ORIGINAL


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June 16, 2000


John L. Clark

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415/765-8443


**VIA FEDERAL EXPRESS**

DEPOSIT D311 DATE JUN 21 2000

Florida Public Service Commission
Division of Administration
Gunter Building
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

000735-TI

**Re: Application Form for Pac-West Telecomm, Inc.**

Dear Sir or Madam:

Enclosed please find:

1. An original and seven (7) copies of the above-referenced document; and

2. A check in the amount of $250.00 for the filing fee.

Please file-stamp the extra copy and return it in the enclosed self-addressed, stamped envelope. Should you have any questions with respect to this filing, please telephone me at (415) 765-8443.

Thank you.

00 JUN 19 AM 10:3 MAIL ROOM

Very truly yours,

John Clark

Enclosures

RECEIVED & FILED

FPSC-BUREAU OF RECORDS

Check received with filing and forwarded to Fiscal for deposit. Fiscal to forward a copy of check to RAR with proof of deposit.

Initials of person who forwarded check:

DOCUMENT NUMBER-DATE
07398 JUN 19 8
FPSC-RECORDS/REPORTING

ORIGINAL

*FLORIDA PUBLIC SERVICE COMMISSION*

DIVISION OF COMMUNICATIONS

BUREAU OF SERVICE EVALUATION

# APPLICATION FORM
for
# AUTHORITY TO PROVIDE INTEREXCHANGE TELECOMMUNICATIONS SERVICE WITHIN THE STATE OF FLORIDA

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## Instructions

A. This form is used for an original application for a certificate and for approval of sale, assignment or transfer of an existing certificate. In case of a sale, assignment or transfer, the information provided shall be for the purchaser, assignee or transferee (See Appendix A).

B. Respond to each item requested in the application and appendices. If an item is not applicable, please explain why.

C. Use a separate sheet for each answer which will not fit the allotted space.

D. If you have questions about completing the form, contact:

**Florida Public Service Commission**
**Division of Communications**
**Bureau of Service Evaluation**
**2540 Shumard Oak Blvd.**
**Gunter Building**
**Tallahassee, Florida 32399-0850**
**(904) 413-6600**

E. Once completed, submit the original and six (6) copies of this form along with a non-refundable application fee of $250.00 to:

**Florida Public Service Commission**
**Division of Administration**
**2540 Shumard Oak Blvd.**
**Gunter Building**
**Tallahassee, Florida 32399-0850**
**(904) 413-6251**

1. Select what type of business your company will be conducting (check all that apply):

- ( ) **Facilities Based Carrier** - company owns and operates or plans to own and operate telecommunications switches and transmission facilities in Florida.
- ( ) **Operator Service Provider** - company provides or plans to provide alternative operator services for IXCs; or toll operator services to call aggregator locations; or clearinghouse services to bill such calls.
- **(X)** **Reseller** - company has or plans to have one or more switches but primarily leases the transmission facilities of other carriers. Bills its own customer base for services used.
- ( ) **Switchless Rebiller** - company has no switch or transmission facilities but may have a billing computer. Aggregates traffic to obtain bulk discounts from underlying carrier. Rebills end users at a rate above its discount but generally below the rate end users would pay for unaggregated traffic.
- ( ) **Multi-Location Discount Aggregator** - company contracts with unaffiliated entities to obtain bulk/volume discounts under multi-location discount plans from certain underlying carriers. Then offers the resold service by enrolling unaffiliated customers.
- ( ) **Prepaid Debit Card Provider** - any person or entity that purchases 800 access from an underlying carrier or unaffiliated entity for use with prepaid debit card service and/or encodes the cards with personal identification numbers.

2. This is an application for (check one):

- **(X)** **Original Authority** (New company).
- ( ) **Approval of Transfer** (To another certificated company).
- ( ) **Approval of Assignment of Existing Certificate** (To an uncertificated company).
- ( ) **Approval for Transfer of Control** (To another certificated company).

3. Name of corporation, partnership, cooperative, joint venture or sole proprietorship: The name of the applicant is **Pac-West Telecomm, Inc.**, a California corporation.

4. Name under which the applicant will do business (fictitious name, etc.): Applicant will do business under the name **Pac-West Telecomm, Inc.**

5. National address (including street name and number, post office box, city, state and zip code): The Applicant's address is as follows: 4210 Coronado Avenue, Stockton, California 95204. Telephone: (209) 926-3300.

6. Florida address (including street name and number, post office box, city, state and zip code): Applicant does not currently operate an office in Florida.

7. Structure of organization:

| | | | |
|---|---|---|---|
| ( ) | Individual | (X) | Corporation |
| ( ) | Foreign Corporation | ( ) | Foreign Partnership |
| ( ) | General Partnership | ( ) | Limited Partnership |
| ( ) | Other | | |

8. If applicant is an individual or partnership, please give name, title and address of sole proprietor or partners: Applicant is not an individual or partnership. Therefore, this questions does not apply to applicant.

a. Provide proof of compliance with the foreign limited partnership statute (Chapter 620.169 FS), if applicable: Not applicable because Applicant is not an individual or partnership.

b. Indicate if the individual or any of the partners have previously been:

(1) adjudged bankrupt, mentally incompetent, or found guilty of any felony or of any crime, or whether such actions may result from pending proceedings: Not applicable because Applicant is not an individual or partnership.

(2) officer, director, partner or stockholder in any other Florida certificated telephone company. If yes, give name of company and relationship. If no longer associated with company, given reason why not: Not applicable because Applicant is not an individual or partnership.

9. If incorporated, please give:

a. Proof from the Florida Secretary of State that the applicant has authority to operate in Florida.
Corporate charter number: F00000002647.

See **Exhibit A** (Copy of Registration as Foreign Corporation).

b. Name and address of the company's Florida registered agent.

CT Corporation System
1200 South Pine Island Road
Plantation, Florida 33324

c. Provide proof of compliance with the fictitious name statute (Chapter 865.09 FS), if applicable: not applicable

d. Indicate if any of the officers, directors or any of the ten largest stockholders have previously been:

(1) adjudged bankrupt, mentally incompetent, or found guilty of any felony or of any crime, or whether such actions may result from pending proceedings: No.

(2) officer, director, partner or stockholder in any other Florida certificated telephone company. If yes, give name of company and relationship. If no longer associated with company, give reason why not: No.

10. Who will serve as liaison with the Commission in regard to (please give name, title, address and telephone number):

a. The application;

Regina M. DeAngelis or John Clark
Attorney
Goodin, MacBride, Squeri, Ritchie & Day, LLP
505 Sansome Street, Suite 900
San Francisco, California 94111
Tel: (415) 392-7900

b. Official Point of Contact for the ongoing operations of the company;

Robert Townsend
Pac-West Telecomm, Inc.
4210 Coronado Avenue
Stockton, California 95204-2340
Tel: (209) 926-3300
Fax: (209) 926-4585

c. Tariff;

Robert Townsend
Pac-West Telecomm, Inc.
4210 Coronado Avenue
Stockton, California 95204-2340
Tel: (209) 926-3300
Fax: (209) 926-4585

d. Complaints/Inquiries from customers.

Robert Townsend
Pac-West Telecomm, Inc.
4210 Coronado Avenue
Stockton, California 95204-2340
Tel: (209) 926-3300
Fax: (209) 926-4585

11. List the states in which the applicant:

a. Has operated as an interexchange carrier: Yes. Applicant is operating as an interexchange carrier in California and Nevada.

b. Has applications pending to be certificated as an interexchange carrier: Applicant has applications pending to be certificated as an interexchange carrier in Wyoming.

c. Is certificated to operate as an interexchange carrier: Applicant is certificated to operate as an interexchange carrier in Washington, Oregon, Texas, Colorado, Arizona, Montana and Idaho.

d. Has been denied authority to operate as an interexchange carrier and the circumstances involved: Applicant has never been denied authority to operate as an interexchange carrier.

e. Has had regulatory penalties imposed for violations of telecommunications statutes and the circumstances involved: Applicant has never been assessed regulatory penalties for violations of telecommunications statutes.

f. Has been involved in civil court proceedings with an interexchange carrier, local exchange company or other telecommunications entity, and the circumstances involved: Applicant has never been involved in civil court proceedings with an interexchange carrier, local exchange company or other telecommunications entity.

12. What services will the applicant offer to other certificated telephone companies:

( ) Facilities
( ) Billing and Collection
( ) Maintenance
( ) Operators
( ) Sales
( ) Other: ______________________

13. Do you have a marketing program?

Yes.

14. Will your marketing program:

(X) Pay commissions?
( ) Offer sales franchises?
( ) Offer multi-level sales incentives?
( ) Offer other sales incentives?

15. Explain any of the offers checked in question 14 (to whom, what amount, type of franchise, etc.).

Applicant will utilize independent agents to market its services. Each agents will be paid commissions by Applicant based on actual revenue streams for services rendered to subscribers signed up the agent. No sign-up bonuses or commissions will be paid.

16. Who will receive the bills for your service (check all that apply)?

( ) Residential customers
(X) Business customers
( ) PATS providers
( ) PATS station end-users
( ) Hotels and motels
( ) Hotel and motel guests
( ) Universities
( ) University dormitory residents
( ) Other: ______________________________

17. Please provide the following (if applicable):

a. Will the name of your company appear on the bill for your services, and if not who will the billed party contact to ask questions about the bill (provide name and phone number) and how is this information provided?

Yes.

b. Name and address of the firm who will bill for your service.

All billing functions will be performed in-house by Applicant at its Stockton, California offices.

18. Please provide all available documentation demonstrating that the applicant has the following capabilities to provide interexchange telecommunications service in Florida.

a. Financial capability.

Regarding the showing of financial capability, the following applies:

The application should contain the applicant's financial statements for the most recent 3 years, including:

(1) the balance sheet;

(2) income statement;

(3) statement of retained earnings.

Attached hereto as **Exhibit B**, please find a copy of its financials.

Further, a written explanation, which can include supporting documentation, regarding the following should be provided to show financial capability

(4) Please provide documentation that the applicant has sufficient financial capability to provide the requested service in the geographic area proposed to be served.

See **Exhibit B**.

(5) Please provide documentation that the applicant has sufficient financial capability to maintain the requested service.

See **Exhibit B**.

(6) Please provide documentation that the applicant has sufficient financial capability to meet its lease or ownership obligations.

See **Exhibit B**.

NOTE: This documentation may include, but is not limited to, financial statements, a projected profit and loss statement, credit references, credit bureau reports, and descriptions of business relationships with financial institutions.

If available, the financial statements should be audited financial statements.

If the applicant does not have audited financial statements, it shall be so stated. The unaudited financial statements should then be signed by the applicant's chief executive officer and chief financial officer. The signatures should affirm that the financial statements are true and correct.

Applicant provides an audited financial statement at **Exhibit B.**

b. Managerial capability.

**Biographies of Key Members of Pac-West's Management Team**

Pac-West's proposed operations will be directed by its current senior management, Mr. John La Rue, Mr. John Sumpter, and Mr. Jason Mills.

Mr. La Rue, Senior Vice-President, Director, and Founder of Pac-West, gained his technical expertise through assignments with the Navy and Atomic Energy Commission. For the past 31 years, Mr. La Rue has been involved in the telecommunications industry. Under his guidance, Pac-West has grown into a large and well-managed telecommunications company.

Mr. Jason Mills, Vice-President Network Operations, has worked for Pac-West for approximately 15 years. During this time, he has been responsible for network operations, including all functions regarding the ordering and provisions of digital network services. His scope of responsibility includes the maintenance and monitoring of over several thousands of circuits and the switching equipment.

Mr. John Sumpter, Vice-President of Regulatory, joined Pac-West in July 1999. He has over 28 years of experience in the telecommunications industry. Prior to joining Pac-West, he was employed with AT&T from 1984-1999 where he held several executive level regulatory positions, including Division Manager of Law and Government Affairs. Mr. Sumpter is responsible for Pac-West's relations with government regulatory agencies, regulatory compliance, and intercarrier relations.

Applicant believes that the foregoing demonstrates that Applicant's operations are well-planned and that Applicant is fully capable of establishing successful operations in Florida and bringing new and efficiently priced telecommunications options to the marketplace. Accordingly, Applicant submits that it has shown its managerial ability to successfully carry out the proposed service.

c. Technical capability.

Based on the response to (b) above, Applicant submits that it has the technical capacity to provide the proposed service.

19. Please submit the proposed tariff under which the company plans to begin operation. Use the format required by Commission Rule 25-24.485 (example enclosed): A copy of the Applicant's proposed tariff is included herein as **Exhibit C**.

20. The applicant will provide the following interexchange carrier services (check all that apply):

____ **MTS with distance sensitive per minute rates**
____ Method of access is FGA
____ Method of access is FGB
____ Method of access is FGD
____ Method of access is 800

____ **MTS with route specific rates per minute**
____ Method of access is FGA
____ Method of access is FGB
____ Method of access is FGD
____ Method of access is 800

__X_ **MTS with statewide flat rates per minute (i.e., not distance sensitive)**
____ Method of access is FGA
____ Method of access is FGB
__X_ Method of access is FGD
____ Method of access is 800

____ **MTS for pay telephone service providers**

____ **Block-of-time calling plan (Reach out Florida, Ring America, etc.)**

__X_ **800 Service (Toll free)** (Will not be offered initially, but may be offered in future.)

__X_ **WATS type service (Bulk or volume discount)** (Will not be offered initially, but may be offered in future.)
__X_ Method of access is via dedicated facilities (Will not be offered initially, but may be offered in future.)
__X_ Method of access is via switched facilities (Will not be offered initially, but may be offered in future.)

____ **Private Line services (Channel Services)**
(For ex. 1.544 mbps., DS-3, etc.)

____ **Travel Service**
____ Method of access is 950
_X__ Method of access is 800

____ **900 Service**

____ **Operator Services**
____ Available to presubscribed customers
____ Available to non-presubscribed customers (for example, to patrons of hotels, students in universities, patients in hospitals.)
____ Available to inmates

**Services included are:**

____ Station assistance
____ Person-to-person assistance
____ Directory assistance
____ Operator verify and interrupt
____ Conference calling

21. What does the end user dial for each of the interexchange carrier services that were checked in services included (above).

To place an MTS call, customers direct dial with 1+ access. For the travel services, a customer must first access the Applicant's network by dialing a toll-free number and then the customer dials the termination telephone number.

22. ____ Other: None.

## APPLICANT ACKNOWLEDGEMENT STATEMENT

1. **REGULATORY ASSESSMENT FEE:**
   I understand that all telephone companies must pay a regulatory assessment fee in the amount of .15 of one percent of its gross operating revenue derived from intrastate business. Regardless of the gross operating revenue of a company, a minimum annual assessment fee of $50 is required.

2. **GROSS RECEIPTS TAX:**
   I understand that all telephone companies must pay a gross receipts tax of two and one-half percent on all intra and interstate business.

3. **SALES TAX:**
   I understand that a seven percent sales tax must be paid on intra and interstate revenues.

4. **APPLICATION FEE:**
   A non-refundable application fee of $250.00 must be submitted with the application.

5. **RECEIPT AND UNDERSTANDING OF RULES:**
   I acknowledge receipt and understanding of the Florida Public Service Commission's Rules and Orders relating to my provision of interexchange telephone service in Florida. I also understand that it is my responsibility to comply with all current and future Commission requirements regarding interexchange service.

6. **ACCURACY OF APPLICATION:**
   By my signature below, I the undersigned owner or officer of the named utility in the application, attest to the accuracy of the information contained in this application and associated attachments. I have read the foregoing and declare that to the best of my knowledge and belief, the information is a true and correct statement.

   **Further, I am aware that pursuant to Chapter 837.06, Florida Statutes, "Whoever knowingly makes a false statement in writing with the intent to mislead a public servant in the performance of his official duty shall be guilty of a misdemeanor of the second degree, punishable as provided in s.775.082 and s.775.083".**

**UTILITY OFFICIAL:**

[signature]
Signature

6/1/2000
Date

John Sumpter

Vice President - Regulatory
Title

209 926 3136
Telephone No.

**** APPENDIX A ****

CERTIFICATE TRANSFER STATEMENT

I, **(TYPE NAME)** N/A ____________________,

**(TITLE)** ______ N/A __________, of **(NAME OF COMPANY)**

____________ N/A ______________, and current

holder of certificate number ___N/A_________, have reviewed

this application and join in the petitioner's request for a

transfer of the above-mention certificate.

UTILITY OFFICIAL:

| | | |
|---|---|---|
| ____________ | ____________ | |
| Signature | Date | |
| ____________ | ____________ | |
| ____________ | ____________ | |
| Title | Telephone No. | |

## ** APPENDIX B **

A statement of how the Commission can be assured of the security of the customer's deposits and advance payments may be responded to in one of the following ways (applicant please check one):

(X) **The applicant will not collect deposits nor will it collect payments for service more than one month in advance.**

( ) **The applicant will file with the Commission and maintain a surety bond in an amount equal to the current balance of deposits and advance payments in excess of one month. (Bond must accompany application.)**

UTILITY OFFICIAL:

[signature] 6/1/00
Signature Date

John Sumpter

VP Regulatory 209 9263136
Title Telephone No.

## ** APPENDIX C **

**NOTE: Applicant initially intends to operate as a switchless reseller within the State of Florida, but may install its own switching facilities at a later time if traffic volumes warrant. Accordingly, Applicant currently will not have any interstate or intrastate network facilities used to complete calls to Florida subscribers.**

### INTERSTATE NETWORK

23. **POP:** Addresses where located, and indicate if owned or leased.

    N.A.

24. **SWITCHES:** Address where located, by type of switch, and indicate if owned or leased.

    N.A.

25. **TRANSMISSION FACILITIES:** Pop-to-Pop facilities by type of facilities (microwave, fiber, copper, satellite, etc.) and indicate if owned or leased.

    N.A.

26. **ORIGINATING SERVICE:** Please provide the list of exchanges where you are proposing to provide originating service within thirty (30) days after the effective date of the certificate (Appendix D).

27. **TRAFFIC RESTRICTIONS:** Please explain how the applicant will comply with the EAEA requirements contained in Commission Rule 25-24.471 (4) (a) (copy enclosed).

    N.A.

28. **CURRENT FLORIDA INTRASTATE SERVICES:** Applicant has ( ) or has not (X) previously provided intrastate telecommunications in Florida. If the answer is has, fully describe the following:

    a) What services have been provided and when did these services begin?

b) If the services are not currently offered, when were they discontinued?

UTILITY OFFICIAL: [signature] 6/1/00

Signature Date

John Sumpter

VP-Regulatory 209-926-3136

Title Telephone No.

## ** APPENDIX D **

**Note: Applicant intends to offer its resold services on a statewide basis.**

FLORIDA TELEPHONE EXCHANGES

AND

EAS ROUTES

Describe the service area in which you hold yourself out to provide service by telephone company exchange. If all services listed in your tariff are not offered at all locations, so indicate.

In an effort to assist you, attached is a list of major exchanges in Florida showing the small exchanges with which each has extended area service (EAS)

## ** FLORIDA EAS FOR MAJOR EXCHANGES **

| Extended Service Area with | These Exchanges |
|---|---|
| PENSACOLA | Cantonment, Gulf Breeze Pace, Milton Holley-Navarre. |
| PANAMA CITY | Lynn Haven, Panama City Beach, Youngstown-Fountain and Tyndall AFB. |
| TALLAHASSEE: | Crawfordville, Havana, Monticello, Panacea, Sopchoppy and St. Marks. |
| JACKSONVILLE: | Baldwin, Ft. George, Jacksonville Beach, Callahan, Maxville, Middleburg Orange Park, Ponte Vedra and Julington. |
| GAINESVILLE: | Alachua, Archer, Brooker, Hawthorne, High Springs, Melrose, Micanopy, Newberry and Waldo. |
| OCALO: | Belleview, Citra, Dunnellon, Forest Lady Lake (B21), McIntosh, Oklawaha, Orange Springs, Salt Springs and Silver Springs Shores. |
| DAYTONA BEACH: | New Smyrna Beach |

| | | |
|---|---|---|
| TAMPA: | Central<br>East<br>North<br>South<br>West | None<br>Plant City<br>Zephyrhills<br>Palmetto<br>Clearwater |

| | |
|---|---|
| CLEARWATER: | St. Petersburg, Tampa-West and Tarpon Springs. |
| ST. PETERSBURG: | Clearwater. |
| LAKELAND: | Bartow, Mulberry, Plat City, Polk City and Winter Haven. |
| ORLANDO: | Apopka, East Orange, Lake Buena Vista, Orlando, Oviedo, Sanford, Windermere, Winter Garden, Oviedo-Winter Springs Reedy Creek, Geneva and Montverde. |
| TITUSVILLE: | Cocoa and Cocoa Beach. |
| COCOA: | Cocoa Beach, Eau Gallie, Melbourne and Titusville. |
| MELBOURNE: | Cocoa, Cocoa Beach, Eau Gallie and Sebastian. |
| SARASOTA: | Bradenton, Myakka and Venice. |
| FT. MYERS: | Cape Coral, Ft. Myers Beach, North Cape Coral, North Ft. Myers, Pine Island, Lehigh Acres and Sanibel-Captiva Islands. |
| NAPLES: | Marco Island and North Naples. |
| WEST PALM BEACH: | Boynton Beach and Jupiter. |
| POMPANO BEACH: | Boca Raton, Coral Springs, Deerfield Beach and Ft. Lauderdale. |
| FT. LAUDERDALE: | Coral Springs, Deerfield Beach, Hollywood and Pompano Beach. |
| HOLLYWOOD: | Ft. Lauderdale and North Dade. |
| NORTH DADE: | Hollywood, Miami and Perrine. |
| MIAMI: | Homestead, North Dade and Perrine |

## ** APPENDIX E **

## ** GLOSSARY **

**ACCESS CODE:** The term denotes a uniform four or seven digit code assigned to an individual IXC. The five digit code had the form 10XXX and the seven digit code has the form 950-XXXX.

**BYPASS:** Transmission facilities that go direct from the local exchange end user to an IXC point of presence, thus bypassing the local exchange company.

**CARRIERS CARRIER:** An IXC that provides telecommunications service, mainly bulk transmission service, to other IXC only.

**CENTRAL OFFICE:** A local operating unit by means of which connections are established between subscribers' lines and trunk of toll lines to other central offices within the same exchange or other exchanges. Each three (3) digit central office code (NXX) used shall be considered a separate central office unit.

**CENTRAL OFFICE CODE:** The term denotes the first three digits (NXX) of the seven (7) digit telephone number assigned to a customer's telephone exchange service.

**COMMISSION:** The Florida Public Service Commission.

**COMPANY, TELEPHONE COMPANY, UTILITY:** These terms may be used interchangeably herein and shall mean any person, firm, partnership or corporation engaged in the business of furnishing communication service to the public under the jurisdiction of the Commission.

**DEDICATED FACILITY:** The term denotes a transmission circuit which is permanently for the exclusive use of a customer or a pair of customers.

**END USER:** The term denotes any individual, partnership, association, corporation, governmental agency or any other entity which (A) obtains a common line, uses a pay telephone or obtains interstate service arrangements in the operating territory of the company or (B) subscribes to interstate services provided by an IXC or uses the services of the IXC when the IXC provides interstate service for its own use.

**EQUAL ACCESS EXCHANGE AREAS:** EAEA means a geographic area, configured based on 1987 planned toll center/access tandem areas, in which local exchange companies are responsible for providing equal access to both carriers and customers of carriers in the most economically efficient manner.

**EXCHANGE:** The entire telephone plant and facilities used in providing telephone service to subscribers located in an exchange area. An exchange may include more than one central office unit.

**EXCHANGE (SERVICE) AREA:** The territory, including the base rate suburban and rural areas served by an exchange, within which local telephone service is furnished at the exchange rates applicable within that area.

**EXTENDED SERVICE AREA:** A type of telephone service furnished under tariff provision whereby subscribers of a given exchange or area may complete calls to, and receive messages from, one or more other contiguous exchanges without toll charges, or complete calls to one or more exchanges without toll message charges.

**FACILITIES BASED:** An IXC that has its own transmission and/or switching equipment or other elements of equipment and does not rely on others to provide this service.

**FEATURE GROUPS:** General categories of unbundled tariffs to stipulate related services.

**Feature Group A:** Line side connections presently serving specialized common carriers.

**Feature Group B:** Trunk side connections without equal digit or code dialing.

**Feature Group C:** Trunk side connections presently serving AT&T-C.

**Feature Group D:** Equal trunk access with subscription.

**INTEREXCHANGE COMPANY:** means any telephone company, as defined in Section 364.02(4), F.S. (excluding Payphone Providers), which provides telecommunication service between exchange areas as those areas are described in the approved tariffs of individual local exchange companies.

**INTER-OFFICE CALL:** A telephone call originating in one central office unit or entity but terminating in another central office unit or entity both of which are in the same designated exchange area.

**INTRA-OFFICE CALL:** A telephone call originating and terminating within the same central office unit or entity.

**INTRASTATE COMMUNICATIONS:** The term denotes any communications in Florida subject to oversight by the Florida Public Service Commission as provided by the laws of the State.

**LOCAL ACCESS AND TRANSPORT AREA:** LATA means the geographic area established for the administration of communications service. It encompasses designated exchanges, which are grouped to serve common social, economic and other purposes.

**LOCAL EXCHANGE COMPANY (LEC):** Means any telephone company, as defined in Section 364.02(4), F.S., which, in addition to any other telephonic communication service, provides telecommunication service within exchange areas as those areas are described in the approved tariffs of the telephone company.

**OPTIONAL CALLING PLAN:** An optional service furnished under tariff provisions which recognizes a need of some subscribers for extended area calling without imposing the cost on the entire body of subscribers.

**900 SERVICE:** A service similar to 800 service, except this service is charged back to the customer based on first minute plus additional minute usage.

**PIN NUMBER:** A group of numbers used by a company to identify their customers.

**PAY TELEPHONE SERVICE COMPANY:** Means any telephone company, other than a Local Exchange Company, which provides pay telephone service as defined in Section 364.335(4), F.S.

**POINT OF PRESENCE (POP):** Bell-coined term which designates the actual (physical) location of an IXC's facility. Replaces some applications of the term "demarcation point."

**PRIMARY SERVICE:** Individual line service or party line service.

**RESELLER:** An IXC that does not have certain facilities but purchases telecommunications service from an IXC and then resells that service to others.

**STATION:** A telephone instrument consisting of a transmitter, receiver, and associated apparatus so connected as to permit sending and/or receiving telephone messages.

**SUBSCRIBER, CUSTOMER:** These terms may be used interchangeably herein and shall mean any person, firm, partnership, corporation, municipality, cooperative organization, or governmental agency supplied with communication service by a telephone company.

**SUBSCRIBER LINE:** The circuit or channel used to connect the subscriber station with the central office equipment.

**SWITCHING CENTER:** Location at which telephone traffic, either local or toll, is switched or connected from one circuit or line to another. A local switching center may be comprised of several central office units.

**TRUNK:** A communication channel between central office units or entities, or private branch exchanges.

ATTACHMENTS:

A - CERTIFICATE TRANSFER STATEMENT
B - CUSTOMER DEPOSITS AND ADVANCE PAYMENTS
C - INTRASTATE NETWORK
D - FLORIDA TELEPHONE EXCHANGES AND EAS ROUTES
E - GLOSSARY

0615/018/X11562-1

A

FLORIDA DEPARTMENT OF STATE
Katherine Harris
Secretary of State

May 11, 2000

C T CORPORATION SYSTEM

TALLAHASSEE, FL

Qualification documents for PAC-WEST TELECOMM, INC. were filed on May 11, 2000 and assigned document number F00000002647. Please refer to this number whenever corresponding with this office.

Your corporation is now qualified and authorized to transact business in Florida as of the file date.

The certification you requested is enclosed.

A corporation annual report/uniform business report will be due this office between January 1 and May 1 of the year following the calendar year of the file date. A Federal Employer Identification (FEI) number will be required before this report can be filed. If you do not already have an FEI number, please apply NOW with the Internal Revenue by calling 1-800-829-3676 and requesting form SS-4.

Please be aware if the corporate address changes, it is the responsibility of the corporation to notify this office.

Should you have any questions regarding this matter, please telephone (850) 487-6051, the Foreign Qualification/Tax Lien Section.

Buck Kohr
Corporate Specialist
Division of Corporations

Letter Number: 900A00026535

# State of Florida

**Department of State**

I certify the attached is a true and correct copy of the application by PAC-WEST TELECOMM, INC., a California corporation, authorized to transact business within the State of Florida on May 11, 2000 as shown by the records of this office.

The document number of this corporation is F00000002647.

Given under my hand and the
Great Seal of the State of Florida
at Tallahassee, the Capitol, this the
Eleventh day of May, 2000

GREAT SEAL OF THE STATE OF FLORIDA
IN GOD WE TRUST

Katherine Harris

Katherine Harris
Secretary of State

CR2EO22 (1-99)

# APPLICATION BY FOREIGN CORPORATION FOR AUTHORIZATION TO TRANSACT BUSINESS IN FLORIDA

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*IN COMPLIANCE WITH SECTION 607.1503, FLORIDA STATUTES, THE FOLLOWING IS SUBMITTED TO REGISTER A FOREIGN CORPORATION TO TRANSACT BUSINESS IN THE STATE OF FLORIDA:*

1. PAC-WEST TELECOMM, INC.
(Name of corporation: must include the word "INCORPORATED", "COMPANY", "CORPORATION", or words or abbreviations of like import in language as will clearly indicate that it is a corporation instead of a natural person or partnership if not so contained in the name at present.)

2. California
(State or country under the law of which it is incorporated)

3. 68-0383568
(FEI number, if applicable)

4. May 15, 1996
(Date of incorporation)

5. Perpetual
(Duration: Year corp. will cease to exist or "perpetual")

6. Upon Qualification
(Date first transacted business in Florida. (See sections 607.1501, 607.1502, and 817.155, F.S.))

7. 4210 Coronado Avenue, Stockton, California 95204-2340
(Current mailing address)

8. telecommunications services
(Purpose(s) of corporation authorized in home state or country to be carried out in the state of Florida)

9. Name and street address of Florida registered agent:

Name: C T Corporation System

Office Address: c/o C T Corporation System, 1200 South Pine Island Road

Plantation, Florida, 33324
(Zip Code)

10. Registered agent acceptance:
*Having been named as registered agent and to accept service of process for the above stated corporation at the place designated in this application, I hereby accept the appointment as registered agent and agree to act in this capacity. I further agree to comply with the provisions of all statutes relative to the proper and complete performance of my duties, and I am familiar with and accept the obligation of my position as registered agent.*

C T Corporation System

(Registered agent's signature) (Officer)

(Type Name and Title of Officer)

11. Attached is a certificate of existence duly authenticated, not more than 90 days prior to delivery of this application to the Department of State, by the Secretary of State or other official having custody of corporate records in the jurisdiction under the law of which it is incorporated.

12. Names and addresses of officers and/or directors:

A. DIRECTORS

Chairman: See attached list of directors

Address: ______

Vice Chairman: See attached list of directors

Address: ______

Director: See attached list of directors

Address: ______

Director: ______

Address: ______

B. OFFICERS

President: See attached list of officers

Address: ______

Vice President: ______

Address: ______

Secretary: ______

Address: ______

Treasurer: ______________________

Address: ______________________

______________________

NOTE: If necessary, you may attach an addendum to the application listing additional officers and/or directors.

13. ______________________
(Signature of Chairman, Vice Chairman, or any officer listed in number 12 of the application)

14. John Sumpter - Vice President
(Typed or printed name and capacity of person signing application)

**NAMES, TITLES & BUSINESS ADDRESSES OF THE OFFICERS AND DIRECTORS OF PAC-WEST TELECOMM, INC.**

<u>Executive Officers:</u>

| | |
|---|---|
| Wallace W. Griffin | President, Chief Executive Officer and Director |
| John K. La Rue | Executive Vice President – Technology and Network Operations and Director |
| Richard E. Bryson | Chief Financial Officer |
| Brian K. Johnson | Senior Vice President and General Manager – Business Segment |
| Joel A. Effron | Senior Vice President – Sales and Marketing |
| Dennis V. Meyer | Vice President – Finance and Treasurer |
| Jason R. Mills | Vice President – Network Operations |
| Gregory Joksch | Vice President – Information Technologies |
| Jeff M. Webster | Vice President – Business Operations |
| John F. Sumpter | Vice President – Regulatory |
| H. Ravi Brar | Vice President – Business Development |



<u>Directors:</u>

| | |
|---|---|
| Jerry L. Johnson | Chairman of the Board of Directors |
| David G. Chandler | Director |
| Mark S. Fowler | Director |
| Samuel A. Plum | Director |
| Dr. Jagdish N. Sheth | Director |

<u>Business Addresses</u>

The business addresses of each Pac-West officer and/or directors is as follows:

4210 Coronado Avenue
Stockton, CA 95204

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## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders
of Pac-West Telecomm, Inc.:

We have audited the accompanying balance sheets of Pac-West Telecomm, Inc. (a California corporation) as of December 31, 1998 and 1999, and the related statements of operations, changes in stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pac-West Telecomm, Inc. as of December 31, 1998 and 1999, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States.

Arthur Andersen LLP

San Francisco, California,
February 10, 2000

# Balance Sheets (as of December 31, 1998 and 1999)

## ASSETS

| | 1998 | 1999 |
|---|---|---|
| **Current Assets:** | | |
| Cash and cash equivalents | $ 15,236,000 | $ 82,688,000 |
| Restricted cash | — | 10,087,000 |
| Short-term investments | — | 70,138,000 |
| Trade accounts receivable, net of allowances of $400,000 and $675,000 in 1998 and 1999, respectively | 4,623,000 | 8,339,000 |
| Accounts receivable from related parties | 64,000 | 63,000 |
| Income tax receivable | 1,971,000 | 195,000 |
| Inventories | 447,000 | 952,000 |
| Prepaid expenses and other current assets | 861,000 | 2,786,000 |
| Deferred financing costs, net | 457,000 | 864,000 |
| Deferred tax assets | 151,000 | 580,000 |
| Total current assets | 23,810,000 | 176,692,000 |
| **Equipment, Vehicles and Leasehold Improvements:** | | |
| Network and other communication equipment | 29,817,000 | 71,142,000 |
| Office furniture and equipment | 1,965,000 | 3,640,000 |
| Vehicles | 717,000 | 1,199,000 |
| Leasehold improvements | 5,581,000 | 11,661,000 |
| Projects in progress (Note 2) | 25,597,000 | 32,405,000 |
| | 63,677,000 | 120,047,000 |
| Less: Accumulated depreciation and amortization | (6,383,000) | (14,858,000) |
| Equipment, vehicles and leasehold improvements, net | 57,294,000 | 105,189,000 |
| **Other Assets,** net | 1,389,000 | 8,219,000 |
| Total assets | $ 82,493,000 | $ 290,100,000 |

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

## Balance Sheets (as of December 31, 1998 and 1999)

### LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

| | 1998 | 1999 |
|---|---|---|
| **Current Liabilities:** | | |
| Current portion of notes payable | $ 132,000 | $ 99,000 |
| Accounts payable | 5,147,000 | 13,158,000 |
| Accrued payroll and related expenses | 846,000 | 1,719,000 |
| Accrued interest on Senior Notes | — | 8,435,000 |
| Other accrued liabilities | 2,153,000 | 1,269,000 |
| Income taxes payable | — | 520,000 |
| Total current liabilities | 8,278,000 | 25,200,000 |
| **Senior Notes** | — | 150,000,000 |
| **Senior Secured Borrowings and Other Long-Term Obligations** (Note 3) | 100,000,000 | — |
| **Notes Payable,** less current portion | 116,000 | 17,000 |
| Total long-term debt | 100,116,000 | 150,017,000 |
| **Deferred Income Taxes** | 1,888,000 | 8,633,000 |
| Total liabilities | 110,282,000 | 183,850,000 |
| **Commitments and Contingencies** (Note 5) | | |
| **Convertible Redeemable Preferred Stock,** $0.001 par value; 1,750,000 shares authorized; 1,750,000 and 0 issued and outstanding at December 31, 1998 and 1999, respectively (preference in liquidation of $45,000,000, plus accrued cumulative dividends of $1,324,000 at December 31, 1998) | 46,324,000 | — |
| **Stockholders Equity (Deficit):** | | |
| Common stock, $0.001 par value: | | |
| Authorized shares—50,000,000 | | |
| Issued and outstanding shares—17,587,458 and 35,393,326 at December 31, 1998 and 1999, respectively | 18,000 | 35,000 |
| Additional paid-in capital | 8,905,000 | 173,345,000 |
| Notes receivable from stockholders | (233,000) | (233,000) |
| Retained earnings (deficit) | (82,803,000) | (66,897,000) |
| Total stockholders' equity (deficit) | (74,113,000) | 106,250,000 |
| Total liabilities and stockholders' equity (deficit) | $ 82,493,000 | $ 290,100,000 |

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

## Statements of Operations (for the years ended December 31, 1997, 1998 and 1999)

| | 1997 | 1998 | 1999 |
|---|---|---|---|
| **Revenues** (Note 5) | $ 29,551,000 | $42,211,000 | $ 95,505,000 |
| **Costs and Expenses:** | | | |
| Operating | 12,060,000 | 15,344,000 | 20,510,000 |
| Selling, general and administrative: | | | |
| Selling, general and administrative | 7,367,000 | 10,779,000 | 22,855,000 |
| Transaction bonuses and consultant's costs (Note 1) | — | 3,798,000 | — |
| Depreciation and amortization | 2,204,000 | 4,106,000 | 8,689,000 |
| Total costs and expenses | 21,631,000 | 34,027,000 | 52,054,000 |
| Income from operations | 7,920,000 | 8,184,000 | 43,451,000 |
| **Other Expense (Income):** | | | |
| Interest expense | 932,000 | 4,199,000 | 18,124,000 |
| Gain on disposal of answering service division | (385,000) | — | — |
| Costs of merger with PWT Acquisition Corp. and recapitalization | — | 3,004,000 | — |
| Other income, net | (119,000) | (330,000) | (3,690,000) |
| Total other expense, net | 428,000 | 6,873,000 | 14,434,000 |
| Income before provision for income taxes and extraordinary item | 7,492,000 | 1,311,000 | 29,017,000 |
| **Provision for Income Taxes** | 2,997,000 | 1,561,000 | 13,111,000 |
| Income (loss) before extraordinary item | 4,495,000 | (250,000) | 15,906,000 |
| **Extraordinary Item:** | | | |
| Loss on early extinguishment of debt, net of income tax benefit of $278,000 | — | (417,000) | — |
| Net income (loss) | 4,495,000 | (667,000) | 15,906,000 |
| **Accrued Preferred Stock Dividends** | — | (1,324,000) | (4,085,000) |
| **Net Income (Loss) Applicable to Common Stockholders** | $ 4,495,000 | $ (1,991,000) | $ 11,821,000 |
| **Income (Loss) Before Extraordinary Item Per Share:** | | | |
| Basic | $ 32.11 | $ (0.30) | $ 0.59 |
| Diluted | $ 32.11 | $ (0.30) | $ 0.56 |
| **Net Income (Loss) Per Share:** | | | |
| Basic | $ 32.11 | $ (0.38) | $ 0.59 |
| Diluted | $ 32.11 | $ (0.38) | $ 0.56 |
| **Weighted Average Shares Outstanding:** | | | |
| Basic | 140,000 | 5,244,191 | 20,172,968 |
| Diluted | 140,000 | 5,244,191 | 21,293,828 |

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

## Statements of Changes in Stockholders' Equity (Deficit)

**FOR THE YEARS ENDED DECEMBER 31, 1997, 1998 AND 1999**

| | Common Stock | | Additional Paid-in Capital | Notes Receivable from Stockholders | Retained Earnings (Deficit) | Total Stockholders' Equity (Deficit) |
|---|---|---|---|---|---|---|
| | Shares | Amount | | | | |
| **BALANCE, December 31, 1996** | 140,000 | $ 4,037,000 | $ — | $ — | $ 140,000 | $ 4,177,000 |
| Net income | — | — | — | — | 4,495,000 | 4,495,000 |
| **BALANCE, December 31, 1997** | 140,000 | 4,037,000 | — | — | 4,635,000 | 8,672,000 |
| Conversion to $0.001 par value stock | — | (4,037,000) | 4,037,000 | — | — | — |
| Effect of merger with PWT Acquisition Corp. and recapitalization (Note 1) | 7,176,988 | 7,000 | 1,193,000 | — | (86,771,000) | (85,571,000) |
| Issuance of common stock | 9,658,012 | 10,000 | 4,708,000 | — | — | 4,718,000 |
| Accrued cumulative dividends—preferred stock | — | — | (1,324,000) | — | — | (1,324,000) |
| Issuances of common stock for cash and notes receivable | 612,458 | 1,000 | 291,000 | (233,000) | — | 59,000 |
| Net loss | — | — | — | — | (667,000) | (667,000) |
| **BALANCE, December 31, 1998** | 17,587,458 | 18,000 | 8,905,000 | (233,000) | (82,803,000) | (74,113,000) |
| Net proceeds from initial public offering of common stock | 12,765,000 | 12,000 | 118,121,000 | — | — | 118,133,000 |
| Conversion of preferred stock | 5,040,868 | 5,000 | 50,404,000 | — | — | 50,409,000 |
| Accrued cumulative dividends—preferred stock | — | — | (4,085,000) | — | — | (4,085,000) |
| Net income | — | — | — | — | 15,906,000 | 15,906,000 |
| **BALANCE, December 31, 1999** | 35,393,326 | $ 35,000 | $173,345,000 | $ (233,000) | $(66,897,000) | $106,250,000 |

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

## Statements of Cash Flows

**FOR THE YEARS ENDED DECEMBER 31, 1997, 1998 AND 1999**

| | 1997 | 1998 | 1999 |
|---|---|---|---|
| **Operating Activities:** | | | |
| Net income (loss) | $ 4,495,000 | $ (667,000) | $ 15,906,000 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | |
| Extraordinary item—loss on early extinguishment of debt, net of income tax benefit | – | 417,000 | – |
| Costs of merger with PWT Acquisition Corp. and recapitalization | – | 3,004,000 | – |
| Depreciation and amortization | 2,204,000 | 4,106,000 | 8,689,000 |
| Amortization of deferred financing costs | – | 1,438,000 | 1,162,000 |
| Gain on disposal of answering service division | (385,000) | – | – |
| Gain on disposal of equipment | (15,000) | – | – |
| Interest earned on restricted cash | – | – | (629,000) |
| Provision for doubtful accounts | 216,000 | 100,000 | 275,000 |
| Deferred income tax provision | 711,000 | 963,000 | 6,316,000 |
| Changes in operating assets and liabilities: | | | |
| Increase in trade accounts receivable | (2,034,000) | (1,061,000) | (3,991,000) |
| Decrease (increase) in accounts receivable from related parties | (67,000) | 97,000 | 1,000 |
| Decrease (increase) in income tax receivable | 0 | (1,971,000) | 1,776,000 |
| (Increase) decrease in inventories | 195,000 | (117,000) | (505,000) |
| Increase in prepaid expenses and other current assets | (175,000) | (263,000) | (1,975,000) |
| Decrease (increase) in other assets | (56,000) | 91,000 | (2,541,000) |
| Increase in accounts payable | 654,000 | 3,988,000 | 8,011,000 |
| Increase in accrued interest on Senior Notes | – | – | 8,435,000 |
| Increase in income taxes payable | – | – | 520,000 |
| Increase (decrease) in accrued payroll and related expenses and other liabilities | 133,000 | 1,908,000 | (11,000) |
| Net cash provided by operating activities | 5,876,000 | 12,033,000 | 41,439,000 |
| **Investing Activities:** | | | |
| Purchases of equipment, vehicles and leasehold improvements | (7,103,000) | (42,176,000) | (56,370,000) |
| Purchases of short-term investments | – | – | (70,138,000) |
| Purchase of restricted cash investments, net of redemptions of $10,238,000 | – | – | (9,458,000) |
| Proceeds from disposal of answering service division | 402,000 | – | – |
| Proceeds from disposal of equipment | 82,000 | 145,000 | – |
| Net cash used in investing activities | (6,619,000) | (42,031,000) | (135,966,000) |
| **Financing Activities:** | | | |
| Proceeds from issuance of Senior Notes | – | – | 150,000,000 |
| Net proceeds from initial public offering of common stock | – | – | 118,133,000 |
| Repayment of senior secured borrowings | – | – | (100,000,000) |
| Proceeds from notes payable | 5,931,000 | 10,514,000 | – |
| Repayments on notes payable | (1,332,000) | (2,658,000) | (132,000) |
| Principal payments on capital leases | (730,000) | (828,000) | – |
| Payment for deferred financing costs | – | (1,195,000) | (6,022,000) |
| Proceeds from senior secured borrowings | – | 15,587,000 | – |
| Increase in other long-term obligations | – | 9,000,000 | – |
| Proceeds from the issuance of common stock | – | 9,000 | – |
| Merger with PWT Acquisition Corp. and recapitalization: | | | |
| Proceeds from the issuance of preferred stock | – | 31,844,000 | – |
| Proceeds from the issuances of common stock | – | 5,968,000 | – |
| Proceeds from senior secured borrowings | – | 75,413,000 | – |
| Payments to existing stockholders | – | (74,015,000) | – |
| Extinguishments of notes payable and capital leases | – | (23,159,000) | – |
| Payment for deferred financing costs | – | (1,895,000) | – |
| Costs of merger with PWT Acquisition Corp. and recapitalization | – | (2,954,000) | – |
| Repayment of loans payable to officers and stockholder | (211,000) | – | – |
| Net cash provided by financing activities | 3,658,000 | 41,631,000 | 161,979,000 |
| Net increase in cash and cash equivalents | 2,915,000 | 11,633,000 | 67,452,000 |
| **Cash And Cash Equivalents:** | | | |
| Beginning of year | 688,000 | 3,603,000 | 15,236,000 |
| End of year | $ 3,603,000 | $ 15,236,000 | $ 82,688,000 |

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

# NOTES TO FINANCIAL STATEMENTS

## ITEM 1. ORGANIZATION

Pac-West Telecomm, Inc. (the Company) is a rapidly growing provider of integrated communications services in the western United States. The Company's customers include Internet Service Providers (ISPs), small and medium businesses and enhanced communications service providers, many of which are communications intensive users.

The Company was incorporated in May 1996 in the state of California as a wholly owned subsidiary of CalPage (a telephone, answering and paging services company), also formerly named Pac-West Telecomm, Inc. CalPage transferred its telephone and answering service divisions to the Company effective September 30, 1996 (the Initial Transfer).

During 1997, the Company sold the customer base and other assets of its answering service division (see Note 10).

The success of the Company is dependent upon several factors. These factors include the Company's ability to penetrate additional markets and to manage network growth and technological change within the telecommunications industry, the successful implementation of local and enhanced services to its customers and ISPs, and competition from preexisting and new providers of local and long-distance services, as well as positive and timely responses regarding governmental regulations.

On September 16, 1998, the Company completed a merger with PWT Acquisition Corp. (PWT) and a recapitalization of the Company (the Transaction). PWT was formed by a group of investors (the New Stockholders) for the purpose of injecting additional equity into the Company and effecting the recapitalization. In connection with the Transaction, PWT was merged into the Company, with the Company being the surviving corporation. In connection with the Transaction, the existing stockholders of the Company received cash payments of approximately $74 million, as well as shares of newly issued preferred and common stock of the Company in exchange for a substantial portion of their ownership interests. Additionally, at the consummation of the Transaction, the Company paid transaction bonuses and consultant's costs totaling approximately $3.8 million, which are included in the accompanying statements of operations. Under the terms of the Transaction, the existing stockholders of the Company were entitled to receive additional consideration up to $20 million in the event that certain billings under dispute were received subsequent to the recapitalization (see Note 5). After consummation of the Transaction, the existing stockholders continue to hold approximately 28 percent of the issued and outstanding common stock of the Company. As a result of the continued significant ownership interests of the existing stockholders, no adjustments have been made to the historical carrying amounts of the Company's assets and liabilities as a result of the Transaction.

In November 1999, the Company consummated an initial public offering of its common stock. A total of 12,765,000 shares were issued in connection with the offering resulting in net proceeds after underwriters' discount and expenses of approximately $118.1 million. In addition, concurrent with the offering, all outstanding preferred stock and related accrued cumulative dividends were converted into 5,040,868 shares of the Company's common stock.

## ITEM 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

### Concentration of Customers and Suppliers

The relative concentrations of customers and suppliers of the Company are:

| | 1997 | 1998 | 1999 |
|---|---|---|---|
| Revenues (percent of revenues): | | | |
| Incumbent Local Exchange Carriers (ILECs, see Note 5) | 37% | 37% | 58% |
| Suppliers (percent of operating costs): largest supplier | 44% | 50% | 49% |

In 1997, 1998 and 1999, the Company's largest supplier was also the largest ILEC.

### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

### Regulation and Competition

Rates charged by the Company for certain telephone services are subject to the approval of various regulatory authorities. Trends in the telecommunications industry point toward increased competition in virtually all markets and the continued deregulation or alternative regulation of telecommunications services in many jurisdictions.

### Revenue Recognition

Revenues from the sale of telecommunications products are recognized in the month in which the service is provided, except for reciprocal compensation generated by calls placed to ISPs connected through the Company's network.

The rights of competitive local exchange carriers, such as the Company, to receive this type of compensation is the subject of numerous regulatory and legal challenges (see Note 5). Until this issue is ultimately resolved, the Company will continue to recognize this revenue on a cash-received basis.

Revenues from the sale of telecommunications products are recognized upon installation, or if no installation is required, upon shipment. Initial non-recurring revenues from the installation of telecommunication products are recognized upon completion of installation to the extent of direct costs incurred. Any initial non-recurring installation revenue in excess of direct costs is deferred and amortized over the expected service contract period, generally two years or less.

### Cash Equivalents

For purposes of reporting cash flows, the Company considers all highly liquid investments with an original maturity of three months or less from the date of acquisition to be cash equivalents.

### Restricted Cash

Restricted cash represents short-term investments deposited in an interest reserve trust account to fund the initial interest payments through February 1, 2000 under the $150,000,000 Senior Notes. All such interest payments have been made.

### Short-Term Investments

All investments with an original maturity of greater than three months from the date of acquisition are accounted for under Financial Accounting Standards Board (FASB) Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The Company determines the appropriate classification at the time of purchase. All investments as of December 31, 1999 were classified as available-for-sale and appropriately carried at fair value. Realized gains and losses are included in other income, net in the accompanying statements of operations. Differences between cost and fair value are recorded as unrealized gains and losses in a separate component of stockholders' equity. As of December 31, 1999, the cost of these investments approximated market.

### Inventories

Inventories consist of telephone equipment, parts and installation materials, which are valued at the lower of cost or market. Cost is determined by the average cost method. Provision is made to reduce slow moving inventory to reflect its estimated net realizable value.

### Equipment, Vehicles and Leasehold Improvements

Equipment, vehicles and leasehold improvements are stated at cost and include network and other communication equipment, office furniture and equipment, vehicles, leasehold improvements, projects in progress and equipment deposits. Equipment includes assets acquired under capital leases. Expenditures for maintenance are charged to expense as incurred. Upon retirement, the asset cost and related accumulated depreciation are relieved from the financial statements. Gains and losses associated with dispositions of equipment, vehicles and leasehold improvements are reflected as a component of other income, net in the accompanying statements of operations. Depreciation and amortization is computed using the straight-line method based on the following estimated useful lives:

| | |
|---|---|
| Equipment | 3 to 7 years |
| Vehicles | 5 years |
| Leasehold improvements | 10 years or life of lease, whichever is shorter |

The Company capitalizes interest on capital projects when the project involves considerable time and major expenditures. Such interest is capitalized as part of the cost of the equipment and leasehold improvement and is amortized over the remaining life of the assets. Interest is capitalized based on rates for borrowings that are outstanding over the period required to complete the asset. In 1998 and 1999, the Company capitalized $303,000 and $2,346,000, respectively, of interest related to capital projects. Capitalizable interest in 1997 was insignificant.

Depreciation and amortization of equipment, vehicles and leasehold improvements was $2,204,000, $4,106,000 and $8,475,000 for the years ended December 31, 1997, 1998 and 1999, respectively.

Included in projects in progress at December 31, 1998 is $20,828,000 for deposits paid or payable on equipment not in service at year-end.

### Deferred Financing Costs, Net

Deferred financing costs, net consist primarily of capitalized amounts for underwriter fees, professional fees and other expenses related to the issuance and subsequent registration of the $150,000,000 Senior Notes. These deferred financing costs are being amortized on a straight-line basis (which approximates the effective interest method) over the estimated 10 year term of the notes beginning January 29, 1999. Other deferred financing costs are for the senior notes exchange offering and costs relating to the senior credit facility. Amortization expense for the years ended December 31, 1998 and 1999, was $1,438,000 and $1,162,000, respectively, and is included within interest expense in the accompanying statements of operations.

**Other Assets**

At December 31, other assets consist of the following:

| | 1998 | 1999 |
|---|---|---|
| Deferred financing costs | $ 1,195,000 | $ 5,648,000 |
| Acquisition of lease rights | — | 1,513,000 |
| Long-term portion of prepaid expenses and deposits | — | 849,000 |
| Long-term portion of covenant not to compete | 150,000 | — |
| Other | 44,000 | 209,000 |
| | $ 1,389,000 | $ 8,219,000 |

During 1999, the Company purchased lease rights of additional space in its Los Angeles facility. This amount is included in other assets as listed above and is being amortized over the life of the lease.

**Other Accrued Liabilities**

Other accrued liabilities include approximately $1,018,000 and $397,000 as of December 31, 1998 and 1999, respectively, of amounts collected from customers for taxes due to various governmental and regulatory authorities.

**Supplemental Statements of Cash Flows Information**

| | 1997 | 1998 | 1999 |
|---|---|---|---|
| Cash paid during the period for: | | | |
| Interest (net of amount capitalized) | $ 924,000 | $ 2,565,000 | $8,723,000 |
| Income taxes (net of refunds) | 2,351,000 | 2,195,000 | 4,499,000 |
| Supplemental disclosure of noncash transactions: | | | |
| Acquisition of fixed assets using capital lease obligations | 4,781,000 | 290,000 | — |
| Issuance of the Preferred Stock in conjunction with the Transaction | — | 13,156,000 | — |
| Refinancing of capital lease obligation with note payable | — | 1,599,000 | — |

**Income Taxes**

The Company provides for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes." SFAS No. 109 requires the asset and liability method of accounting for income taxes. Under this method, deferred income taxes are recognized for the tax consequences of "temporary differences" by applying the applicable statutory tax rate to the differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. Under SFAS No. 109, the effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date based on the applicable tax rate.

**Other Comprehensive Income**

In September 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes the disclosure requirements for comprehensive income and its components within the financial statements. There were no items of other comprehensive income for the years ended December 31, 1997, 1998 and 1999; therefore, comprehensive income is the same as net income (loss) for each of these years.

**Segment Reporting**

The Company has adopted Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures about Segments of an Enterprise and Related Information." As an integrated telecommunications provider, the Company has one reportable operating segment. While the Company's chief decision-maker monitors the revenue streams of various services, operations are managed and financial performance is evaluated based upon the delivery of multiple services over common networks and facilities. This allows the Company to leverage its costs in an effort to maximize return. As a result, there are many shared expenses generated by the various revenue streams; because management believes that any allocation of the expenses to multiple revenue streams would be impractical and arbitrary, management does not currently make such allocations internally. The chief decision-maker does, however, monitor revenue streams at a more detailed level than those depicted in the Company's historical general purpose financial statements.

Specifically, the following table presents revenues by service type:

| | 1997 | 1998 | 1999 |
|---|---|---|---|
| Local services | $17,810,000 | $ 28,147,000 | $79,071,000 |
| Long distance services | 5,133,000 | 6,328,000 | 7,974,000 |
| Dedicated transport services | 3,312,000 | 4,155,000 | 5,162,000 |
| Products and services | 2,073,000 | 2,104,000 | 1,485,000 |
| Other | 1,223,000 | 1,477,000 | 1,813,000 |
| | $29,551,000 | $ 42,211,000 | $95,505,000 |

Local services revenues for the year ended December 31, 1999 include $26,308,000 of reciprocal compensation settlement payments (Note 5).

### Other Recent Pronouncements

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and for Hedging Activities," effective for fiscal years beginning after June 15, 1999. Management does not expect adoption of SFAS No. 133 in future periods to have a significant impact on the Company's financial statements.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 ("SAB 101"), Revenue Recognition in Financial Statements. SAB 101 provides guidance on applying generally accepted accounting principles to revenue recognition in financial statements, and is effective for us in the second quarter of 2000. While we believe that SAB 101 will have no material effect on our current accounting policies, we will evaluate our current policies to ensure that they are in accordance with SAB 101.

### Income (Loss) Per Share

Income (loss) per share has been calculated under SFAS No. 128, "Earnings per Share." SFAS No. 128 requires companies to compute income (loss) per share under two methods (basic and diluted). Basic net income (loss) per share is calculated by dividing net income (loss) by the weighted average shares of common stock outstanding during the period. Diluted net income (loss) per share information considers the effect of dilutive securities (stock options and convertible preferred stock) as follows:

| | For the Year Ended December 31, 1999 | | |
|---|---|---|---|
| | Income | Shares | Per Share |
| Basic net income per share: | | | |
| Net income applicable to common stockholders | $11,821,000 | 20,172,968 | $ 0.59 |
| Effect of dilutive securities: | | | |
| Convertible redeemable preferred stock | — | — | |
| Stock options | — | 1,120,860 | |
| Diluted net income per share: | | | |
| Income available to common stockholders and assumed conversions | $11,821,000 | 21,293,828 | $ 0.56 |

Conversion of the convertible redeemable preferred stock for the years ended December 31, 1998 and 1999 and the effect of the exercise of stock options for year ended December 31, 1998 are antidilutive and have been excluded from the calculation of diluted income (loss) per share. The Company consummated an initial public offering of its common stock and converted all outstanding convertible redeemable preferred stock in November 1999 (see Note 1).

Basic and diluted income per share was the same for the year ended December 31, 1997 as there were no convertible preferred stock or stock options outstanding during 1997.

The Company evaluated the requirements of the Securities and Exchange Commission Staff Accounting Bulletin (SAB) No. 98 and concluded that there are no nominal issuances of common stock or potential common stock that would be required to be shown as outstanding for all periods presented herein as outlined in SAB No. 98.

### 3. LONG-TERM DEBT AND OTHER LONG-TERM OBLIGATIONS:

Long-term debt and other long-term obligations consisted of the following at December 31, 1998 and 1999:

| | 1998 | 1999 |
|---|---|---|
| Senior Notes | $ — | $150,000,000 |
| Senior secured borrowings and other long-term obligations | 100,000,000 | — |
| Notes payable, less current portion | 116,000 | 17,000 |
| | $100,116,000 | $150,017,000 |

On January 29, 1999, the Company issued $150,000,000 of Senior Notes at par. The Senior Notes bear interest at 13.5 percent payable in semiannual installments, with principal due on February 1, 2009.

Proceeds of the Senior Notes were used to repay $100,000,000 of senior secured borrowings (including $9,000,000 of other long-term obligations subsequently financed through senior secured borrowings) and to establish an interest reserve account to cover initial interest payments due under the Senior Notes through February 1, 2000.

The Senior Notes carry provisions that allow the Company, at its option, to (i) redeem up to 35 percent of the notes with proceeds of certain public offerings of equity prior to February 1, 2002, (ii) redeem all or part of the notes at specified prices on or after February 1, 2004, or (iii) offer to exchange the notes within 180 days from the issue date for a new issue of identical debt securities registered under the Securities Act of 1933, as amended (the Securities Act). In August 1999, the Company completed the registration of these notes under the Securities Act and on September 22, 1999 all of the unregistered Senior Notes were exchanged for Senior Notes registered under the Securities Act of 1933.

The basic covenants of these notes restrict (subject to certain limitations) the Company's future ability to pay dividends, repurchase stock, pledge or sell assets as security for other transactions, or engage in mergers and business combinations. The covenants allow the Company to incur additional debt subject to various limitations.

The Company has a three-year senior credit facility expiring June 15, 2002 that provides for maximum borrowings of $40 million to finance working capital, the cost of the Company's planned capital expansion and other corporate transactions. The borrowings are secured by substantially all of the Company's assets. Borrowings under this senior credit facility will bear interest, at the Company's option, at (1) the Base Rate (as defined) or (2) the LIBOR Rate (as defined) plus between 2.25 percent and 3.5 percent. As of December 31, 1999, there were no amounts outstanding under this facility and the borrowing rate would have been 9.25 percent. The credit facility requires the Company to meet certain financial tests, including, without limitation, maximum levels of debt as a ratio of earnings before interest, taxes, depreciation and amortization (as defined), minimum interest coverage and maximum amount of capital expenditures. The credit facility contains certain covenants which, among other things limit the incurrence of additional indebtedness, investments, dividends, transactions with affiliates, asset sales, acquisitions, mergers and consolidations, prepayments of other indebtedness (including the Senior Notes), liens and encumbrances and other matters customarily restricted in such agreements, unless specific consent is obtained.

At December 31, 1998 and 1999, notes payable consisted of contracts payable to banks and finance companies for vehicles, requiring monthly principal and interest payments of $602 to $1,510 at interest rates from 0.9 percent to 8.2 percent due through June 2001. Notes payable are secured by Company owned vehicles. Future principal payments consist of $99,000 and $17,000 in 2000 and 2001, respectively.

## 4. EXTRAORDINARY ITEM—LOSS ON EARLY EXTINGUISHMENT OF DEBT:

In conjunction with the Transaction (see Note 1) and the receipt of the senior secured borrowings during 1998, as discussed in Note 3, the Company repaid certain amounts outstanding under notes payable and capital leases for equipment. The resulting loss in 1998 from the early extinguishment of the debt of $695,000, less the applicable income tax benefit of $278,000, has been reflected as an extraordinary item in the accompanying statements of operations for the year ended December 31, 1998.

## 5. COMMITMENTS AND CONTINGENCIES:

### Leases

The Company leases its five principal facilities in Stockton, Oakland, Los Angeles, Las Vegas and Seattle pursuant to noncancellable operating leases that expire in June 2002, November 2003, September 2006, August 2009 and December 2009, respectively. The lease expiring in June 2002 also contains five two-year renewal options. The leases expiring in November 2003, September 2006, August 2009 and December 2009 also contain two five-year renewal options. The Company also leases telephone equipment sites and telephone circuits on month-to-month, annual and long-term noncancellable leases. Management of the Company expects that these leases will be renewed or replaced by other leases in the normal course of business.

The Company's future minimum lease payments with initial terms in excess of one year as of December 31, 1999, are as follows:

| | Operating Leases | |
|---|---|---|
| | Space | Telephone Circuits and Equipment |
| 2000 | $ 1,650,000 | $ 6,894,000 |
| 2001 | 1,584,000 | 6,535,000 |
| 2002 | 1,400,000 | 4,805,000 |
| 2003 | 1,113,000 | 3,105,000 |
| 2004 | 1,043,000 | 1,462,000 |
| 2005 and thereafter | 3,362,000 | — |
| | $10,152,000 | $22,801,000 |

Rental expense charged to operations for the years ended December 31, 1997, 1998 and 1999, for all operating leases for space was $432,000, $650,000 and $1,260,000, respectively, and is included in selling, general and administrative expense in the accompanying statements of operations. Rental expense charged to operations for telephone circuits of approximately $6,000,000, $9,935,000 and $12,729,000 for the years ended December 31, 1997, 1998 and 1999, respectively, is included in operating costs in the accompanying statements of operations.

Rental expense paid to related parties was approximately $ -0-, $35,000 and $163,000 for the years ended December 31, 1997, 1998 and 1999, respectively.

### Purchase Commitments

At December 31, 1999, the Company has approximately $19,000,000 of purchase orders outstanding for network equipment due for delivery during 2000. These purchase orders are cancelable up to 60 days prior to delivery without penalty and are expected to be financed from the proceeds received from the Senior Notes, from internally generated cash flows, from borrowings under the senior credit facility or from proceeds from the Company's initial public offering consummated November 9, 1999.

In addition, the Company is in the process of implementing a new billing and operations support system. Total estimated costs for this system aggregate approximately $16,500,000 of which approximately $9,000,000 was incurred in 1999, $6,000,000 is estimated to be incurred in 2000 and $1,500,000 in 2001. All of the amounts incurred in 1999 are recorded in projects in progress at December 31, 1999.

During 1998 and 1999, the Company purchased approximately 50 percent and 56 percent, respectively, of total fixed assets from a single vendor.

**Employment Agreements**

The Company has entered into employment agreements with certain key executives that provide for minimum annual base salaries, bonus entitlements upon the achievement of certain objectives, and the issuance of stock options.

These employment agreements, which were approved by the Company's stockholders in 1998 in connection with the Transaction (see Note 1), granted options to two executives to purchase up to 568,750 shares of the Company's common stock. The exercise price of these options of $0.48 per share approximated the fair market value of the Company's common stock at the date of grant. These options vest over various dates through October 2001 and expire at various dates through October 2008 (see Note 6).

The employment agreements were effective as of or subsequent to the close of the Transaction and have terms varying from one to three years; however, they may be terminated by either party at an earlier date under certain circumstances. As of December 31, 1998 and 1999, the Company accrued approximately $304,000 and $811,000 in accrued payroll and related expenses in the accompanying balance sheets for bonuses payable under these agreements.

**Revenue Recognition and Legal Proceedings**

The Company has established interconnection agreements with certain Incumbent Local Exchange Carriers (ILECs). The Telecommunications Act of 1996 requires ILECs to enter into interconnection agreements with Competitive Local Exchange Companies (CLECs, such as the Company) and other competitors and requires state Public Utilities Commissions (PUCs) to arbitrate such agreements.

The interconnection agreements outline, among other items, compensation arrangements for calls originating or terminating in the other party's switching equipment, payment terms, and level of services.

Various ILECs have disputed, and are continuing to dispute, that internet traffic calls made to an ISP are not local calls, and as such are not covered by the interconnection agreements. Further, two ILECs with which the Company has interconnection agreements had withheld payments from amounts billed by the Company under their agreements since August 1997, and have filed complaints with the Superior Court of the State of California and the California and Nevada Public Utility Commissions (PUC's). The Superior Court ordered the complaint stayed pending the California PUC's review of the issues raised by the complaint.

In February 1999, the Federal Communications Commission (FCC) issued a Declaratory Ruling on the issue of reciprocal compensation for calls bound to ISPs. The FCC ruled that the calls are jurisdictionally interstate calls. The FCC, however, determined that this issue did not resolve the question of whether reciprocal compensation is owed. The FCC noted a number of factors that would allow the state PUCs to leave their decisions requiring the payment of compensation undisturbed.

On June 24, 1999, the California PUC adopted a decision in the arbitration proceeding between the Company and Pacific Bell which held that reciprocal compensation would be payable for ISP calls under the new interconnection agreement with Pacific Bell which became effective on June 29, 1999. Pacific Bell has requested a rehearing of the decision, although Pacific Bell has paid the full amount of billings for calls since the effective date of the new agreement.

On September 9, 1999, the Company entered into a settlement agreement with Pacific Bell regarding its claims for unpaid reciprocal compensation under their prior interconnection agreement. Under the terms of the settlement agreement, Pacific Bell agreed to pay $20.0 million to the Company and $20.0 million to certain stockholders of the Company as of the date of the recapitalization (see Note 1), in settlement of those claims. As a result of these payments, the terms of the September 1998 recapitalization requiring additional distribution to certain shareholders have been satisfied.

On September 2, 1999, Nevada Bell named the Company and others as defendants in a suit to reverse the decision of the Public Utilities Commission of Nevada. The Company is contesting the claims of Nevada Bell and no assurances can be given concerning the outcome of this case or any resulting appeal.

On August 25, 1999, the Company along with the commissioners of the California Public Utilities Commission and others, were named as a defendant in an action filed by GTE California (GTE). The action challenges the legality of the California Public Utilities Commission's decision regarding requiring reciprocal compensation for traffic termination to ISPs. GTE argues that such calls to ISPs are not local calls within the meaning of its agreement with the Company even though they are dialed and billed as local calls. The Company is contesting the claims of GTE.

In October 1999, GTE paid, and the Company recorded as revenue, $6,308,000 of reciprocal compensation that GTE had previously withheld. GTE has not waived its rights to appeal, contest and seek subsequent reimbursements of amounts paid for reciprocal compensation.

In February 2000, the California Public Utilities Commission commenced a separate generic proceeding to develop its policy regarding reciprocal compensation.

The Company cannot predict the impact of the FCC's ruling on existing state decisions or the outcome of pending appeals or on additional cases in this matter. Given the uncertainty concerning the final outcome of the PUC proceedings, the possibility of future extended appeals or additional litigation, and future decisions by the FCC, the Company continues to record the revenue associated with reciprocal compensation billings to ILECs on a cash-received basis.

The amounts withheld by the two ILECs which had withheld payments from amounts billed by the Company under their agreements during the years ended December 31, 1997, 1998 and 1999 are as follows:

| | 1997 | 1998 | 1999 |
|---|---|---|---|
| Total amount billed to specified ILECs during the year | $14,858,000 | $48,264,000 | $58,866,000 |
| Amount withheld by specified ILECs and not recorded as revenue in the Company's statements of operations | (3,793,000) | (32,845,000) | (29,855,000) |
| Amounts received for prior withholding and recorded as revenue | — | 254,000 | 26,308,000 |
| Net amount recorded as revenue from the specified ILECs during the year | $11,065,000 | $15,673,000 | $55,319,000 |

## 6. STOCKHOLDERS' EQUITY:

### Common Stock

In connection with the transactions in September 1998, certain stockholders of the Company entered into a Registration Agreement, whereby at any time prior to September 26, 2001, one of the stockholders of the Company may request that the Company grant holders of the common stock of that stockholder the right to purchase a certain number of shares of the Company's common stock (the "Rights Offering"). The Rights Offering, covering 924,165 shares offered from the stockholder to its shareholders, was consummated in connection with the initial public offering of the Company's common stock in November 1999. Following 180 days after the Rights Offering, subject to certain limitations, stockholders of the Company who are party to the Registration Agreement may request that the Company register all or any portion of such stockholder's common stock in the Company with the Securities and Exchange Commission (SEC). In addition, the Registration Agreement provides that, subject to certain limitations, the parties to the Registration Agreement and certain transferors of common stock originally issued to the parties of the Registration Agreement may request that the Company include any common stock held by such persons or entities with any of the Company's common stock that the Company proposes to register.

### Stock Split

On March 19, 1999, the Board of Directors authorized a ten-for-one split of the Company's authorized and outstanding common stock and preferred stock. On October 7, 1999, the Board of Directors authorized a 1.4 for 1 split of the Company's outstanding common and preferred stock. In addition, on October 7, 1999, the Board of Directors approved a resolution to increase the authorized shares of common stock to 50,000,000 shares. All share and per share data have been restated to reflect these stock splits.

### Convertible Redeemable Preferred Stock

The preferred stock has preference over common stock in liquidation equal to its liquidation value of $25.72 per share, plus accrued dividends computed at a 10 percent rate, compounded quarterly (collectively, the Preference Amount). After payment of the Preference Amount, the preferred stock and the common stock share ratably in any distributions by the Company. As of the date of the initial public offering in November 1999, all of the outstanding preferred stock and cumulative dividends then outstanding were converted into common stock.

**Stock Options**

In January 1999, the Company's Board of Directors approved the terms of the 1999 Stock Incentive Plan (the "Plan") which authorizes the granting of stock options, including restricted stock, stock appreciation rights, dividend equivalent rights, performance units, performance shares or other similar rights or benefits to employees, directors, consultants and advisors. Options granted under the Plan have a term of ten years. In addition, options have been granted to two senior officers outside of the 1999 Plan but governed by the rules of the 1999 plan. An aggregate of 3,150,000 shares of common stock have been reserved for option grants.

A summary of the status of the Company's stock options plan at December 31, 1999 and changes during the years ended December 31, 1998 and 1999 are presented in the table below:

| | Qualifying | Nonqualifying | Total | Weighted Average Exercise Price | Weighted Average Fair Value Of Options Granted |
|---|---|---|---|---|---|
| Balance, December 31, 1997 | — | — | — | — | |
| Granted | — | 568,750 | 568,750 | $ 0.48 | $ 0.08 |
| Balance, December 31, 1998 | — | 568,750 | 568,750 | 0.48 | |
| Granted | 1,325,865 | 366,335 | 1,692,200 | 5.06 | 3.00 |
| Cancelled | (36,300) | — | (36,300) | 2.57 | |
| Balance, December 31, 1999 | 1,289,565 | 935,085 | 2,224,650 | $ 3.93 | |

Options outstanding, exercisable and vested by price range at December 31, 1999 are as follows:

| Range of Exercise Price | Number Outstanding | Weighted Average Contractual Life | Number Vested and Exercisable |
|---|---|---|---|
| $ 0.48 | 568,750 | 8.8 | 422,917 |
| 2.14 | 1,215,900 | 9.3 | — |
| 10.00 | 319,000 | 9.8 | 224,000 |
| 22.06 | 121,000 | 9.9 | — |
| | 2,224,650 | | 646,917 |

The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." Had compensation expense for the Plan been determined based on the fair value at the grant dates, as prescribed in SFAS No. 123, the Company's earnings and earnings per share would have been as follows:

| | 1997 | 1998 | 1999 |
|---|---|---|---|
| Net income (loss) attributable to common stockholders: | | | |
| As reported | $ 4,495,000 | $ (1,991,000) | $ 11,821,000 |
| Pro forma | 4,495,000 | (2,020,000) | 11,423,000 |
| Basic earnings per common share | | | |
| As reported | $ 32.11 | $ (0.38) | $ 0.59 |
| Pro forma | 32.11 | (0.38) | 0.57 |
| Diluted earnings per common share: | | | |
| As reported | $ 32.11 | $ (0.38) | $ 0.56 |
| Pro forma | 32.11 | (0.38) | 0.54 |

The fair value of each option was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions used for the grants: expected dividend yield of 0 percent in all periods; expected volatility of 74 percent for 1999 and 0 percent for 1997 and 1998; weighted average risk-free interest rates ranging from 4.9 percent to 6.17 percent for all periods presented in the table above; and expected lives of four years for all periods.

## 7. INCOME TAXES:

The provision for income taxes consists of the following:

| | 1997 | 1998 | 1999 |
|---|---|---|---|
| Current: | | | |
| Federal | $ 1,783,000 | $ 353,000 | $ 6,795,000 |
| State | 503,000 | 245,000 | — |
| Deferred: | | | |
| Federal | 546,000 | 861,000 | 5,595,000 |
| State | 165,000 | 102,000 | 721,000 |
| | $ 2,997,000 | $ 1,561,000 | $ 13,111,000 |

The Company's provision for income tax differed from the amount computed by applying the statutory federal income tax rate to income before income taxes and extraordinary item, as follows:

| | 1997 | Rate | 1998 | Rate | 1999 | Rate |
|---|---|---|---|---|---|---|
| Income tax determined by applying the statutory federal income tax rate to income before income taxes and extraordinary item | $2,547,000 | 34.0% | $ 446,000 | 34.0% | $10,156,000 | 35.0% |
| State income taxes, net of federal income tax benefit | 450,000 | 6.0 | 230,000 | 17.5 | 470,000 | 1.6 |
| Federal income tax effect of nondeductible costs related to the Transaction (see Note 1) | — | — | 885,000 | 67.6 | — | — |
| Reciprocal compensation settlement | — | — | — | — | 1,500,000 | 5.2 |
| Changes in reserves | — | — | — | — | 936,000 | 3.2 |
| Other | — | — | — | — | 49,000 | 0.2 |
| Provision for income taxes | $2,997,000 | 40.0% | $1,561,000 | 119.1% | $ 13,111,000 | 45.2% |

The cumulative balance sheet effects of deferred tax items are:

| | 1997 | 1998 | 1999 |
|---|---|---|---|
| Trade accounts receivable allowances | $ 129,000 | $ 171,000 | $ 173,000 |
| Vacation and other accrued expenses | 26,000 | 76,000 | 130,000 |
| Inventory reserves | 46,000 | 46,000 | 95,000 |
| Tax credits | — | 876,000 | 151,000 |
| State taxes | 250,000 | 163,000 | 152,000 |
| Deferred tax assets | 451,000 | 1,332,000 | 701,000 |
| Depreciation and amortization | (1,097,000) | (2,834,000) | (5,982,000) |
| Capitalized interest | — | (130,000) | (884,000) |
| Reciprocal compensation settlement | — | — | (980,000) |
| Other reserves | (128,000) | (105,000) | (908,000) |
| Deferred tax liabilities | (1,225,000) | (3,069,000) | (8,754,000) |
| Net deferred tax liability | (774,000) | (1,737,000) | (8,053,000) |
| Less: Amount classified as current deferred tax asset | 160,000 | 151,000 | 580,000 |
| Net noncurrent deferred tax liability | $ (934,000) | $ (1,888,000) | $ (8,633,000) |

Tax credits of $876,000 and $151,000, shown above, represent unused tax credits associated with the payment of Alternative Minimum Tax (AMT) as of December 31, 1998 and 1999, respectively. Such credits, which do not expire, may be used to offset future income taxes payable.

## 8. RELATED-PARTY TRANSACTIONS:

### Bay Alarm Company (Bay Alarm)

Bay Alarm (a stockholder of the Company) and its subsidiary, InReach Internet, LLC, are collectively one of the Company's largest customers of telephone network services, comprising approximately $2,109,000, $2,680,000 and $2,667,000, or 7.1 percent, 6.3 percent and 2.8 percent, of the Company's revenues for the years ended December 31, 1997, 1998 and 1999, respectively. The Company also had amounts due from Bay Alarm at December 31, 1998 and 1999. These amounts are included in accounts receivable from related parties in the accompanying balance sheets.

Bay Alarm provides the Company with security monitoring services at its normal commercial rates. The Company has recorded $48,000, $58,000 and $60,000 as selling, general and administrative expense for these services for the years ended December 31, 1997, 1998 and 1999, respectively.

As outlined in Note 5, the Company leases its facility in Oakland from Bay Alarm. In addition to rent paid under this lease, the company recorded selling, general and administrative expense of $0, $59,000 and $35,000 for the years ended 1997, 1998 and 1999, respectively, for related utility charges. In May 1999, the Company restructured the agreement to allow for direct payments to the utility company.

### Notes Receivable from Stockholder

In connection with the Transaction, a stockholder of the Company, who is also an officer, purchased 37,500 shares of common stock from the Company for $250,000. The Company received $50,000 in cash from the stockholder and entered into a note receivable for the remaining balance of $200,000. Subsequent to the Transaction, another officer of the Company acquired 6,247 shares of common stock for $42,000. The Company received $9,000 in cash and entered into a note receivable for the remaining $33,000 due from the officer. The notes accrue interest at 5.54 percent and 5.12 percent, respectively, compounded annually, with any unpaid accrued interest and principal due at the earlier of (1) the sale of the above stock with proceeds received first applied to unpaid interest, then to principal; (2) sale of the Company; (3) 60 days from the date the stockholder is no longer an employee of the Company or a subsidiary; or (4) September 16, 2003 and October 16, 2003, respectively.

## 9. RETIREMENT PLAN:

In October 1996, the Company adopted a 401(k) retirement plan (the Plan) for all full-time employees who have completed six months of service. The plan year is from January 1 to December 31, and the Company will contribute $0.50 for every $1.00 contributed by the employee, subject to the Company's contribution not exceeding 3 percent of the employee's salary. Participants become fully vested after six years of service, although they vest incrementally on an annual basis after two years of service and until the six-year period is completed. The Company recorded selling, general and administrative expense of $63,000, $58,000 and $134,000 for the years ended December 31, 1997, 1998 and 1999, respectively, for the Company's matching contributions.

Employees of the Company previously contributing to the CalPage 401(k) retirement plan (with identical provisions to the Plan) were able to roll their accumulated benefits into the Plan at date of commencement (October 1, 1996), with all prior employer contributions becoming fully vested on the date of rollover.

## 10. SALE OF ANSWERING SERVICE DIVISION:

In March 1997, the Company sold the customer base and other assets of its answering service division for $420,000, payable $200,000 in cash and a promissory note of $220,000. The promissory note was paid in October 1997 at a discount of $18,000. The Company recognized a net gain of $385,000 on the sale in the year ended December 31, 1997.

## 11. SUBSEQUENT EVENTS:

Effective January 1, 2000, the Company acquired the customer base and certain other assets of Napa Valley Telecom (Napa Telecom), a switch-based, long distance telecommunications company headquartered in Napa Valley, California. The total purchase price, which was paid in cash, was approximately $4,000,000 plus additional payments not to exceed $500,000 if certain revenue targets are met. In connection with this agreement, the Company granted certain key employees of Napa Telecom options to purchase the Company's common stock at its November 1999 initial public offering price of $10. As a result, the Company will recognize deferred compensation of approximately $900,000. This amount will be amortized as an operating expense over the four year vesting term.

Effective February 1, 2000, the Company acquired all of the outstanding stock of Installnet, Inc. (Installnet) and three other related companies headquartered in Southern California. Installnet is primarily in the business of telecommunications equipment installation. The total purchase price, which was paid in cash and stock, approximated $14,000,000 plus additional payments not to exceed $1,500,000, if certain revenue targets are met. In addition, the Company has granted options to certain Installnet employees to purchase an aggregate of 105,000 shares of the Company's common stock at the market price at the date of grant.

These acquisitions will be accounted for using the purchase method of accounting.

ARTHUR ANDERSEN LLP

PAC WEST TELECOMM, INC.

FINANCIAL STATEMENTS
AS OF DECEMBER 31, 1998 AND 1997
TOGETHER WITH REPORT OF
INDEPENDENT PUBLIC ACCOUNTANTS

ARTHUR ANDERSEN LLP

## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders
of Pac-West Telecomm, Inc.:

We have audited the accompanying balance sheets of Pac-West Telecomm, Inc. (a California corporation) as of December 31, 1998 and 1997, and the related statements of operations, changes in stockholders' equity (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pac-West Telecomm, Inc. as of December 31, 1998 and 1997, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

Arthur Andersen LLP

San Francisco, California,
February 10, 1999

# PAC-WEST TELECOMM, INC

## BALANCE SHEETS
## AS OF DECEMBER 31, 1998 AND 1997

### ASSETS

| | 1998 | 1997 |
|---|---|---|
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $15,236,000 | $ 3,603,000 |
| Trade accounts receivable, net of allowances for doubtful accounts of $400,000 and $300,000 in 1998 and 1997, respectively | 4,623,000 | 3,662,000 |
| Accounts receivable from related parties | 64,000 | 161,000 |
| Income tax receivable | 1,971,000 | 0 |
| Inventories | 447,000 | 330,000 |
| Prepaid expenses and other current assets | 861,000 | 398,000 |
| Deferred financing costs, net | 457,000 | 0 |
| Deferred tax assets | 151,000 | 160,000 |
| Total current assets | 23,810,000 | 8,314,000 |
| EQUIPMENT, VEHICLES AND LEASEHOLD IMPROVEMENTS: | | |
| Communications equipment | 29,817,000 | 17,193,000 |
| Office furniture and equipment | 1,965,000 | 1,176,000 |
| Vehicles | 717,000 | 301,000 |
| Leasehold improvements | 5,581,000 | 2,869,000 |
| Construction in progress (Note 5) | 25,597,000 | 0 |
| | 63,677,000 | 21,539,000 |
| Less: Accumulated depreciation and amortization | (6,383,000) | (2,460,000) |
| Equipment, vehicles and leasehold improvements, net | 57,294,000 | 19,079,000 |
| OTHER ASSETS, net | 1,389,000 | 135,000 |
| Total assets | $82,493,000 | $27,528,000 |

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

# PAC-WEST TELECOMM, INC.

## BALANCE SHEETS

## AS OF DECEMBER 31, 1998 AND 1997

### LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

| | *1998* | *1997* |
|---|---|---|
| CURRENT LIABILITIES: | | |
| Current portion of notes payable | $ 132,000 | $ 2,034,000 |
| Current portion of capital lease obligations | 0 | 1,432,000 |
| Accounts payable | 5,147,000 | 1,159,000 |
| Accrued payroll and related expenses | 846,000 | 331,000 |
| Other accrued liabilities | 2,153,000 | 760,000 |
| Total current liabilities | 8,278,000 | 5,716,000 |
| SENIOR SECURED BORROWINGS AND OTHER LONG-TERM OBLIGATIONS (Note 3) | 100,000,000 | 0 |
| NOTES PAYABLE, less current portion | 116,000 | 6,627,000 |
| CAPITAL LEASE OBLIGATIONS, less current portion | 0 | 5,579,000 |
| Total long-term debt and capital lease obligations | 100,116,000 | 12,206,000 |
| DEFERRED INCOME TAXES | 1,888,000 | 934,000 |
| Total liabilities | 110,282,000 | 18,856,000 |
| COMMITMENTS AND CONTINGENCIES (Note 5) | | |
| CONVERTIBLE REDEEMABLE PREFERRED STOCK, $0.01 par value; 175,000 shares authorized; 125,000 issued and outstanding at December 31, 1998 (preference in liquidation of $45,000,000, plus accrued cumulative dividends of $1,324,000) | 46,324,000 | 0 |
| STOCKHOLDERS' EQUITY (DEFICIT): | | |
| Common stock: | | |
| December 31, 1997, no par value: | | |
| Authorized shares—1,000,000 | | |
| Issued and outstanding shares—10,000 | 0 | 4,037,000 |
| December 31, 1998, $0.01 par value: | | |
| Authorized shares—1,500,000 | | |
| Issued and outstanding shares—1,256,247 | 13,000 | 0 |
| Additional paid-in capital | 8,910,000 | 0 |
| Notes receivable from stockholders | (233,000) | 0 |
| Retained earnings (deficit) | (82,803,000) | 4,635,000 |
| Total stockholders' equity (deficit) | (74,113,000) | 8,672,000 |
| Total liabilities and stockholders' equity (deficit) | $ 82,493,000 | $ 27,528,000 |

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

PAC-WEST TELECOMM, INC.

STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 1998 AND 1997

| | *1998* | *1997* |
|---|---|---|
| REVENUES (Note 5) | $42,211,000 | $29,551,000 |
| COSTS AND EXPENSES: | | |
| Operating | 15,344,000 | 12,060,000 |
| Selling, general and administrative: | | |
| Selling, general and administrative | 10,779,000 | 7,367,000 |
| Transaction bonuses and consultant's costs (Note 1) | 3,798,000 | 0 |
| Depreciation and amortization | 4,106,000 | 2,204,000 |
| Total costs and expenses | 34,027,000 | 21,631,000 |
| Income from operations | 8,184,000 | 7,920,000 |
| OTHER EXPENSE (INCOME): | | |
| Interest expense | 4,199,000 | 932,000 |
| Gain on disposal of answering service division | 0 | (385,000) |
| Costs of merger with PWT Acquisition Corp. and recapitalization | 3,004,000 | 0 |
| Other income, net | (330,000) | (119,000) |
| Total other expense, net | 6,873,000 | 428,000 |
| Income before provision for income taxes and extraordinary item | 1,311,000 | 7,492,000 |
| PROVISION FOR INCOME TAXES | 1,561,000 | 2,997,000 |
| Income (loss) before extraordinary item | (250,000) | 4,495,000 |
| EXTRAORDINARY ITEM: Loss on early extinguishment of debt, net of income tax benefit of $278,000 | (417,000) | 0 |
| Net income (loss) | $ (667,000) | $ 4,495,000 |

The accompanying notes are an integral part of these statements.

# PAC-WEST TELECOMM, INC.

## STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT) FOR THE YEARS ENDED DECEMBER 31, 1998 AND 1997

| | *Common Stock* | | *Additional Paid-in Capital* | *Notes Receivable from Stockholders* | *Retained Earnings (Deficit)* | *Total Stockholders' Equity (Deficit)* |
|---|---|---|---|---|---|---|
| | *Shares* | *Amount* | | | | |
| BALANCE, December 31, 1996 | 10,000 | $ 4,037,000 | $ 0 | $ 0 | $ 140,000 | $ 4,177,000 |
| Net income for the year ended December 31, 1997 | 0 | 0 | 0 | 0 | 4,495,000 | 4,495,000 |
| BALANCE, December 31, 1997 | 10,000 | 4,037,000 | 0 | 0 | 4,635,000 | 8,672,000 |
| Conversion to $0.01 par value stock | 0 | (4,037,000) | 4,037,000 | 0 | 0 | 0 |
| Effect of merger with PWT Acquisition Corp. and recapitalization (Note 1) | 512,642 | 6,000 | 1,194,000 | 0 | (86,771,000) | (85,571,000) |
| Issuance of common stock | 689,858 | 7,000 | 4,711,000 | 0 | 0 | 4,718,000 |
| Accrued cumulative dividends - preferred stock | 0 | 0 | (1,324,000) | 0 | 0 | (1,324,000) |
| Issuances of common stock for cash and notes receivable | 43,747 | 0 | 292,000 | (233,000) | 0 | 59,000 |
| Net loss for the year ended December 31, 1998 | 0 | 0 | 0 | 0 | (667,000) | (667,000) |
| BALANCE, December 31, 1998 | 1,256,247 | $ 13,000 | $ 8,910,000 | $(233,000) | $(82,803,000) | $(74,113,000) |

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

# PAC-WEST TELECOMM, INC.

## STATEMENTS OF CASH FLOWS
## FOR THE YEARS ENDED DECEMBER 31, 1998 AND 1997

| | *1998* | *1997* |
|---|---|---|
| OPERATING ACTIVITIES: | | |
| Net income (loss) | $ (667,000) | $ 4,495,000 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Extraordinary item—loss on early extinguishment of debt, net of income tax benefit | 417,000 | 0 |
| Costs of merger with PWT Acquisition Corp. and recapitalization | 3,004,000 | 0 |
| Depreciation and amortization | 4,106,000 | 2,204,000 |
| Amortization of deferred financing costs | 1,438,000 | 0 |
| Gain on disposal of answering service division | 0 | (385,000) |
| Gain on disposal of equipment | 0 | (15,000) |
| Provision for doubtful accounts | 100,000 | 216,000 |
| Deferred income tax provision | 963,000 | 711,000 |
| Changes in operating assets and liabilities: | | |
| Increase in trade accounts receivable | (1,061,000) | (2,034,000) |
| Decrease (increase) in accounts receivable from related parties | 97,000 | (67,000) |
| Increase in income tax receivable | (1,971,000) | 0 |
| (Increase) decrease in inventories | (117,000) | 195,000 |
| Increase in prepaid expenses and other current assets | (263,000) | (175,000) |
| Decrease (increase) in other assets | 91,000 | (56,000) |
| Increase in accounts payable | 3,988,000 | 654,000 |
| Increase in accrued payroll and related expenses and other liabilities | 1,908,000 | 133,000 |
| Net cash provided by operating activities | 12,033,000 | 5,876,000 |
| INVESTING ACTIVITIES: | | |
| Purchases of equipment, vehicles and leasehold improvements | (42,176,000) | (7,103,000) |
| Proceeds from disposal of answering service division | 0 | 402,000 |
| Proceeds from disposal of equipment | 145,000 | 82,000 |
| Net cash used in investing activities | (42,031,000) | (6,619,000) |
| FINANCING ACTIVITIES: | | |
| Proceeds from notes payable | 10,514,000 | 5,931,000 |
| Repayments on notes payable | (2,658,000) | (1,332,000) |
| Principal payments on capital leases | (828,000) | (730,000) |
| Payment for deferred financing costs associated with senior notes | (1,195,000) | 0 |
| Proceeds from senior secured borrowings | 15,587,000 | 0 |
| Increase in other long-term obligations | 9,000,000 | 0 |
| Proceeds from the issuance of common stock | 9,000 | 0 |
| Merger with PWT Acquisition Corp. and recapitalization: | | |
| Proceeds from the issuance of preferred stock | 31,844,000 | 0 |
| Proceeds from the issuances of common stock | 5,968,000 | 0 |
| Proceeds from senior secured borrowings | 75,413,000 | 0 |
| Payments to existing stockholders | (74,015,000) | 0 |
| Extinguishments of notes payable and capital leases | (23,159,000) | 0 |
| Payment for deferred financing costs | (1,895,000) | 0 |
| Costs of merger with PWT Acquisition Corp. and recapitalization | (2,954,000) | 0 |
| Repayment of loans payable to officers and stockholder | 0 | (211,000) |
| Net cash provided by financing activities | 41,631,000 | 3,658,000 |
| Net increase in cash and cash equivalents | 11,633,000 | 2,915,000 |
| CASH AND CASH EQUIVALENTS: | | |
| Beginning of year | 3,603,000 | 688,000 |
| End of year | $15,236,000 | $ 3,603,000 |

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

PAC-WEST TELECOMM, INC.

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 1998

## 1. ORGANIZATION:

Pac-West Telecomm, Inc. (the Company) was incorporated in May 1996 in the state of California as a wholly owned subsidiary of CalPage (a telephone, answering and paging services company), also formerly named Pac-West Telecomm, Inc. CalPage transferred its telephone and answering service divisions to the Company effective September 30, 1996 (the Initial Transfer).

The Company is engaged in the business of providing switched local and long-distance telecommunications services and "one-stop" integrated telecommunications services to Internet Service Providers (ISPs), paging companies and other inbound call service providers, as well as to medium and small businesses, principally within California.

During 1997, the Company sold the customer base and other assets of its answering service division (see Note 10).

The success of the Company is highly dependent upon several factors. These factors include the Company's ability to penetrate additional markets and to manage network growth and technological change within the telecommunications industry, the successful implementation of local and enhanced services to its customers and ISPs, and competition from preexisting and new providers of local and long-distance services, as well as positive and timely responses regarding governmental regulations.

Additionally, the Company is managed by a limited number of key individuals, several of whom are subject to employment contracts. The Company is also dependent on the development of an effective sales force and the retention of skilled and qualified personnel.

As a result of the merger and recapitalization discussed below, the Company became highly leveraged. As of December 31, 1998, the Company's borrowings and other long-term obligations totaled $100,248,000 and the Company had a stockholders' deficit of $74,113,000. As discussed in Note 11, in January 1999, the Company issued $150,000,000 of 13.5 percent senior notes due on February 1, 2009. A portion of the proceeds from these notes was used to repay the senior secured borrowings. The balance of the proceeds will be used for future capital expenditures and working capital needs, including the establishment of an interest reserve to cover certain initial interest payments due under the senior notes.

### Merger and Recapitalization

On September 16, 1998, the Company completed a merger with PWT Acquisition Corp. (PWT) and a recapitalization of the Company (the Transaction). PWT was formed by a group of investors (the New Stockholders) for the purpose of injecting additional equity into the Company and effecting the recapitalization. In connection with the Transaction, PWT was merged into the Company, with the Company being the surviving corporation.

In connection with the Transaction, Bay Alarm Company and Mr. John La Rue (the Existing Stockholders) received cash payments of approximately $74 million (primarily financed through senior secured borrowings—see Note 3), as well as shares of newly issued preferred and common stock of the Company in exchange for a substantial portion of their ownership interests. Additionally, at the consummation of the Transaction, the Company paid transaction bonuses and consultant's costs totaling approximately $3.8 million which are included in the accompanying statements of operations. Under the terms of the Transaction, the Existing Stockholders of the Company are entitled to receive additional consideration up to $20 million in the event that the Company achieves certain earnings targets (including receipt of certain billings under dispute—see Note 5) subsequent to the recapitalization. After consummation of the Transaction, the Existing Stockholders continue to hold approximately 28 percent of the issued and outstanding common stock of the Company. As a result of the continued significant ownership interests of the Existing Stockholders, no adjustments have been made to the historical carrying amounts of the Company's assets and liabilities as a result of the Transaction.

A summary of the Transaction is as follows:

| | |
|---|---|
| Issuance of convertible redeemable preferred stock* | $ 31,844,000 |
| Issuance of common stock, $0.01 par value | 5,968,000 |
| Proceeds from senior secured borrowings | 75,413,000 |
| Total sources of cash | 113,225,000 |
| Payments to Existing Stockholders, including $400,000 for noncompete agreements* | (74,015,000) |
| Extinguishment of debt** | (23,437,000) |
| Transaction bonuses and consultant's costs | (3,798,000) |
| Transaction costs*** | (4,593,000) |
| Total uses of cash | (105,843,000) |
| Net cash provided by Transaction | $ 7,382,000 |

In order to effect the above, the Company amended its articles of incorporation such that the authorized capital of the Company consists of 1,500,000 shares of common stock and 175,000 shares of convertible redeemable preferred stock (the Preferred Stock). The issued and outstanding preferred stock and common stock of PWT were converted into Preferred Stock and common stock of the Company, respectively, on a one-for-one basis.

* Net of $13,156,000 of noncash convertible redeemable preferred stock issued as part of the Transaction payments to Existing Stockholders.

** Includes $695,000 of early extinguishment costs before income tax benefit (see Note 4).

*** Includes costs of merger with PWT Acquisition Corp. and recapitalization of $3,004,000 (less amortization of noncompete agreements of $50,000 during 1998) and deferred financing costs incurred in connection with the senior secured borrowings of $1,895,000; net of $256,000 of common stock issued as payment for professional services provided.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

### Concentration of Customers and Suppliers

The relative concentrations of customers and suppliers of the Company greater than 10 percent are:

| | *1998* | *1997* |
|---|---|---|
| Revenues (percent of revenues): | | |
| Incumbent Local Exchange Companies (ILECs, see Note 5) | 37% | 37% |
| Suppliers (percent of operating costs): | | |
| Largest supplier | 50 | 44 |

In 1998 and 1997, the Company's largest supplier was also the largest ILEC.

### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

### Regulation and Competition

Rates charged by the Company for certain telephone services are subject to the approval of various regulatory authorities. Trends in the telecommunications industry point toward increased competition in virtually all markets and the continued deregulation or alternative regulation of telecommunications services in many jurisdictions.

### Revenue Recognition

Revenues are generally recognized when service is provided or equipment is shipped and/or installed. See Note 5 for discussion of the revenue recognition policy related to certain billings under dispute with two significant ILECs.

### Cash Equivalents

For purposes of reporting cash flows, the Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

### Inventories

Inventories consist of telephone equipment, parts and installation materials, which are valued at the lower of cost or market. Cost is determined by the average-cost method. Provision is made to reduce slow moving inventory to reflect its estimated net realizable value.

**Reclassifications**

Certain reclassifications have been made to the 1997 financial statements to conform to the current year presentation.

**Equipment, Vehicles and Leasehold Improvements**

Equipment, vehicles and leasehold improvements transferred to the Company are stated at the net book value on the date of the Initial Transfer. Subsequent additions are stated at cost. Equipment includes assets acquired under capital leases. Expenditures for maintenance are charged to expense as incurred. Upon retirement, the asset cost and the related accumulated depreciation are removed from the accounts. Gains and losses associated with dispositions of equipment, vehicles and leasehold improvements are reflected as a component of other income, net in the accompanying statements of operations. Equipment, vehicles and leasehold improvements from the Initial Transfer are depreciated or amortized over their remaining useful lives as of the date of the Initial Transfer. For subsequent additions including assets acquired under capital leases, depreciation and amortization is computed using the straight-line method based on the following estimated useful lives:

| | |
|---|---|
| Equipment | 3 to 7 years |
| Vehicles | 5 years |
| Leasehold improvements | 10 years or life of lease, whichever is shorter |

The Company capitalizes interest on self-constructed capital projects when construction involves considerable time and major expenditures. Such interest is capitalized as part of the cost of the equipment and leasehold improvement and is amortized over the remaining life of the assets. Interest is capitalized based on rates for borrowings that are outstanding over the period required to complete the asset. In 1998, the Company capitalized $303,000 of interest related to the construction of assets. Capitalizable interest in 1997 was insignificant.

Depreciation and amortization of equipment, vehicles and leasehold improvements was $4,106,000 and $2,204,000 for the years ended December 31, 1998 and 1997, respectively.

**Deferred Financing Costs, Net**

Deferred financing costs, net consist of capitalized amounts for bank financing fees, professional fees, and other expenses related to the senior secured borrowings obtained on September 16, 1998 (see Note 3). Amortization is computed using the straight-line method over the term of the borrowings through January 29, 1999. Amortization expense for the year ended December 31, 1998, was $1,438,000 and is included within interest expense in the accompanying statements of operations.

**Other Assets**

At December 31, 1998, other assets consist primarily of deferred financing costs of $1,195,000 associated with the Company's subsequent issuance of senior notes (see Note 11) and the long-term portion of covenants not to compete of $150,000. Upon issuance of the senior notes, the deferred financing costs will be amortized over the estimated maturity of the debt of 10 years.

### Other Accrued Liabilities

Other accrued liabilities include approximately $1,018,000 and $424,000 as of December 31, 1998 and 1997, respectively, of amounts collected from customers for taxes due to various governmental and regulatory authorities.

### Supplemental Statements of Cash Flow Information

| | *1998* | *1997* |
|---|---|---|
| Cash paid during the period for: | | |
| Interest (net of amount capitalized) | $ 2,565,000 | $ 924,000 |
| Income taxes | 2,195,000 | 2,351,000 |
| Supplemental disclosure of noncash transactions: | | |
| Acquisition of fixed assets using capital lease obligations | 290,000 | 4,781,000 |
| Issuance of the Preferred Stock in conjunction with the Transaction | 13,156,000 | 0 |
| Refinancing of capital lease obligation with note payable | 1,599,000 | 0 |

### Income Taxes

The Company provides for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes." SFAS No. 109 requires the asset and liability method of accounting for income taxes. Under this method, deferred income taxes are recognized for the tax consequences of "temporary differences" by applying the applicable statutory tax rate to the differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. Under SFAS No. 109, the effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date based on the applicable tax rate.

### Recent Accounting Pronouncements

In June 1997, the Financial Accounting Standards Board issued SFAS No. 130, "Reporting Comprehensive Income," and SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." In February and June 1998, the Financial Accounting Standards Board issued SFAS No. 132, "Employer's Disclosures about Pension Plans and Other Postretirement Benefits," and SFAS No. 133, "Accounting for Derivative Instruments and for Hedging Activities," respectively. The Company has adopted SFAS Nos. 130 and 131, the effect of which did not have a material impact on the Company's financial reporting in 1998. Management does not expect adoption of SFAS Nos. 132, and 133 in future periods to have a significant impact on the Company's financial statements.

## 3. SENIOR SECURED BORROWINGS:

On September 16, 1998, concurrent with the Transaction discussed in Note 1, the Company entered into a senior secured borrowing agreement with several financial institutions allowing for borrowings up to $100,000,000. The outstanding balance under this agreement was due at the earlier of the completion of a high-yield debt offering (see Note 11) or March 16, 1999, with interest due monthly, bearing interest at a floating rate equal to, at the Company's option, the base rate (defined as the higher of (a) 0.5 percent above the latest Federal Funds Rate; and (b) the rate of interest in effect as publicly announced by the principal lender as its "reference rate"), or the offshore rate (as defined in the senior secured borrowings agreement) plus 2.0 percent. As of December 31, 1998, the Company had elected to utilize the offshore rate, which was 8.625 percent, including the additional 2.0 percent. The borrowings were secured by substantially all assets of the Company. The Company was subject to certain covenants, which included limitations on additional debt, restrictions on the payment of dividends and maintenance of certain interest coverage requirements.

At December 31, 1998, the Company had senior secured borrowings outstanding of $91,000,000 and other obligations of $9,000,000. The $9,000,000 of other obligations related to equipment purchases as of December 31, 1998, which were subsequently financed through additional senior secured borrowings.

On January 29, 1999, the Company paid off all outstanding senior secured borrowings and accrued interest through the issuance of a high-yield debt offering due February 1, 2009 (see Note 11). As a result of the subsequent refinancing, the senior secured borrowings and other obligations have been classified as long-term debt and other long-term obligations in the accompanying balance sheet as of December 31, 1998.

## 4. NOTES PAYABLE, EXTRAORDINARY ITEM AND LINE OF CREDIT:

### Notes Payable

Notes payable consisted of the following at December 31, 1998 and 1997:

| | *1998* | *1997* |
|---|---|---|
| Contracts payable to banks and finance companies for equipment, requiring monthly principal and interest payments of $1,474 to $69,921 at interest rates from 8.6 percent to 9.6 percent, due through June 2003, repaid in full in September 1998 | $ 0 | $ 8,454,000 |
| Contracts payable to banks and finance companies for vehicles, requiring monthly principal and interest payments of $355 to $1,510 at interest rates from 0.9 percent to 8.3 percent due through June 2001 | 248,000 | 207,000 |
| | 248,000 | 8,661,000 |
| Less: Current portion | (132,000) | (2,034,000) |
| | $ 116,000 | $ 6,627,000 |

Notes payable are secured by all of the Company's owned equipment and vehicles. Aggregate future principal payments by year on notes payable are as follows at December 31, 1998:

| | |
|---|---|
| 1999 | $132,000 |
| 2000 | 99,000 |
| 2001 | 17,000 |
| | $248,000 |

### Extraordinary Item—Loss on Early Extinguishment of Debt

In conjunction with the Transaction (see Note 1) and the receipt of the senior secured borrowings during 1998, as discussed in Note 3, the Company repaid amounts outstanding under notes payable and capital leases for equipment. The resulting loss from the early extinguishment of the debt of $695,000, less the applicable income tax benefit of $278,000, has been reflected as an extraordinary item in the accompanying statements of operations.

### Line of Credit

The Company maintained a credit agreement with a bank that provided for a line of credit with a maximum borrowing limit of $2,500,000. The credit agreement and related security agreement contained various restrictive covenants, including restrictions on the incurrence of new liens and long-term indebtedness except for the financing of new equipment, the payment of dividends, the entering into business combinations or mergers, and requirements to maintain certain financial ratios. For the years ended December 31, 1998 and 1997, no amounts were borrowed under this line of credit. During 1998, the Company terminated the line of credit.

## 5. COMMITMENTS AND CONTINGENCIES:

### Leases

The Company leases its four principal facilities in Stockton, Oakland, Los Angeles and Las Vegas pursuant to noncancelable operating leases that expire in June 2002, November 2003, September 2006 and October 2009, respectively. The lease expiring in June 2002 also contains five two-year renewal options. The leases expiring in November 2003, September 2006 and October 2009 also contain two five-year renewal options. Prior to September 16, 1998, the Company leased certain equipment under capital leases that were repaid in connection with the Transaction (see Note 1). The Company also leases telephone equipment sites and telephone circuits on month-to-month, annual and long-term noncancellable leases. Management of the Company expects that these leases will be renewed or replaced by other leases in the normal course of business.

The Company's future minimum lease payments with initial terms in excess of one year for the years ending December 31, 1998, are as follows:

| | *Operating Leases* | |
|---|---|---|
| | *Space* | *Telephone Circuits and Equipment* |
| 1999 | $ 947,000 | $ 4,516,000 |
| 2000 | 908,000 | 4,114,000 |
| 2001 | 907,000 | 3,982,000 |
| 2002 | 768,000 | 2,456,000 |
| 2003 | 640,000 | 599,000 |
| 2004 and thereafter | 1,911,000 | 0 |
| | $6,081,000 | $15,667,000 |

Rental expense charged to operations for the years ended December 31, 1998 and 1997, for all operating leases for space was $650,000 and $432,000, respectively, and is included in selling, general and administrative expense in the accompanying statements of operations. Rental expense charged to operations for telephone circuits of approximately $9,935,000 and $6,000,000 for the years ended December 31, 1998 and 1997, respectively, is included in operating costs in the accompanying statements of operations.

Rental expense paid to related parties was approximately $35,000 and $0 for the years ended December 31, 1998 and 1997, respectively.

**Purchase Commitments**

At December 31, 1998, the Company had commitments under various contracts for the purchase of telephone switch equipment. The Company has recorded $11,585,000 of construction-in-progress in the accompanying balance sheet as of December 31, 1998, for equipment received prior to year-end but not yet installed. This amount includes $9,000,000 of purchases that were subsequently financed through the issuance of additional senior secured borrowings (see Note 3).

In addition, at December 31, 1998, the Company had approximately $52,000,000 of purchase orders outstanding for telephone switch equipment due for delivery during 1999 and 2000. These purchase orders are cancelable up to 60 days prior to delivery and are expected to be financed from proceeds received from the senior notes (see Note 11) and internally generated cash flows.

**Employment Agreements**

The Company has entered into employment agreements with six executives that provide for minimum annual base salaries, bonus entitlements upon the achievement of certain objectives, and issuance of options under the new 1999 Employee Stock Option Plan (Note 11). The employment agreements were effective as of or subsequent to the close of the Transaction and have terms varying from one to three years; however, they may be terminated by either party at an earlier date under certain circumstances. As of December 31, 1998, the Company accrued approximately $304,000 in accrued payroll and related expenses in the accompanying balance sheet for bonuses payable under these agreements.

**Revenue Recognition—Billings under Dispute**

The Company has established interconnection agreements with certain Incumbent Local Exchange Companies (ILECs) in California. The Telecommunications Act of 1996 requires ILECs to enter into interconnection agreements with Competitive Local Exchange Companies (CLECs, such as the Company) and other competitors and requires state Public Utilities Commissions (PUCs) to arbitrate such agreements.

The interconnection agreements outline, among other items, compensation arrangements for calls originating or terminating in the other party's switching equipment, payment terms, and level of services.

Two ILECs with which the Company has interconnection agreements have withheld payments from amounts billed by the Company under their agreements during the years ended December 31, 1998 and 1997, as follows:

| | *1998* | *1997* |
|---|---|---|
| Total amount billed to specified ILECs during the year | $48,264,000 | $14,858,000 |
| Amount withheld by specified ILECs and not recorded as revenue in the Company's statements of operations | (32,845,000) | (3,793,000) |
| Amounts received for prior withholding and recorded as revenue | 254,000 | 0 |
| Net amount recorded as revenue from the specified ILECs during the year | $15,673,000 | $11,065,000 |

The first ILEC withheld payment of 48 percent of the Company's August 1997 billing and continued to withhold payments monthly, at declining percentages, including a withholding of 20 percent of the December 1997 billing. During 1998, this ILEC withheld an average of 69 percent of amounts billed. The ILEC has indicated that it has paid the withheld amounts into an escrow account pursuant to a dispute claim.

The other ILEC has withheld payments on 100 percent of the monthly amounts billed by the Company for October 1997 through December 1997 and has withheld an average of 59 percent of amounts billed during 1998. In 1998, this ILEC paid $254,000 of amounts previously withheld from 1997 billings. This ILEC has made no escrow payments.

Both ILECs have continued to withhold significant percentages of payments during 1999.

The issue giving rise to the dispute, based on correspondence with the first ILEC, relates to the classification of telephone calls entering the Company's system and terminating to an ISP. Under the interconnection agreements, the ILECs are obligated to pay the Company for calls originating in the ILECs' systems and terminating in the Company's system. Local calls are the most prevalent calls compensated for under the interconnection agreements.

The first ILEC filed a complaint with the Superior Court of the State of California that outlined its opinion that Internet traffic calls made to an ISP are not local calls (but rather interstate calls), and as such are not covered by the interconnection agreement and are not subject to the jurisdiction of the PUC. Management understands a similar position was taken by the other ILEC. The Superior Court ordered this complaint stayed pending the California PUC's (CPUC's) review of the issues raised by the complaint.

The first ILEC has requested (without specifying any particular monetary claims) that the Company refund, with interest, all amounts previously paid to the Company for Internet traffic calls. All revenues recognized from this ILEC in the Company's financial statements since the Company's commencement, including those amounts associated with ISP calls previously paid to the Company, total $24,998,000, consisting of $13,861,000 and $10,533,000 for the years ended December 31, 1998 and 1997, respectively. It is not possible for the Company or for the ILECs (based on the Company's understanding of their systems) to determine which calls to an ISP telephone number are then connected, by way of the ISP's equipment, on to the Internet network. Accordingly, it is not possible to identify amounts specifically billed to or paid by the ILECs for calls actually connected, by way of the ISP's equipment, on to the Internet network.

Management, after consultation with its regulatory attorneys, believes that calls originated in the ILECs' systems and terminated in the Company's system at an ISP, including all calls actually connected by way of the ISP's equipment on to the Internet network, are local calls, and, accordingly, the Company is entitled to compensation pursuant to its interconnection agreements with the ILECs. Further, the Company believes decisions and actions taken by PUCs of various states, including California, support the Company's position. As a result, no amounts have been accrued for in the Company's financial statements for any potential refunds of any amounts previously received from these ILECs. In October 1998, the CPUC issued a decision supporting the Company's position that local telephone calls placed to ISPs terminate at the ISP and, therefore, are local calls entitled to reciprocal compensation. Subsequent to this decision, the ILEC involved in this complaint filed an Application for Rehearing of the above decision. In addition, in February 1999, the Federal Communications Commission (FCC) issued a Declaratory Ruling on the issue of reciprocal compensation for calls bound to ISPs. The FCC ruled that the calls are jurisdictionally interstate calls. The FCC, however, determined that this issue did not resolve the question of whether reciprocal compensation is owed. The FCC noted a number of factors that would allow the state PUCs to leave their decisions requiring the payment of compensation undisturbed. The Company cannot predict the impact of the FCC's ruling on existing state decisions or the outcome of pending appeals or on additional cases in this matter. Given the uncertainty concerning the final outcome of the CPUC proceedings, the possibility of future extended appeals or additional litigation, and future decisions by the FCC, management continues to record the revenue associated with reciprocal compensation billings to the two ILECs discussed above on a cash-received basis.

## 6. STOCKHOLDERS' EQUITY:

### Common Stock

Pursuant to the Transaction, the stockholders of the Company entered into a Shareholders' Agreement that provides for, among other things, the election of certain individuals as Directors of the Company, restrictions on transfers, rights of first-offer, and participation rights in any shares of Preferred Stock or common stock. Under this agreement, the Company has agreed not to issue or sell additional shares of common stock prior to an initial public offering unless certain parties to the Shareholders' Agreement are given the opportunity to subscribe for and purchase their pro rata portion of the additional shares at the same price and same terms.

The stockholders of the Company also entered into a Registration Agreement whereby at any time prior to September 26, 2001, a certain stockholder may request that the Company grant holders of its common stock the right to purchase a certain number of shares of the Company's common stock (the Rights Offering). Within a certain period after the Rights Offering closes, the Company's stockholders may request that the Company register all or any portion of the stockholders' common stock in the Company with the Securities and Exchange Commission (SEC) when the offering value of the Company's securities in an initial public offering is at least $25,000,000.

**Convertible Redeemable Preferred Stock**

On September 16, 1998, the Company, as discussed in Note 1, amended and restated its articles of incorporation to allow for the issuance of the 175,000 shares of nonvoting $0.01 par value Preferred Stock. The Preferred Stock has preference over common stock in liquidation equal to the liquidation value of $360 per share, plus accrued dividends computed at a 10 percent rate, compounded quarterly (the Preference Amount). After payment of the Preference Amount, the Preferred Stock and the common stock share ratably in any distribution by the Company. At December 31, 1998, $1,324,000 (or $10.59 per outstanding share of Preferred Stock) is accrued for cumulative preferred dividends.

The holders of a majority of the outstanding Preferred Stock have the right to convert all of the outstanding Preferred Stock into shares of common stock in connection with the consummation of a public offering of debt or equity securities or rights to acquire any debt or equity securities of the Company offered to the public (a Public Offering). Additionally, any holder of at least 5 percent of the outstanding Preferred Stock may convert its shares of Preferred Stock to shares of common stock in connection with a Public Offering. Each share of Preferred Stock will be convertible into a number of shares of common stock determined by dividing the Preference Amount by the initial Public Offering price of the common stock.

The Company is required to redeem at the request of a majority of the holders in the event of a Public Offering or after December 31, 2003, all of the Preferred Stock outstanding. In addition, any 5 percent holder may require the Company to redeem its shares of Preferred Stock with the net proceeds of a Public Offering at a redemption price equal to 100 percent of the liquidation preference thereof, plus accumulated and unpaid dividends at the date of redemption.

**7. INCOME TAXES:**

The provision for income taxes consists of the following:

| | *1998* | *1997* |
|---|---|---|
| Current: | | |
| Federal | $ 353,000 | $1,783,000 |
| State | 245,000 | 503,000 |
| Deferred: | | |
| Federal | 861,000 | 546,000 |
| State | 102,000 | 165,000 |
| | $1,561,000 | $2,997,000 |

The Company's provision for income tax differed from the amount computed by applying the statutory federal income tax rate to income before income taxes and extraordinary item, as follows:

| | 1998 | 1997 |
|---|---|---|
| Income tax determined by applying the statutory federal income tax rate to income before income taxes and extraordinary item | $ 446,000 | $2,547,000 |
| State income taxes, net of federal income tax benefit | 230,000 | 450,000 |
| Federal income tax effect of nondeductible costs related to the Transaction (see Note 1) | 885,000 | 0 |
| Provision for income taxes | $1,561,000 | $2,997,000 |

The cumulative balance sheet effects of deferred tax items are:

| | 1998 | 1997 |
|---|---|---|
| Trade accounts receivable allowances | $ 171,000 | $ 129,000 |
| Vacation and other accrued expenses | 76,000 | 26,000 |
| Inventory reserves | 46,000 | 46,000 |
| Tax credits | 876,000 | 0 |
| State taxes | 163,000 | 250,000 |
| Deferred tax assets | 1,332,000 | 451,000 |
| Depreciation | (2,834,000) | (1,097,000) |
| Capitalized interest | (130,000) | 0 |
| Prepaid expenses and other | (105,000) | (128,000) |
| Deferred tax liabilities | (3,069,000) | (1,225,000) |
| Net deferred tax liability | (1,737,000) | (774,000) |
| Less: Amount classified as current deferred tax asset | 151,000 | 160,000 |
| Net noncurrent deferred tax liability | $ (1,888,000) | $ (934,000) |

Tax credits of $876,000, shown above, represent tax credits associated with the payment of Alternative Minimum Tax (AMT) arising in 1998. Such credits, which do not expire, may be used to offset future income taxes payable.

## 8. RELATED-PARTY TRANSACTIONS:

**Loans Payable to Officers and Stockholder**

Loans payable to officers and stockholder consisted of advances from certain former officers (who resigned during the period ended December 31, 1996) and Mr. John La Rue. The loans payable bore interest at 9.5 to 10.0 percent and did not contain specified repayment terms. Interest expense related to these loans was $7,000 for the year ended December 31, 1997. The principal and related accrued interest were paid in full for all such loans during 1997.

**Bay Alarm Company (Bay Alarm)**

Bay Alarm (a major stockholder of the Company) and its subsidiary, InReach Internet, LLC, are collectively one of the Company's largest customers of telephone network services, comprising approximately $2,680,000 and $2,109,000, or 6.4 percent and 7.1 percent, of the Company's revenues for the years ended December 31, 1998 and 1997, respectively. The Company also had amounts due from Bay Alarm at December 31, 1998 and 1997. These amounts are included in accounts receivable from related parties in the accompanying balance sheets.

Bay Alarm provides the Company with security monitoring services at its normal commercial rates. The Company has recorded $58,000 and $48,000 as selling, general and administrative expense for these services for the years ended December 31, 1998 and 1997, respectively.

As outlined in Note 5, Leases, the company leases its facility in Oakland from Bay Alarm. In addition to rent paid under this lease, the company recorded selling, general and administrative expense of $59,000 and $0 for the years ended 1998 and 1997, respectively, for related utility charges.

The Company sublet space to a division of Bay Alarm on a month-to-month basis through December 31, 1997. Rental income recorded for the year ended December 31, 1997, was $14,000.

**Notes Receivable from Stockholder**

In connection with the Transaction, a stockholder of the Company, who is also an officer, purchased 37,500 shares of common stock from the Company for $250,000. The Company received $50,000 in cash from the stockholder and entered into a note receivable for the remaining balance of $200,000. Subsequent to the Transaction, another officer of the Company acquired 6,247 shares of common stock for $42,000. The Company received $9,000 in cash and entered into a note receivable for the remaining $33,000 due from the officer. The notes accrue interest at 5.54 percent and 5.12 percent, respectively, compounded annually, with any unpaid accrued interest and principal due at the earlier of (1) the sale of the above stock with proceeds received first applied to unpaid interest, then to principal; (2) sale of the Company; (3) 60 days from the date the stockholder is no longer an employee of the Company or a subsidiary; or (4) September 16, 2003 and October 16, 2003, respectively.

## 9. RETIREMENT PLAN:

In October 1996, the Company adopted a 401(k) retirement plan (the Plan) for all full-time employees who have completed six months of service. The plan year is from January 1 to December 31, and the Company will contribute $0.50 for every $1.00 contributed by the employee, subject to the Company's contribution not exceeding 3 percent of the employee's salary.

Participants become fully vested after six years of service, although they vest incrementally on an annual basis after two years of service and until the six-year period is completed. The Company recorded selling, general and administrative expense of $58,000 and $63,000 for the years ended December 31, 1998 and 1997, respectively, for the Company's matching contributions.

Employees of the Company previously contributing to the CalPage 401(k) retirement plan (with identical provisions to the Plan) were able to roll their accumulated benefits into the Plan at date of commencement (October 1, 1996), with all prior employer contributions becoming fully vested on the date of rollover.

## 10. SALE OF ANSWERING SERVICE DIVISION:

In March 1997, the Company sold the customer base and other assets of its answering service division for $420,000, payable $200,000 in cash and a promissory note of $220,000. The promissory note was paid in October 1997 at a discount of $18,000. The Company recognized a net gain of $385,000 on the sale in the year ended December 31, 1997.

## 11. SUBSEQUENT EVENTS:

On January 29, 1999, the Company issued $150,000,000 of senior unsecured ten-year notes (the Senior Notes) at par. The Senior Notes bear interest at 13.5 percent payable in semiannual installments, with principal due on February 1, 2009.

Proceeds of the Senior Notes were used to repay the senior secured borrowings (see Note 3) and to establish an interest reserve account to cover certain initial interest payments due under the Senior Notes.

The Senior Notes carry provisions that allow the Company, at its option, to (i) redeem up to 35 percent of the notes with proceeds of certain public offerings of equity prior to February 1, 2002, (ii) redeem all or part of the notes at specified prices on or after February 1, 2004, or (iii) offer to exchange the notes within 180 days from the issue date for a new issue of identical debt securities registered under the Securities Act of 1933, as amended (the Securities Act). The Company intends to register these notes under the Securities Act during the first six months of 1999.

Basic covenants of these notes restrict the Company's future ability to pay dividends, repurchase stock, pledge or sell assets as security for other transactions, or engage in mergers and business combinations. The covenants allow the Company to incur additional debt subject to various limitations.

In January 1999, the Company's Board of Directors approved the terms of the 1999 Employee Stock Option Plan pursuant to which qualified employees and members of the Board of Directors can be issued options to purchase the Company's common stock. On January 29, 1999, two officers of the Company were granted options to purchase up to 40,625 shares of the Company's common stock at an exercise price of $6.67 per share, which approximated the fair market value of the Company's common stock on the date of grant. These options carry certain vesting privileges that range from 33 percent per year to a four-year cliff vesting schedule based on performance targets beginning on November 1, 1998.

The Company will elect to follow Accounting Principle Board Opinion No. 25 (APB 25) and the disclosure-only provisions of SFAS 123, "Accounting for Stock-Based Compensation," for its employee stock options in future periods. Under APB 25, because the exercise price of the employee stock options equals the estimated fair market value of the underlying stock on the date of the grant, no compensation expense is recorded.

Description, regulations, and rates
applicable to the resale of
intrastate Competitive Network Services
within the operating territory of

Pac-West Telecomm, Inc., d/b/a

PAC - WEST TELECOMM

in the State of

FLORIDA

as provided herein

## CHECK SHEET

All sheets of this tariff are effective as of the date shown at the top of each respective sheet. Original and revised sheets as named below comprise all changes from the original tariff and are currently in effect as of the effective date of this sheet.

| SHEET | REVISION NUMBER | SHEET | REVISION NUMBER |
|---|---|---|---|
| 1 | Original | 33 | Original |
| 2 | Original | 34 | Original |
| 3 | Original | 35 | Original |
| 4 | Original | 36 | Original |
| 5 | Original | 37 | Original |
| 6 | Original | 38 | Original |
| 7 | Original | 39 | Original |
| 8 | Original | 40 | Original |
| 9 | Original | 41 | Original |
| 10 | Original | 42 | Original |
| 11 | Original | 43 | Original |
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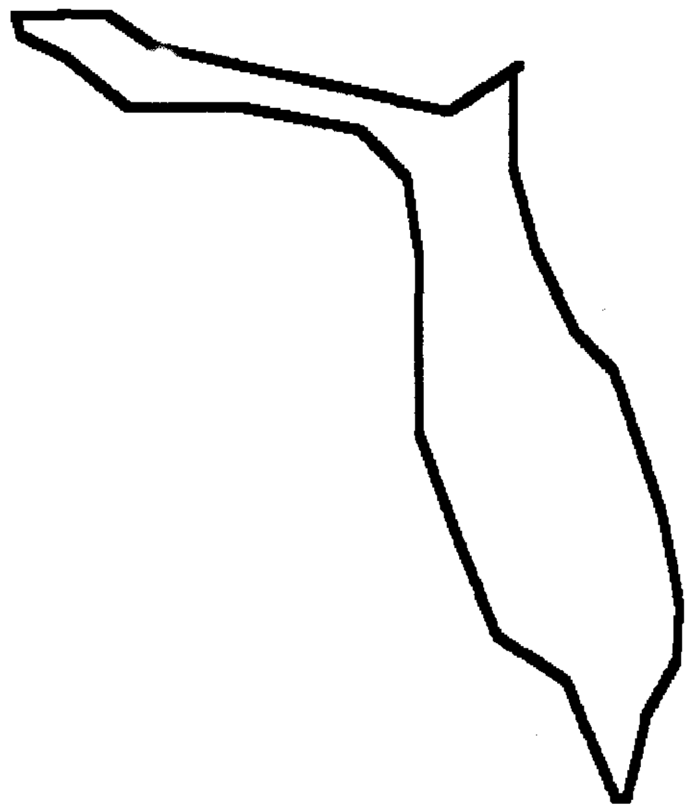
| 30 | Original | | |
| 31 | Original | | |
| 32 | Original | | |

## PRELIMINARY STATEMENT

Pac-West Telecomm has been granted authority by the Florida Public Utilities Commission to provide intrastate network services within the State of Florida. This tariff contains description, regulations and rates for telecommunications services provided by Pac-West Telecomm, Inc.

## SERVICE AREA MAP

The Company provides resold network services in Florida.



## GENERAL TABLE OF CONTENTS

## GENERAL TABLE OF CONTENTS

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### SECTION 2 - GENERAL RULES AND REGULATIONS (Cont'd)



### SECTION 3 - TERMS AND CONDITIONS OF SERVICE

**GENERAL TABLE OF CONTENTS**

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**SECTION 4 - LONG DISTANCE SERVICES**



**SECTION 5 - (RESERVED FOR FUTURE USE)**

**SECTION 6 - (RESERVED FOR FUTURE USE)**

**SECTION 7 - (RESERVED FOR FUTURE USE)**

**SECTION 8 - (RESERVED FOR FUTURE USE)**

**SECTION 9 - (RESERVED FOR FUTURE USE)**

**SECTION 10 - (RESERVED FOR FUTURE USE)**

**SECTION 11 - (RESERVED FOR FUTURE USE)**

**SECTION 12 - (RESERVED FOR FUTURE USE)**

**SECTION 13 - (RESERVED FOR FUTURE USE)**

**SECTION 14 - (RESERVED FOR FUTURE USE)**

**SECTION 15 - MISCELLANEOUS SERVICE CHARGES**

## SECTION 1 - APPLICATION AND REFERENCE

### 1.1 APPLICABILITY

This tariff contains the regulations and rates and charges applicable to resold intrastate Competitive Network Services provided by Pac-West Telecomm, hereinafter referred to as the Company, in the State of Florida.

### 1.2 TARIFF FORMAT

#### 1.2.1 LOCATION OF MATERIAL

The General Table of Contents provides a numerical listing to find the desired section and page for each subject.

#### 1.2.2 SHEET NUMBERING

Sheet numbers appear in the upper right corner of the sheet. Sheets are numbered sequentially. However, new sheets are occasionally added to the tariff. When new sheets fall between existing sheets the numbering of the new sheet will include a decimal followed by additional numbering. For example, a new sheet falling between existing sheets 34 and 35 will be designated as sheet 34.1.

#### 1.2.3 SHEET REVISION NUMBERS

Revision numbers also appear in the upper right corner of the sheet. These numbers are used to determine the most current sheet version on file with the Commission. For example, 1st Revised Sheet 7 replaces Original Sheet 7.

#### 1.2.4 PARAGRAPH NUMBERING SEQUENCE

This document uses nine levels of indentations referred to as Tariff Information Management (TIM) Codes. As outlined below, each level of coding is subservient to its next higher level of coding.

| LEVEL | APPLICATION | EXAMPLE |
|---|---|---|
| 1 | Section Heading | 1. APPLICATION AND REFERENCE |
| 2 | Sub Heading | 1.2 TARIFF FORMAT |
| 3 | Sub Heading | 1.2.1 LOCATION OF MATERIAL |
| 4 | Sub Heading/Text | A. Text |
| 5 | Sub Heading/Text | 1. Text |
| 6 | Sub Heading/Text | a. Text |
| 7 | Sub Heading/Text | (1) Text |
| 8 | Sub Heading/Text | (a) Text |
| 9 | Footnotes | {1} Text |

## SECTION 1 - APPLICATION AND REFERENCE

1.2 TARIFF FORMAT (Cont'd)

1.2.5 CHECK SHEETS

When a tariff filing is made with the Commission, an updated Check Sheet accompanies the tariff filing. The Check Sheet lists the sheets contained in the tariff cross referenced to the current revision number. All revisions made in a given filing are designated by and (*). There will be no other symbols used on this sheet if these are the only changes made to it (i.e., the format, etc. remains the same). The tariff user should refer to the latest Check Sheet to find out if a particular sheet is the most current sheet on file with the Commission.

1.2.6 RATE TABLES

Within the rate tables, four (4) types of entries are allowed:

A. Rate Amount: The rate amount indicates the dollar value associated with the service.

B. N/A: N/A indicates that there is no rate for the service or that a rate amount is not applicable under the specific column header.

C. A footnote designator: The footnote designator indicates that further information is contained in a footnote.

D. ICB: The acronym "ICB" indicates that the product/service is rated on an individual case basis.

## SECTION 1 - APPLICATION AND REFERENCE

1.3 EXPLANATION OF CHANGE SYMBOLS

| SYMBOL | EXPLANATION |
|---|---|
| (C) | To signify changed regulation, term or condition |
| (D) | To signify discontinued material |
| (I) | To signify a rate increase |
| (M) | To signify material moved from or to another part of the Tariff with no change, unless there is another symbol present |
| (N) | To signify new material |
| (R) | To signify a rate reduction |
| (T) | To signify a change in text but no change is rate, regulation, term or condition |

SECTION 1 - APPLICATION AND REFERENCE

1.4 EXPLANATION OF ABBREVIATIONS

| | |
|---|---|
| Cont'd | Continued |
| F.C.C. | Federal Communications Commission |
| LATA | Local Access Transport Area |
| LD | Long Distance |
| MOU | Minutes of Use |
| MTS | Message Toll Service |
| NSF | Non-sufficient Funds |
| PBX | Private Branch Exchange |
| PUC | Public Utilities Commission |
| PWOC | Pac-West Order Code |
| TIM | Tariff Information Management (Code) |
| TOC | Table of Contents |

## SECTION 2 - GENERAL RULES AND REGULATIONS

### 2.1 RULE 1 - APPLICATION AND SCOPE OF TARIFF

#### 2.1.1 APPLICATION

This tariff contains the rates, conditions, and regulations applicable to the regulated intrastate long distance services provided by Pac-West Telecomm, Inc. (Pac-West) between and among points within the state of Florida.

#### 2.1.2 SCOPE

Pac-West's services are provided in Florida subject to the availability of facilities and subject to the terms and conditions of this tariff. All services within the jurisdiction of the Florida Public Utilities Commission provided by Pac-West between and among points in Florida are governed by this tariff.

#### 2.1.3 INTERCONNECTION

Service provided by Pac-West will be provided over facilities provided by carriers other than Pac-West. However, service provided by Pac-West is not part of a joint undertaking with any other carrier providing telecommunications services.

#### 2.1.4 BRIEF DESCRIPTION OF BASIC SERVICES

Pursuant to this tariff and as described in further detail herein, Pac-West provides resold intrastate long distance services.

### 2.2 RULE 2 - DEFINITIONS

Application for Service: A standard order form that includes all pertinent billing, technical, and other descriptive information that will enable the Company to provide the communications service(s) as required.

Applicant: The term "Applicant" means an individual, partnership, corporation, association, or government agency that applies to the Company for any new or additional telephone service.

Authorized User: An person, firm, corporation, or other entity authorized by the Customer to receive or send communications.

Base Rate Area: The term "base rate area" means a closely built up section of an exchange area as shown in the effective and current tariffs of the Local Exchange Companies.

## SECTION 2 - GENERAL RULES AND REGULATIONS

2.2 RULE 2 - DEFINITIONS (Cont'd)

Business Hours: The phrase "business hours" means the time after 8:00 A.M. and before 5:00 P.M., Monday through Friday excluding holidays.

Cancellation of Order: A Customer initiated request to discontinue processing a service order, either in part or in its entirety, prior to its completion.

Commission: The term "Commission" means the Florida Public Utilities Commission.

Company: The term "Company" or "Utility" means Pac-West Telecomm.

Completed Calls: Completed calls are calls answered either manually or electronically at the distance end.

Customer: The person, firm, company, corporation, or other entity which orders or uses service and is responsible, by law, for of charges, as well as, compliance with the Company's regulations pursuant to this tariff.

Customer Provided Equipment: Terminal equipment provided by a Customer.

Delinquent or Delinquency: The terms "delinquent" and "delinquency" refer to an account for which payment has not been paid in full on or before the last day for timely payment.

Disconnection: The disabling of circuitry preventing outgoing and incoming toll communication service provided by the Company.

Local Calling Area: The term "Local Calling Area" means the extended service areas in which the Customer's premises is located, as shown in the current and effective tariffs of The Local Exchange Company(ies).

Local Access Transport Area ("LATA"): The phrase "Local Access Transport Area" means a geographical area established by the U.S. District Court for the District of Columbia in Civil Action No. 820192.

Message: A completed telephone call by a Customer or User.

Premises: The space occupied by an individual customer in a building or in adjoining buildings occupied entirely by the Customer, or on contiguous property occupied by the Customer separated only by a public thoroughfare, a railroad right-of-way, or a natural barrier.

Service Connection Fee: The term "service connection fee" means the charge for establishing or re-establishing service to a Customer.

## SECTION 2 - GENERAL RULES AND REGULATIONS

2.2 RULE 2 - DEFINITIONS (Cont'd)

Terminal Equipment: All telephone instruments, including pay telephone equipment, the common equipment of large and small key and PBX systems and other devices and apparatus, and associated wiring, which are intended to be connected electrically, acoustically, or inductively to the telecommunications system of the telephone utility.

2.3 RULE 3 - DESCRIPTION OF SERVICE

The Company provides intrastate network services to Customer's for their direct transmission of voice, data, and other types of telecommunications.

Communications originate when the Customer accesses the Company directly or through the facilities of the local service carrier via one or more access lines, equal access or on a dial-up basis. The local service carrier may act as the Customer's agent for ordering access connection facilities provided by other carriers or entities when authorized by the Customer, to allow connection of a Customer's location to the Company's network. The Customer shall be responsible for all charges due for such service arrangements.

The Company's services are provided on a monthly basis, (30 days) and are available twenty-four (24) hours per day, seven (7) days per week.

2.3.1 APPLICATION OF RATES

The application of rates to the services provided by the Company is governed by the actual or obvious use made of the service by the Customer.

2.3.2 LIMITATION OF SERVICE

The Company does not undertake, by this tariff, to provide, maintain, repair, or operate any wiring, equipment, facilities, or service on the Customer's side of the point of demarcation The point of demarcation is specified in the demarcation tariff schedules of the Local Exchange Company(ies) filed with the Commission that are current and effective as of the effective date of this tariff sheet.

All services are subject to the initial and continuing availability of the Company's facilities and necessary services and facilities furnished by any underlying carriers. The Company reserves the right to refuse to provide service in cases where the costs of providing such service, including charges to the Company for necessary facilities and services furnished by underlying carriers, render the Company, in its sole judgement, unable to furnish service on an economical basis.

## SECTION 2 - GENERAL RULES AND REGULATIONS

### 2.4 RULE 4 - APPLICATION OF SERVICE

Application for new or additional services may be made by mail or in person. If the Company has reason to believe that an Applicant has defrauded, is defrauding, or intends to defraud the Company, or if other good cause exists, the Company may refuse to accept an application for service by mail and may, instead, require the Applicant to apply for service in person and to provide identification acceptable to the Company and to sign a completed service order. In addition, Applicants may be required to meet credit or deposit requirements as set forth in this tariff.

At the time of all initial contacts for service, Applicants will be informed of the basic services available to the class of Customer to which the Applicant belongs.

In the event the Company, at its sole option, accepts an oral request for service, the Company will, within 10 days of initiating the service order, provide a confirmation letter setting forth a brief description of the services ordered and itemizing all charges that will appear on the customer's bill. The letter will be in the language in which the sale was made.

Applicants whose requests for service are accepted by the Company are responsible for all charges for services provided by the Company, including any charges to the Company is assessed by any underlying carrier for special arrangements or services undertaken on the Applicant's behalf. In the event an Applicant cancels, the Applicant remains responsible for any non-recoverable costs incurred by the Company in meeting the Applicant's request prior to cancellation, change, deferral, or modification, including any charges to the Company assessed by any underlying carrier for special arrangements or services undertaken on the Applicant's behalf. Notwithstanding the foregoing, an Applicant will not be liable for any charges or non-recoverable costs that were not disclosed to the Applicant by the Company before initiating service.

Applicants who are denied service due to failure to establish credit or pay a deposit will be given the reason for the denial in writing within 10 days of the denial of service.

### 2.5 RULE 5 - CONTRACTS

The Company and a Customer may enter into a contract for service to be provided under a specified rate plan for a specified term, which term may be automatically renewed if agreed to by the parties. Unless otherwise provided, contracts may be terminated by the Customer only upon providing the Company with thirty (30) days advance written notice. In the event the effective date of termination is prior to the end of the current contract term the Customer will be liable for a termination fee equal to the sum of the recurring service charges specified for the remainder of the contract.

## SECTION 2 - GENERAL RULES AND REGULATIONS

### 2.6 RULE 6 - SPECIAL INFORMATION REQUIRED ON FORMS

#### 2.6.1 CUSTOMER BILLS

The Company will be identified on each bill. Each bill will prominently display a toll-free number for service or billing inquiries, along with an address where the Customer may write. If the Company uses a billing agent, the Company will also include the name of the billing agent. Each bill for telephone service will contain notations concerning the following areas:

- When to pay the bill;
- Billing detail including the period of service covered by the bill;
- Late payment charge and when applied;
- How to pay the bill;
- Questions about the bill;
- Network access for interstate calling;
- In addition to the above, each bill will include the following statement:

The bill is due and payable upon receipt; it becomes subject to a late payment charge if not paid within 15 calendar days of the due date, which is the date of mailing, as shown by the postmark on the billing envelope, or such later date as shown on the bill itself. An explanation of the bill may be requested from the Company.

#### 2.6.2 DEPOSIT RECEIPTS

Each deposit receipt shall contain the following provisions:

This deposit, less the amount of any unpaid bills for service furnished by the Company, shall be refunded, together with any interest due, within 30 calendar days after the discontinuance of service, or after 12 months of service, whichever comes first. However, deposits may not receive interest if the Customer has received a minimum of two notices of discontinuance of service for nonpayment of bills in a 12-month period.

### 2.7 RULE 7 - ESTABLISHMENT AND REESTABLISHMENT OF CREDIT

Each Applicant must provide credit information satisfactory to the Company or pay a deposit.

#### 2.7.1 A DEPOSIT WILL NOT BE REQUIRED IF

The Applicant provides a credit history acceptable to the Company. Credit information contained in an Applicant's account record may include, without limitation, account establishment date, 'can-be-reached' number, name of employer, employer's address, driver's license number or other acceptable personal identification, billing name, and location of current and previous service. Credit will not be denied for failure to provide a social security number. A cosigner or guarantor with a credit history acceptable to the Company agrees in writing to be responsible for all charges.

## SECTION 2 - GENERAL RULES AND REGULATIONS

2.7 RULE 7 - ESTABLISHMENT AND REESTABLISHMENT OF CREDIT (Cont'd)

2.7.2 IF A DEPOSIT IS REQUIRED

The Company will not refuse a deposit to establish credit for service. However, the Company may request the deposit to be in cash or another acceptable form of payment (e.g., cashier's check, money order, bond, or letter of credit.)

2.8 RULE 8 - DEPOSITS AND ADVANCE PAYMENTS

2.8.1 DEPOSITS

The Company may require an Applicant or an existing Customer who fails to establish a satisfactory credit history to post a deposit as a guarantee for the payment of charges as a condition to receiving service or additional services. The Company reserves the right to review an Applicant's or Customer's credit history at anytime to determine if a deposit is required.

A. Amount

The amount of the deposit will not exceed the charges for two months of service based on the Applicant or Customer's average bills during the previous twelve months. When, in the Company's judgement circumstances so require, the amount of the deposit may be based on an estimate of two month's service determined from the Customer's past usage, the Customer's own estimate of expected usage, or the Company's network average usage considering the type and nature of the Customer's service.

B. Nondiscrimination

Deposit requirements will not be based on race, sex, creed, national origin, marital status, age, number of dependents, condition of physical handicap, source of income, or geographical area of business.

C. Refund or Credit

Upon discontinuance of service or prompt and timely payment of all charges for twelve consecutive billing periods, whichever comes first, the Company will refund the deposit together with any interest due. In the case of discontinuance of service , the Company will credit the deposit to the charges stated on the final bill. The balance, if any, will be returned to the Customer within 30 days after the discontinuance of service. In the case a refund is due after timely payments of the Company's charges, the Company will refund the deposit and interest within 30 days. Payment of a charge is satisfactory if received prior to the date that the charge becomes delinquent provided that it is not returned for insufficient funds or closed account.

## SECTION 2 - GENERAL RULES AND REGULATIONS

2.8 RULE 8 - DEPOSITS AND ADVANCE PAYMENTS (Cont'd)

2.8.1 DEPOSITS (Cont'd)

D. Interest

Interest will be paid on deposits annually at a rate of 6%, in accordance with the rules of the Commission, except under the following condition: no interest shall be given if the Customer has received two or more notices of discontinuance of service within a 12 month period in accordance with Rule 9, following.

2.8.2 ADVANCE PAYMENTS

At the time an application for service is made, an Applicant may be required to pay an amount equal to one month's service charges and applicable service connection charges. The amount of the first month's service charges and applicable service connection charges will be credited to the Customer's account on the first bill rendered.

Negotiation of a Customer's advance payment shall not itself obligate the Company to provide services or continue to provide service if a later check of Applicant's credit record is unacceptable to the Company and no deposit has been tendered. In the event service is not provided, the advance payment will be refunded.

2.9 RULE 9 - PROVISION OF NOTICES AND INFORMATION

2.9.1 GENERAL

Unless otherwise provided by these Rules, any notice by the Company to a Customer may be given either verbally to the Scriber or to the Customer's authorized representative, by written notice mailed to the Customer's last known address. Where written notice is given, the notice will be of legible size and printed in type having a minimum point size of 10. Mailed notices will be deemed given on the date of mailing as shown by the postmark on the notice or envelope that contains the notice.

Unless otherwise provided by these Rules, any notice by the Customer or its authorized representative may be given verbally to the Company by telephone or at the Company's business office or by written notice mailed to the Company's business office.

Customers are responsible for notifying the company of their desire to discontinue service on or before the date of disconnection. Such notice either may be verbal or written.

2.9.2 RATE INFORMATION

Rate information and information regarding the terms and conditions of service will be provided in writing upon request by an Applicant or Customer. Customers will be advised of optional service plans in writing as they become available. In addition, Customers will be advised of changes to the terms and conditions of service no later than the Company's next billing cycle.

## SECTION 2 - GENERAL RULES AND REGULATIONS

2.9 RULE 9 - PROVISION OF NOTICES AND INFORMATION (Cont'd)

2.9.3 NOTICE OF TERMINATION

Notices to discontinue service for nonpayment of bills will be provided in writing by first class mail to the Customer not less than 7 calendar days prior to termination. Each notice will include all of the following information:

- The name and address of the Customer.
- The amount that is delinquent
- The date when payment or arrangements for payment must be made in order to avoid termination.
- The procedure the Customer may use to initiate a complaint or to request an investigation concerning service or charges.
- The telephone number of the Company's representative who can provide additional information or institute arrangements for payment.
- The telephone number or the address of the Commission's Consumer Services Branch where the Customer may direct inquiries.

2.9.4 CHANGE OF OWNERSHIP OR IDENTITY

The Company will notify Customers in writing of a change in ownership or identity in the Company's next monthly billing cycle.

2.9.5 PRIVACY

The Company will, in accordance with the provisions below, furnish Customers with a written description of how it handles Customers' private information and a disclosure of any ways that such information might be used or transferred that would not otherwise be obvious to the Customer. This information will be provided at the time service is initiated and annually thereafter.

- Disclosure of Telephone Numbers During 800, 888 and 900 Calls

  The Company will provide an annual written notice to all Customers that use of 800, 888, and 900 numbers may result in disclosure of the Customer's telephone number to the called party.

## SECTION 2 - GENERAL RULES AND REGULATIONS

2.9 RULE 9 - PROVISION OF NOTICES AND INFORMATION -(Cont'd)

2.9.5 PRIVACY (Cont'd)

The foregoing provision does not apply to: (i) identification services used within the same limited system, including, but not limited to, a Centrex or private branch exchange system, as the recipient telephone; (ii) identification services that are used on public agencies' emergency telephone lines or on lines that receive the primary emergency telephone number (911); (iii) identification services provided in connection with legally sanctioned call tracing or tapping procedures and (iv) identification services in connection with 800, 888, or 900 access code services.

2.9.6 OTHER

On request, the Company will provide each Applicant and Customer with the following information:

The Florida Public Utilities Commission identification number or its registration to operate as a telecommunications corporation within Florida.

The address and telephone number of the Florida Public Utilities Commission to verify its authority to operate.

A toll free number to call for service or billing inquiries, along with an address where the Applicant or Customer may write the Company.

A full disclosure of all fictitious names under which the Company operates.

The names of billing agents the Company used in place of performing the billing function itself.

2.10 RULE 10 - RENDERING AND PAYMENT OF BILLS

2.10.1 ISSUANCE OF BILLS

Customers' bills are issued monthly. The Customer will receive bills on or about the same day of each month. Months are presumed to have 30 days. The billing date is dependent on the billing cycle assigned to the Customer. Each bill contains monthly recurring charges billed in advance, usage charges billed in arrears, and the last date for timely payment. Recurring charges will be prorated in the event that the service for which the charges are made is less than 30 days.

2.10.2 BILLING STATEMENT DUE DATE

Bills are due and payable as specified on the bill. Bills may be paid by mail or in person at the Company's business office or an agency authorized to receive such payment. All charges for service are payable only in United States currency. Payment may be made by cash, check, money order or cashier's check.

## SECTION 2 - GENERAL RULES AND REGULATIONS

2.10 RULE 10 - RENDERING AND PAYMENT OF BILLS (Cont'd)

2.10.3 CUSTOMERS' PAYMENTS

Customer's payments are considered prompt when received by the Company or its agent within 15 days of the due date. The Company or its agent will credit payments within 24 hours of receipt. The due date is the date the bill is mailed, as shown by the postmark on the billing envelope, or such later date as set forth on the Customer's bill.

2.10.4 DEMAND FOR PAYMENT

However, if a Customer's service has been discontinued within the past 12 months or if a Customer incurs usage charges during a billing period which are equal to at least 200% of the amount of the Customer's deposit or guarantee, payment may be demanded for the usage charges by a telephone call to the Customer followed by written notification of such demand sent by first class mail. If the usage charges remain unpaid for five days from the rendition of the written notification or a mutually established late payment arrangement date or 30 days from the date of the bill, the usage charge will be deemed delinquent.

2.10.5. LATE PAYMENT CHARGES

Charges deemed delinquent will be subject to a late payment charge accruing at the rate of 1.5% per month from the due date on all delinquent amounts.

2.10.6 CURRENT CHARGES

A bill will not include any previously unbilled charge for service furnished prior to three months immediately preceding the date of the bill, except charges for collect calls, credit card calls, third party calls and "error file" calls (those calls that cannot be billed due to the unavailability of complete billing information to the Company), which shall have a six month back billing period.[1]

2.10.7 RETURN CHECK CHARGE

In the event a Customer pays all or any portion of a bill by check and the check is returned unpaid for any reason, the Customer will be assessed a charge per returned check as shown in 15.1.4, following. The Company may require the Customer to make payment in cash, by money order, certified check, or other means which guarantee the Customer's payment. A Customer who tenders and insufficient check shall in no way be relieved of the obligation to render payment to the Company under the original terms of the bill nor defer the Company's provision for termination of service for non-payment of bills.

[1] Applies to usage only.

## SECTION 2 - GENERAL RULES AND REGULATIONS

2.11 RULE 11 - DISPUTED BILLS

In the event a Customer disputes the amount of a bill for the Company's service, the Customer shall pay the undisputed portion of the bill and notify the Company that such unpaid amount is in dispute prior to the delinquent date of the bill. Upon receipt of the Customer's notice of dispute, the Company will conduct and investigation and review the disputed amount. If the Company is notified of such dispute in writing, the Company will notify the Customer of receipt of a written dispute within five (5) working days.

The Company will withhold disconnection of service until the investigation is completed and the Customer is informed of the results. Once the Customer has received the results of such investigation, the Customer shall submit payment of any outstanding charges within five (5) working days. Failure to make full payment shall be grounds for termination of service.

In the event the Customer and the Company cannot resolve a service and or bill dispute, the Company shall inform the Customer of his right of appeal to the Commission prior to the termination of service.

Any unresolved disputes may be directed to:

Florida Public Utilities Commission
Consumer Affairs
2540 Shumard Oak Blvd.
Tallahassee, Florida

Toll Free 1-800-342-3552

To avoid having service disconnected payment arrangements acceptable to the Company should be made pending the outcome of the Commission's Consumer Services review. The Consumer Services Division of the Commission shall review the basis of the billed amount, communicate the results of its review to the parties and inform you of your recourse to pursue the matter further with the Commission.

All bills rendered during the resolution of the dispute by the Commission, unless made part of the initial dispute, shall be due and payable on the current statement's due date. If the Customer fails to pay such bills, the Company may implement normal termination procedures.

## SECTION 2 - GENERAL RULES AND REGULATIONS

### 2.12 RULE 12 - DISCONTINUANCE AND RESTORATION OF SERVICE

#### 2.12.1 DISCONTINUANCE BY CUSTOMER

Customers may discontinue service by giving the Company proper notice as specified in the Company's tariff. The subscriber is responsible for payment of all charges incurred for the period during which service is rendered. In addition, if termination occurs prior to the end of a current contract term, the customer may be liable of a termination fee as provided in Rule 5, proceeding.

No minimum or termination charge will apply if service is terminated because of condemnation, destruction, or damage to the property by fire or other causes beyond the control of the Customer.

#### 2.12.2 DISCONTINUANCE BY THE COMPANY

The Company may discontinue service under the following circumstances:

Incurring charges not covered by a deposit or guarantee and evidencing an intent not to pay such charges when due.

Nonpayment of any sum due to the Company for service more than 15 days beyond the due date. This include charges for services at a previous location, or if the Customer receives service at one or more than one location, at any such location.

In the event an action is brought for nonpayment, the non-prevailing party may be liable for reasonable court costs and attorney's fees as determined by the Commission or by the court.

A violation of, or failure to comply with, any regulation governing the furnishing of service.

Failure to post a required deposit or guarantee.

In the event that the Customer supplied false or inaccurate information of a material nature in order to obtain service.

Incurring charges not covered by a deposit or guarantee and evidencing an intent not to pay such charges when due.

Any violation of the conditions governing the furnishing of service.

The Company may refuse service, refuse to resume service, or terminate service without giving notice otherwise required by these rules:

- If an unsafe or hazardous condition related to the service exists on the premises of the Customer;

## SECTION 2 - GENERAL RULES AND REGULATIONS

2.12 RULE 12 - DISCONTINUANCE AND RESTORATION OF SERVICE (Cont'd)

2.12.2 DISCONTINUANCE BY THE COMPANY (Cont'd)

- If the use of the service on the premises of the Customer is determined by the Company to be detrimental or damaging to the facilities or services of the Company or its other Customers
- Upon the order of any court of competent jurisdiction or the Florida Public Utilities Commission;
- Upon written determination by a magistrate that there is probable cause to believe that the service:
- Is prohibited by law; or
- Is being used or is to be used, directly or indirectly, to violate or assist in violation of the law.
- If the Company determines, based upon the acts of the Customer or the condition of the Customer's premises, that the Customer has defrauded, is defrauding, or intends to defraud the Company, unless the conditions constituting the fraud have been corrected;
- If an event in nature of force majeure or vis major occurs that requires the termination of service; or
- If the location at which the service is provided has been abandoned.

Except as otherwise provided in this tariff, the Company will provide notice to the Customer of its intent to terminate service.

Service may be discontinued during business hours on or after the date specified in the notice of discontinuance, which date will be at least 7 days after such notice is given. Service will not be discontinued on any Saturday, Sunday, legal holiday, or any other day when the Company's offices are not available to facilitate reconnection of service.

2.12.3 RESTORATION OF SERVICE

The Company will restore service to a Customer upon full payment of all amounts due and the Customer's payment of a deposit or reestablishment of credit. However, the Company may refuse to accept a personal check if the Customer's check for payment of service has been dishonored, excepting bank error, within the last twelve months. The Company will impose a charge for restoration of service after disconnection in accordance with its tariff.

Or, the Company will resume service upon the order of any court of competent jurisdiction or the Florida Public Utilities Commission.

## SECTION 2 - GENERAL RULES AND REGULATIONS

### 2.13 RULE 13 - INFORMATION TO BE PROVIDED TO THE PUBLIC

A copy of this tariff will be available for public inspection in the Company's business office during regular business hours.

A copy of this tariff will be provided by the Company on request upon payment of a nominal fee to cover postage and copying costs.

### 2.14 RULE 14 - CONTINUITY OF SERVICE

In the event that the Company has advance knowledge of an interruption of service for a period exceeding 24 hours, the Company will attempt to notify Customers in writing at least one week in advance.

Upon reasonable notice, any equipment provided by the Company shall be made available to the Company for such tests and adjustments as may be necessary to maintain them in satisfactory condition. No interruption allowance will be granted for the time during which such tests and adjustments are made.

### 2.15 RULE 15 - LIMITATION OF LIABILITY

The provisions of this rule do not apply to errors and omissions caused by willful misconduct, fraudulent conduct, or violations of law.

In the event an error or omission is caused by the gross negligence of the Company, the liability of the Company shall be limited to and in no event exceed the sum of $10,000.

#### 2.15.1 INDEMNIFICATION

A Customer shall indemnify and save the Company harmless against all claims arising out of the Customer's use of the Company's service, including but not limited to the following:

- Acts of omissions of other companies when their facilities are used to provide service; and
- Claims for libel, slander, or infringement of copyright arising from material transmitted over said facilities; claims for infringement of patents arising from the Customer's combining apparatus and systems of the Customer with, or using apparatus and systems of the Customer in connection with, the facilities of another company; and
- all other claims arising out of any act or omission of the Customer in connection with facilities provided by any Company.

Fraudulent usage of employees or third persons, including but not limited to usage originating outside the Customer's premises but routed through the Customer's PBX or other equipment or facilities.

## SECTION 2 - GENERAL RULES AND REGULATIONS

2.15 RULE 15 - LIMITATION OF LIABILITY (Cont'd)

2.15.2 FURNISHING OF SERVICES

The Company's obligation to furnish service is dependent upon its ability to secure and retain suitable facilities and rights for the provision of the service without unreasonable expense. The Company makes no warranty, whether express, or implied or statutory, as to the description, quality, merchantability, completeness or fitness for any purpose of service or local access, or as to any other matter, all of which warranties by the Company are hereby excluded and disclaimed.

2.15.3 TRANSMITTING MESSAGES

The Company shall not be liable for errors in transmitting, receiving, or delivering oral messages by telephone over the lines of the Company and connecting utilities.

2.15.4 LIABILITY OF THE COMPANY

The Company's liability, if any, for damages arising out of its negligent provision of any service or failure to provide any service, or for mistakes, omission, interruptions, delays, error, or defects in transmission during the course of furnishing service, shall in no event exceed an amount equivalent to the Company's charges for service during the period affected by such negligence, or in which such mistakes, omissions, interruptions, delays, errors, or defects in transmission occurred, provided that the Company will have no such liability for such damages incurred at any time prior to 48 hours following the time the Customer notifies the Company of the negligence, or mistake, omission, interruption, delay, error, or defect in transmission. In no event will the Company be responsible for any lost profits, consequential damages, or incidental damages of the Customer or any other party, or for any claim of damage by the Customer or against the Customer by any other party. Any mistakes, omissions, interruptions, delays, errors, or defects in transmission or service that are caused by or contributed to by the negligence or willful acts of the Customer, or that arise from facilities or equipment used by the Customer, shall not result in the imposition of any liability upon the Company.

The Company will not be liable for any act, omission to act, negligence, or defect in the quality of service of any underlying carrier or other service provider whose facilities or services are used in furnishing any portion of the service received by the Customer.

The Company will not be liable for any failure of performance due to causes beyond its control, including by not limited to cable dig-up by a third party, acts of God, civil disorders, actions of governmental authorities, actions of civil or military authority, labor problems, national emergency, insurrection, riots, war, fire, flood, atmospheric conditions, or other phenomena of nature, such as radiation. In addition, the Company will not be liable for any failure of performance due to necessary network reconfiguration, system modifications for technical upgrades, or actions taken by any court or governmental agency having jurisdiction over the Company.

## SECTION 2 - GENERAL RULES AND REGULATIONS

2.15 RULE 15 - LIMITATION OF LIABILITY (Cont'd)
2.15.4 LIABILITY OF THE COMPANY (Cont'd)

The Company will not be liable for any failure of performance caused by or the result of any act or omission by the Customer or any entity other than the Company who furnishes services, facilities, or equipment used in connection with the Company's services or facilities.

2.15.5 OVERPAYMENT

The Company will not be obligated to refund any overpayment by a Customer unless a written claim for such overpayment, together with substantiating evidence that will reasonably permit the Company to verify such claim, is submitted within 120 days of the alleged overpayment.

2.15.6 DISCLAIMER OF WARRANTIES

Except as expressly provided in this tariff, the Company makes no expressed or implied representations, or warranties, including warranties regarding merchantability of fitness for a particular purpose.

2.16 RULE 16 - USE OF SERVICE FOR UNLAWFUL PURPOSES

The Company's services are furnished subject to the condition that they will not be used for any unlawful purpose. Service will not be furnished if any law enforcement agency, acting within its jurisdiction advises that such services are being used or are likely to be used in violation of the law. If the Company receives other evidence giving reasonable cause to believe that such services are being or are likely to be so used, it will either discontinue or deny the services or refer the matter to the appropriate law enforcement agency.

2.17 RULE 17 - UNAUTHORIZED USE

Any individual who uses or receives the Company's service, other than under the provisions of an accepted application for service and a current Customer relationship, shall be liable for both the tariffed cost of the service received and the Company's cost of investigation and collection.

2.18 RULE 18 - LIMITATION OF AVAILABILITY

All services provided by the Company are subject to the initial and continuing availability of necessary facilities furnished by the Company and connecting carriers and may not be available in all locations.

2.19 RULE 19 - LOCAL TAXATION

Any county, municipality, or other taxing agency that requires the Company to pay a tax or fee based on revenues generated from the provision of services to Customers within the agency's jurisdiction shall furnish the Company with a listing of all address within its jurisdiction. Such listing must be on a magnetic computer media in a form acceptable to the Company that will allow the Company to identify all Customers to which the tax or fee applies.

## SECTION 2 - GENERAL RULES AND REGULATIONS

2.20 RULE 20 - SPECIAL PROMOTIONAL OFFERINGS

The Company may, from time to time upon prior approval to the Commission, engage in Special Promotional Offerings or Trial Service Offerings limited to certain dates, times, or locations designed to attract new subscribers or to increase subscribers awareness of a particular tariff offering

2.21 (RESERVED FOR FUTURE USE)

2.22 RULE 22 - CHANGE OF SERVICE PROVIDER

2.22.1 SOLICITATION OF CUSTOMER AUTHORIZATION FOR SERVICE TERMINATION OR TRANSFER

Solicitation by the Company or other carriers, or their agents, of a Customer authorization for termination of service with an existing carrier and the subsequent transfer to a new carrier must include current rate information on the new carrier and information regarding the terms and conditions of service with the new carrier. All such solicitations must be legible, clear, conspicuous and printed with a type of sufficient size and readable type to be clearly legible, comparable to the type size and style used in any promotional materials accompanying the sales/marketing offer. The authorization agreement shall also be in the same language as any promotional or inducement materials provided to the customer and include (1) the Customer's name and billing address, (2) a notation of each telephone number to be covered by any change in provider, (3) if applicable, a statement that the Customer intends to change from one provider to another, and (4) a statement that the Customer understands there may be a charge for the change in service. The authorization agreement shall be signed by the Customer before any change may be made in the Customer's provider, and before any charge for any product or service may be placed on the Customer's bill. The Company or their agents may not use a sweepstakes, contest or drawing entry as authorization to change or add services to a Customer's bill or change a Customer's telecommunications service provider.

2.22.2 UNAUTHORIZED SERVICE TERMINATION AND TRANSFER

The Company or other carrier, as applicable, will be held liable for both the unauthorized termination of service with an existing carrier and the subsequent transfer to its own service. The Company and other carriers are responsible for the actions of their respective agents that solicit an authorized service termination and transfers. After notice and an opportunity for a hearing, if the Commission determines that a telecommunications provider has violated any provision of the laws relating to making a change in telecommunication service providers or billing for unauthorized services, the Commission may impose an administrative penalty not to exceed $25,000 per day or amend, suspend or revoke any certificate as specified in Sec.364.285.F.S.

2.23 (RESERVED FOR FUTURE USE)

## SECTION 2 - GENERAL RULES AND REGULATIONS

2.24 RULE 24 - TAXES AND SURCHARGES

2.24.1 TAXES

In addition to the charges specifically pertaining to the Company's services, certain federal, state and municipal taxes and fees will be applied. These taxes and fees are based upon the amount billed to the Customer for the Company's intrastate services.

2.24.2 (RESERVED FOR FUTURE USE)

2.25 RULE 25 - CREDIT ALLOWANCES FOR INTERRUPTION OR IMPAIRMENT OF SERVICE

It shall be the obligation of the Customer to immediately notify the Company of any service interruption. Before giving such notice, the Customer shall ascertain that the trouble is not being caused by any action or omission by or within the Customer's control and is not in wiring or equipment connected to the Company terminal.

The Company will not provide a credit allowance for interruptions of service caused by the Customer's facilities, equipment, or systems.

Except as provided in 2.15.4 preceding, the liability of the Company for damages arising out of mistakes, omissions, interruptions, delays, errors, or defects in any of the services furnished by the Company under this tariff for intrastate long distance service, shall in no event exceed an amount equal to the pro-rated charges to the Customer for the period during which the services or facilities are affected by the mistake, omission, interruption, delay, error, or defect, provided, however, that where any mistake, omission, interruption, delay, error, or defect in any one service or facility affects or diminishes the value of any other service said liability shall include such diminution, but in no event shall the liability exceed the total amount of the charges to the Customer for all services or facilities for the period affected by the mistake, omission, interruption, delay, error, or defect.

A credit allowance for interruptions of service which are not due to the Company's testing or adjusting, to the negligence of the Customer, or to the failure of channels, equipment and/or communications systems provided by the Customer, are subject to the general liability provisions set forth in this tariff.

The Company shall have the right to make necessary repairs or changes in its facilities at any time and will have the right to suspend or interrupt service temporarily for the purpose of making the necessary repairs or changes in its system. When such suspension or interruption of service for any appreciable period is necessary, the Company will give the Customers who may be affected as reasonable notice thereof as circumstances will permit, and will prosecute the work with reasonable diligence, and if practicable at times that will cause the least inconvenience.

When the Company is repairing or changing its facilities, it shall take appropriate precautions to avoid unnecessary interruptions of conversations or Customer's service.

## SECTION 3 - TERMS AND CONDITIONS OF SERVICE

### 3.1 TERMS AND CONDITIONS

All terms and conditions relating to the individual service offerings found in this tariff, as specified on the List of Services, following, can be found in the tariff sections indicated next to that service. All of these terms and conditions are applicable to the provision of service from this tariff.

#### 3.1.1 LIST OF SERVICES

| | | Refer to Section |
|---|---|---|
| A. | Long Distance Service | 4 |
| | IntraLATA/interLATA Long Distance Service | 4.1 |

## SECTION 4 - LONG DISTANCE SERVICE

4.1 INTRALATA/INTERLATA LONG DISTANCE SERVICE

4.1.1 TERMS AND CONDITIONS

Pac-West long distance services are either intraLATA or InterLATA telephone services that allow customers to originate and terminate calls at locations within the state of Florida.

4.1.2 AVAILABILITY

Pac-West offers its long distance services in Florida. In some cases Pac-West's long distance services may be add-ons to interstate long distance services provided by Pac-West, and are available as provided in Pac-West's interstate tariff.

4.1.3 TIMING OF CALLS

The chargeable time for a long distance call is determined by the duration of the call. Chargeable time begins when connection is established between the calling station and the called station. Chargeable time ends when the calling station hangs up. If the called station hangs up, but the calling station does not, chargeable time ends when the connection is released by either automatic timing equipment in the telecommunications network or by an operator. Calls are billed in six (6) second increments with an eighteen (18) second minimum for outbound calling and twenty-four (24) seconds for inbound calling.

4.1.4 CUSTOMER RESPONSIBILITY

The Customer is liable for the charges for all long distance calls made on the Customer's line(s)/ trunk(s), even if these calls are the result of fraudulent use of the Customer's services.

4.1.4 RATES

The following rates apply to intrastate long distance calling. All charges are rounded up and all calls are billed in increments of one cent. There is no time of day discount.

| | Charge |
|---|---|
| Outbound usage Rates (per minute) | |
| IntraLATA | $.178 |
| InterLATA | $.178 |

| | Charge |
|---|---|
| Inbound usage Rates (per minute) | |
| IntraLATA | ICB |
| InterLATA | ICB |

## SECTION 5 – (RESERVED FOR FUTURE USE)

## SECTION 6 - (RESERVED FOR FUTURE USE)

**SECTION 7 - (RESERVED FOR FUTURE USE)**

## SECTION 8 - (RESERVED FOR FUTURE USE)

## SECTION 9 - (RESERVED FOR FUTURE USE)

SECTION 10 - (RESERVED FOR FUTURE USE)

## SECTION 11 - (RESERVED FOR FUTURE USE)

**SECTION 12 - (RESERVED FOR FUTURE USE)**

## SECTION 13 - (RESERVED FOR FUTURE USE)

## SECTION 14 - (RESERVED FOR FUTURE USE)

## SECTION 15 - MISCELLANEOUS SERVICE CHARGES

### 15.1 MISCELLANEOUS CHARGES

#### 15.1.1 EARLY TERMINATION CHARGES

If a Customer terminates service prior to the expiration date of the term of a contract, the Customer will be required to pay an early termination charge in accordance with the Customer's contract for service.

#### 15.1.2 THIRD PARTY VENDOR CHARGES

Customers may also be charged for certain charges incurred by Pac-West in obtaining services (at the Customer's request) from third party vendors. At the earliest opportunity, the Customer will be advised of the nature of the charges and the estimated amount of the charges.

#### 15.1.3 SERVICE RESTORATION

This charge applies to restore service that has been temporarily suspended discontinued by the Company.

| | Charge |
|---|---|
| -per residence line, | $20.00 |
| - per business line or trunk | $40.00 |

#### 15.1.4 NON-SUFFICIENT FUNDS CHARGES

This charge applies when a check has been returned by the bank for non-payment.

| | Charge |
|---|---|
| Per occasion | $20.00 or 5% of the value, whichever is greater. |

#### 15.1.5 SUPERSEDURE

The Company will permit a change in the identity of the Customer to a working service, provided that the new Customer meets the Company's credit and other eligibility criteria and the new Customer's use of the service is in accordance with applicable tariff provisions. In cases where the service subject to supersedure is provided pursuant to an existing contract, the new Customer must agree to accept all obligations under the contract, including, but not limited to, any charges for early termination. Supersedure will not become effective until the Company receives notice from the outgoing Customer agreeing to supersedure and arrangements satisfactory to the Company are made to assure payment of all obligations due prior to supersedure.

## SECTION 15 - MISCELLANEOUS SERVICE CHARGES

15.1 MISCELLANEOUS CHARGES (Cont'd)

15.1.5 SUPERSEDURE (Cont'd)

A. Charge

The Supersedure charge covers the change in billing only. All requests for changes in service at the time of supersedure are subject to normal charges.

| | Charge |
|---|---|
| -per line or DS0 equivalent channel | $20.00 |