexpected changes in regulations and tariffs;
    - Fluctuations in exchange rates;
    - Varying tax consequences; and
- Uncertain market acceptance and difficulties in marketing efforts due to language and cultural differences.

**Our entry into new lines of business, as well as potential future acquisitions, joint ventures or strategic transactions, entail numerous risks and uncertainties that could have an adverse effect on our business.**

We may enter into new or different lines of business, as determined by management and our board of directors. Our acquisitions, as well as any future acquisitions or joint ventures, could result, and in some instances have resulted, in numerous risks and uncertainties including:

- Potentially dilutive issuances of equity securities, which may be issued at the time of the transaction or in the future if certain performance or other criteria are met or not met, as the case may be. These securities may be freely tradable in the public market or subject to registration rights which could require us to publicly register a large amount of our common stock, which could have a material adverse effect on our stock price;
  - Diversion of management's attention and resources from our existing businesses;
- Significant write-offs if we determine that the business acquisition does not fit or perform up to expectations;
- The incurrence of debt and contingent liabilities or impairment charges related to goodwill and other long-lived assets;
- Difficulties in the assimilation of operations, personnel, technologies, products and information systems of the acquired companies;
  - Regulatory and tax risks relating to the new or acquired business;
- The risks of entering geographic and business markets in which we have limited (or no) prior experience;
  - The risk that the acquired business will not perform as expected; and
    - Material decreases in short-term or long-term liquidity.

**RISKS RELATED TO OUR INDUSTRY**

**Our future success depends on the growth in the use of Internet Protocol as a means of communications.**

If the market for IP communications in general, and our services in particular, does not grow or does not grow at the rate we anticipate, we will not be able to increase our number of customers or generate the revenues we anticipate. To be successful, IP communication requires validation as an effective, quality means of communication and as a viable alternative to traditional telephone service. Demand and market acceptance for recently introduced services are subject

to a high level of uncertainty. The Internet may not prove to be a viable alternative to traditional telephone service for reasons including:

- Inconsistent quality or speed of service;
  - Traffic congestion;
- Potentially inadequate development of the necessary infrastructure;
  - Lack of acceptable security technologies;
- Lack of timely development and commercialization of performance improvements; and
  - Unavailability of cost-effective, high-speed access.

If Internet usage grows, the Internet infrastructure may not be able to support the demands placed on it by such growth, or its performance or reliability may decline. In addition, Web sites may from time to time experience interruptions in their service as a result of outages and other delays occurring throughout the Internet network infrastructure. If these outages or delays frequently occur in the future, Internet usage, as well as usage of our communications portal and our services, could be adversely affected.

**Intense competition could reduce our market share and harm our financial performance.**

Competition in the market for IP communications services is becoming increasingly intense, and such competition is expected to increase significantly in the future. The market for Internet and IP communications is new and rapidly evolving. We expect that competition from companies both in the Internet and telecommunications industries will increase in the future. Our competitors include both start-up IP telephony service providers and established traditional communications providers. Many of our existing competitors and potential competitors have broader portfolios of services; greater financial, management and operational resources; greater brand-name recognition; larger subscriber bases; and more experience than we have. In addition, many of our IP telephony competitors use the public Internet instead of a private network to transmit traffic. Operating and capital costs of these providers may be less than ours, potentially giving them a competitive advantage over us in terms of pricing. We also compete against discount telecommunications services including prepaid calling cards, call-back services, dial-around or 10-10 calling and collect calling services. In addition, some Internet service providers have begun to aggressively enhance their real time interactive communications, focusing on instant messaging, PC-to-PC and PC-to-phone, and/or broadband phone services.

In addition, traditional carriers, cable companies and satellite television providers are bundling services and products not offered by us with Internet telephony services. While this provides us with the opportunity to offer these companies our products and services as a way for them to offer Internet telephony services, it also introduces the risk that they will introduce these services on their own utilizing other options while at the same time making it more difficult for us to compete against them with direct-to-consumer offerings of our own. If we are unable to provide competitive service offerings, we may lose existing users and be unable to attract additional users. In addition, many of our competitors, especially traditional carriers, enjoy economies of scale that result in a lower cost structure for transmission and related costs, which cause significant pricing pressures within the industry. In order to remain competitive we intend to increase our efforts to promote our services, and we cannot be sure that we will be successful in doing this.

In addition to these competitive factors, recent and pending deregulation in some of our markets may encourage new entrants. We cannot assure you that additional competitors will not enter markets that we plan to serve or that we will be able to compete effectively.

**Decreasing telecommunications rates may diminish our revenues and profitability.**

International and domestic telecommunications rates have decreased significantly over the last few years in most of the markets in which we operate, and we anticipate that rates will continue to be reduced in all of the markets in which we do business or expect to do business. Users who select our services to take advantage of the current pricing differential between traditional telecommunications rates and our rates may switch to traditional telecommunications carriers as such pricing differentials diminish or disappear, and we will be unable to use such pricing differentials to attract new customers in the future. In addition, our ability to market our carrier transmission services to telecommunications carriers depends upon the existence of spreads between the rates offered by us and the rates offered by traditional telecommunications carriers, as well as a spread between the retail and wholesale rates charged by the carriers from which we obtain wholesale service. Continued rate decreases will require us to lower our rates to remain competitive, could reduce our revenues, and reduce or possibly eliminate our gross profit from our carrier transmission services. If telecommunications rates continue to decline, we may lose users for our services.

**We may not be able to keep pace with rapid technological changes in the communications industry.**

Our industry is subject to rapid technological change. We cannot predict the effect of technological changes on our business. In addition, widely accepted standards have not yet developed for the technologies we use. We expect that new services and technologies will emerge in the market in which we compete. These new services and technologies may be superior to the services and technologies that we use, or these new services may render our services and technologies obsolete. To be successful, we must adapt to our rapidly changing market by continually improving and expanding the scope of services we offer and by developing new services and technologies to meet customer needs. Our success will depend, in part, on our ability to license leading technologies and respond to technological advances and emerging industry standards on a cost-effective and timely basis. We may need to spend significant amounts of capital to enhance and expand our services to keep pace with changing technologies.

**Third parties might infringe upon our proprietary technology, and we could be deemed to have infringed upon others' proprietary technology.**

We cannot assure you that the steps we have taken to protect our intellectual property rights will prevent misappropriation of our proprietary technology. To protect our rights to our intellectual property, we rely on a combination of trademark and trade secret protection, confidentiality agreements and other contractual arrangements with our employees, affiliates, strategic partners and others. We may be unable to detect the unauthorized use of, or take appropriate steps to enforce, our intellectual property rights. Effective copyright and trade secret protection may not be available in every country in which we offer or intend to offer our services. Failure to adequately protect our intellectual property could harm our brand, devalue our proprietary content and affect our ability to compete effectively. Further, defending our intellectual property rights could result in the expenditure of significant financial and managerial resources. In addition, given the growing level of VoIP-related patents and related patent litigation, we could be deemed to have infringed on the patent rights of others, which could also result in the expenditure of significant financial and managerial resources, and which, if we are unsuccessful in defending, could result in significant damage awards.

**If we are not able to obtain necessary licenses of third-party technology at acceptable prices, or at all, some of our products may become obsolete.**

From time to time, we may be required to license technology from third parties to develop new products or product enhancements. Third-party licenses may not be available or continue to be available to us on commercially reasonable terms. The inability to maintain or re-license any third-party licenses required in our current products, or to obtain any new third-party licenses to develop new products and product enhancements, could require us to obtain substitute technology of lower quality or performance standards or at greater cost, and delay or prevent us from making these products or enhancements, any of which could seriously harm the competitiveness of our products. We currently license third party technology for products acquired through the WQN acquisition.

**Government regulation and legal uncertainties relating to IP telephony could harm our business.**

Historically, voice communications services have been provided by regulated telecommunications common carriers. We offer voice communications to the public for international and domestic calls using IP telephony. Based on specific regulatory classifications and recent regulatory decisions, we believe we qualify for certain exemptions from telecommunications common carrier regulation in many of our markets. However, the growth of IP telephony has led to close examination of its regulatory treatment in many jurisdictions, making the legal status of our services uncertain and subject to change as a result of future regulatory action, judicial decisions or legislation in any of the jurisdictions in which we operate. Established regulated telecommunications carriers have sought and may continue to seek regulatory actions to restrict the ability of companies such as ours to provide services or to increase the cost of providing such services. In addition, our services may be subject to regulation if regulators distinguish phone-to-phone telephony service using IP technologies over privately-managed networks such as our services from integrated PC-to-PC and PC-originated voice services over the Internet. Some regulators may decide to treat the former as regulated common carrier services and the latter as unregulated enhanced or information services. Application of new regulatory restrictions or requirements to us could increase our costs of doing business and prevent us from delivering our services through our current arrangements. In such event, we would consider a variety of alternative arrangements for providing our services, including obtaining appropriate regulatory authorizations for our local network partners or ourselves, changing our service arrangements for a particular country or limiting our service offerings. Such regulations could limit our service offerings, raise our costs and restrict our pricing flexibility, and potentially limit our ability to compete effectively. Further, regulations and laws which affect the growth of the Internet could hinder our ability to provide our services over the Internet.

Recent regulatory enactments by the FCC will require us to provide enhanced Emergency 911 dialing capabilities to our subscribers as part of our standard VoIP services and to comply with certain notification requirements with respect to such capabilities. These requirements will result in increased costs and risks associated with the delivery of our VoIP services. Even assuming our full compliance with Emergency 911 requirements, such compliance and our efforts to achieve such compliance will increase our cost of doing business in the VoIP arena and may adversely affect our ability to deliver our VoIP telephony services to new and existing customers in all geographic regions.

**Our products must comply with industry standards, FCC regulations, state, country-specific and international regulations, and changes may require us to modify existing products.**

In addition to reliability and quality standards, the market acceptance of telephony over broadband IP networks is dependent upon the adoption of industry standards so that products from multiple manufacturers are able to communicate with each other. There is currently a lack of agreement among industry leaders about which standard should be used for a particular application, and about the definition of the standards themselves. These standards, as well as audio and video compression standards, continue to evolve. We also must comply with certain rules and regulations of the Federal Communications Commission (FCC) regarding electromagnetic radiation and safety standards established by Underwriters Laboratories, as well as similar regulations and standards applicable in other

countries. Standards are continuously being modified and replaced. As standards evolve, we may be required to modify our existing products or develop and support new versions of our products. The failure of our products to comply, or delays in compliance, with various existing and evolving industry standards could delay or interrupt volume production of our IP telephony products, which would have a material adverse effect on our business, financial condition and operating results.

**Terrorist attacks, hostilities or other sustained military campaigns may adversely impact the industry and us.**

The terrorist attacks that took place in the United States on September 11, 2001, were unprecedented events that have created many economic and political uncertainties, some of which may materially adversely impact us. The long-term impact that terrorist attacks and the threat of terrorist attacks may have on the telecommunications industry is not known at this time. Uncertainty surrounding future hostilities both in the United States and abroad may adversely impact us in unpredictable ways.

## **RISKS RELATED TO OUR STOCK**

**Because many of our current financing agreements contain “favored nations” clauses, future securities issuances at prices below contractual thresholds may trigger price ratchets that could decrease the exercise price or conversion rate of our existing convertible debt and warrants, significantly diluting existing shareholders.**

Many of our existing convertible debt and warrant agreements contain “favored nations” clauses, whereby their related conversion or exercise prices automatically ratchet downward to match potentially more favorable terms issued to new security holders. This has the effect of increasing the number of our common shares issuable upon the assumed conversion or exercise of our existing convertible debt and warrants. Existing conversion or exercise prices related to financing agreements with favored nations clauses have been ratcheted to as low as \$0.18 per share. If future issuances of securities are made at conversion or exercise prices with terms more favorable than this, existing shareholders could be significantly diluted.

### **Our stock price has been and may continue to be volatile.**

The market for technology stocks in general and our common stock in particular, has been and will likely continue to be extremely volatile. The following factors could cause the market price of our common stock to fluctuate significantly:

- The addition or loss of any major customer;
- Changes in the financial condition or anticipated capital expenditure purchases of any existing or potential major customer;
  - Quarterly variations in our operating results;
  - Changes in financial estimates by securities analysts;
  - Speculation in the press or investment community;
- Announcements by us or our competitors of significant contracts, new products or acquisitions, distribution partnerships, joint ventures, or capital commitments;
  - Sales of common stock or other securities by us or by our shareholders in the future;
  - Securities and other litigation;
  - Announcement of a stock split, reverse stock split, stock dividend, or similar event;
- Economic conditions for the telecommunications, networking, and related industries; and
  - Economic instability.

### **We do not expect to pay dividends.**

We do not anticipate paying any cash dividends on our common stock in the foreseeable future. We intend to retain profits, if any, to fund growth and expansion.

### **We do not have sufficient authorized or registered shares, and future common stock dilution is likely.**

Our authorized shares of stock consist of 400,000,000 shares of common stock. As of March 28, 2007, 98,609,701 common shares were issued and outstanding, and approximately 242.1 million additional shares are currently issuable upon the conversion of all convertible debt, and the exercise of all options and warrants. We are also required to reserve an additional 76.6 million common shares under our various financing agreements and stock option plans. We will need to seek future shareholder approval of additional common shares to meet these obligations. If such approval is not obtained, we will be unable to satisfy all of the contractual obligations we have undertaken to issue and reserve future shares of common stock. Also, if significant numbers of additional common shares are issued as allowed for above or in conjunction with new financing, our current shareholders would experience significant dilution of their ownership, and our stock price per share could decline substantially. The following table specifies, for each listed

obligation, the common shares issuable upon the conversion of all convertible debt and the exercise of all options and warrants, additional reservation requirements, and planned common share issuances upon approval of our proposed increase in our authorized common shares.



	<b>Additional Common Stock Outstanding Upon Conversion/Exercise <sup>1</sup> Convertible</b>			<b>Additional Reservation Requirements <sup>2</sup> Convertible</b>			<b>Current Obligations To Issue</b>	<b>Minimum Total Additional Authorized Shares Required</b>
	<b>Notes</b>	<b>Warrants</b>	<b>Options</b>	<b>Subtotal</b>	<b>Notes</b>	<b>Options</b>	<b>Subtotal</b>	<b>Shares <sup>3</sup></b>
May 2005 private placement	-	2,486,970	-	2,486,970	-	-	-	1,535,219
July and October 2005 convertible notes and warrants	2,714,130	3,713,542	-	6,427,672	12,730,778	-	-	4,022,189