MCLEODUSA INC
Form S-1
March 22, 2007

Use these links to rapidly review the document

As filed with the Securities and Exchange Commission on March 22, 2007

Registration No. 333-

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM S-1

**REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933**

McLeodUSA Incorporated

(Exact name of registrant as specified in its charter)

Delaware	**4813**	**42-1407240**
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

**One Martha's Way
Hiawatha, Iowa 52233
(319) 790-7800**

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

**Royce J. Holland
President and Chief Executive Officer
McLeodUSA Incorporated
One Martha's Way
Hiawatha, Iowa 52233
(319) 790-7800**

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

David A. Westenberg, Esq. **Wilmer Cutler Pickering Hale and Dorr LLP** **60 State Street** **Boston, Massachusetts 02109** **Telephone: (617) 526-6000** **Telecopy: (617) 526-5000**	**Bernard L. Zuroff, Esq.** **Group Vice President General Counsel** **McLeodUSA Incorporated** **One Martha's Way** **Hiawatha, Iowa 52233** **Telephone: (319) 790-7800** **Telecopy: (319) 790-7008**	**Nazim Zilkha, Esq.** **White & Case LLP** **1155 Avenue of the Americas** **New York, New York 10036** **Telephone: (212) 819-8200** **Telecopy: (212) 354-8113**

Approximate date of commencement of proposed sale to the public: As soon as practicable after this registration statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	**Proposed Maximum Aggregate Offering Price(1)**	**Amount of Registration Fee(2)**
Common Stock, par value $0.01 per share	$172,500,000	$5,296

(1) Estimated solely for the purpose of calculating the registration fee in accordance with Rule 457(o) under the Securities Act of 1933. Includes the offering price attributable to shares available for purchase by the underwriters to cover over-allotments, if any.

(2) Calculated pursuant to Rule 457(o) based on an estimate of the proposed maximum aggregate offering price.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

Subject to Completion, Dated March 22, 2007

Shares

Common Stock

This is the initial public offering of common stock of McLeodUSA Incorporated. We are offering shares of our common stock. Selling stockholders are offering an additional shares of our common stock. We anticipate that the initial public offering price will be between $ and $ per share. We will not receive any proceeds from the sale of shares by the selling stockholders. We have applied to list our common stock on The Nasdaq Global Market under the symbol "MUSA."

Investing in our common stock involves a high degree of risk. See "Risk Factors" beginning on page 9.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$	$
Underwriting discounts and commissions	$	$
Proceeds, before expenses, to us	$	$
Proceeds, before expenses, to the selling stockholders	$	$

The selling stockholders have granted the underwriters the right to purchase up to additional shares of common stock to cover over-allotments.

Deutsche Bank Securities Jefferies & Company

The date of this prospectus is , 2007.

PROSPECTUS SUMMARY

This summary highlights selected information contained in greater detail elsewhere in this prospectus. This summary may not contain all of the information that you should consider before investing in our common stock. You should carefully read the entire prospectus, including "Risk Factors," our audited consolidated financial statements and the other financial information appearing elsewhere in this prospectus, before making an investment decision.

Company Overview

We provide managed internet protocol-based, or IP-based, communications services to small- and medium-sized enterprises, and traditional circuit-switched telephony services to commercial and residential customers. As part of our competitive communications solutions, we provide an extensive array of broadband IP-based voice and data solutions, including local and long distance voice, dedicated broadband internet access, email, virtual private networking, managed network security, conference calling, high capacity private line services and other integrated voice and data services. We deliver integrated IP-based communications solutions to customers over a high-speed broadband connection on our private managed secure network. We believe our IP-based communications technology provides a level of service and network and call reliability comparable to that of traditional phone networks, with significantly lower capital expenditures and operating costs. We also provide wholesale communications services to other communications services providers through our extensive network facilities, in which we have invested over $3 billion since our inception.

Our Target Market and Value Proposition. Since January 2006, we have primarily targeted small- and medium-sized enterprise and multi-location customers within our geographic footprint with an average monthly telecommunications spend of $500 to $5,000 per location. According to IDC, a telecommunications market research firm, approximately eight million small- and medium-sized enterprises, defined as businesses with less than 500 employees, will spend an aggregate of approximately $76.8 billion in 2007 for communications services sales in the United States. To address our target customers, we have shifted most of our sales resources from telemarketing to field and agent sales and have focused on geographic areas with potential enterprise customers who will use our services in multiple locations within our extensive network footprint. As part of our strategy, we manage all aspects of our service offerings for our customers, including installation, provisioning, monitoring, proactive fault management and billing.

We have also made significant technological improvements to our network, which allows us to deliver a wide range of cost-effective, enhanced communications solutions, including bundled integrated voice and data services, as well as more sophisticated managed services, which can be layered onto these integrated bundled offerings.

We seek to increase the number of services our customers purchase from us, which we believe improves our customer retention as customers increasingly rely on us for a greater portion of their communications needs. In addition, these customers typically enter into multi-year contracts, which we believe allows us to increase customer retention and provides revenue growth opportunities. For example, nearly all of our Dynamic Integrated Access, or DYIA, services are provided under contracts with two- or three-year terms. For our traditional telephony customers, we continue to offer services and pricing that are competitive with those offered by regional Bell operating companies, or RBOCs.

Our Extensive IP and Fiber Optic Network. We deliver our services primarily over our private managed secure network using T-1 and higher connectivity. In addition, we have one of the largest facilities-based networks maintained by a competitive carrier in the United

States, which allows us to offer integrated communications services across 20 states in the Midwest, Rocky Mountain, Southwest and Northwest regions, representing 40% of the U.S. population. We serve 67 metropolitan statistical areas, or MSAs, with our network facilities, including 19 of the top 50 MSAs.

We provide communication services to our customers by connecting their offices to our network through approximately 1000 wire centers, which include approximately 650 collocations and 350 wire centers using enhanced extended loops, or EELs. We operate and maintain an intercity multi-protocol label switched, or MPLS, internet backbone with a nationally distributed IP voice switching architecture to provide a broad set of managed voice and data services cost-effectively. We also operate a circuit-switched based telephony network to provide voice services to our commercial, wholesale and residential customers. As of December 31, 2006, our broadband network and facilities spanned approximately 13,000 intercity and 4,000 metropolitan local fiber route miles and encompassed over one million intercity backbone fiber miles and 500,000 fiber miles of metropolitan local fiber optic cable. We believe owning our own facilities-based network allows us to ensure our network's service quality and reliability, have greater control over customer care and reduce our exposure to regulatory uncertainty associated with leasing network connectivity and facilities from the RBOCs.

As of December 31, 2006, we had nearly 1,600 employees serving approximately 101,900 residential "plain old telephone service," or POTS, lines, 283,500 business POTS lines and 14,300 T-1 circuits in service. As of December 31, 2006, approximately 87% of our revenue was attributable to service using our own network facilities, and approximately 13% was attributable to reselling the services of other carriers, primarily RBOCs. In 2006, we generated revenue of $544.7 million and incurred a net loss of $28.3 million.

Company Strategy

In January 2006, we emerged from Chapter 11 with a new chief executive officer, board of directors and equity ownership, and we shifted our business strategy to focus on providing higher value and lower churn T-1-based solutions of integrated voice, broadband internet access and other data services to voice- and data-intensive business customers. In order to implement this strategy, we reorganized our sales staff to become more customer solutions oriented, which has allowed us to sell effectively to the underserved small- and medium-sized enterprise segment, as well as to strategic multi-location customers. Elements of our strategy include:

Focusing on Small- and Medium-Sized Enterprise Customers. We focus our sales efforts on small- and medium-sized enterprise and multi-location customers with average monthly telecommunications bills of $500 to $5,000 per location. We believe these customers seek services that generate greater revenue than those sought by residential and very small business customers, which were our historic focus.

We plan to continue to aggressively sell into our existing markets and target enterprise customers with our IP-based solutions that we believe will result in increased revenue to us. These services include integrated managed network services, dedicated broadband internet access, T-1-based services such as digital voice calling with primary rate interfaces, as well as traditional voice and data services and voice over IP, or VoIP, telephony solutions, among others. The higher revenue associated with these T-1-based services results in shorter payback periods than traditional lines.

Leveraging Our Managed Network Services and Operational Infrastructure. We have introduced a number of IP-based bundled solutions for our customers which leverages our extensive infrastructure. We seek to expand our small- and medium-sized enterprise customer base within our existing network infrastructure and to sell additional services to our existing customers. As of December 31, 2006, our average network utilization was approximately 50%, as measured by unused capacity in our switches and network backbone.

Continuing to Improve the Efficiency of our Network and Reduce Network Expenses. We believe that our disciplined approach to sales, installation and service, together with our automated business processes, will allow us to further streamline our operations and maintain low operating costs. In March 2006, we established a cross-functional task force to evaluate and rationalize our network, and particularly the 690 collocations that we operated at that time, to improve market penetration, reduce network expenses and improve operating margins, while maintaining our ability to serve the significant majority of our addressable market with our network facilities. The primary initiatives undertaken include reducing monthly recurring costs for electric power and cross-connects for our collocations, decommissioning collocations in areas with limited potential to capture target business customers and eliminating excess leased network capacity. In the approximately 40 local serving areas where we are decommissioning collocations, we expect to continue to serve our T-1 customers using virtual collocations, EELs or special access T-1s. As of December 31, 2006, we had completed approximately 50% of the implementation of the network optimization project, and we have experienced an average payback period of less than five months on invested capital from net cost savings. We expect to have implemented approximately 90% of the network optimization project by June 2007, and to complete the implementation during the third quarter of 2007. We estimate that we will operate approximately 650 collocations and serve approximately 350 additional outlying local serving areas using virtual collocations, EELS or special access T-1s after we complete this effort.

Expanding Field Sales Force and Agency Distribution Channels. In early 2006, we shifted most of our sales resources from telemarketing to field and agent sales, which we believe are more effective in selling higher value services to our larger target customers. We have expanded our field sales force to target small- and medium-sized enterprise customers in geographies with large and attractive addressable markets, and where we have network facilities. In order to better meet the needs of our customers, we have focused our field sales efforts on our managed service offerings such as DYIA, digital voice offering primary rate interfaces, or PRIs, digital trunks, private lines and virtual private networks, or VPNs. To further leverage our field and agent sales force, we have targeted customers who will use our services in multiple locations within our network footprint. For our traditional telephony customers, we continue to offer services and pricing that are competitive with those offered by the RBOCs.

Continuing to Develop Products and Services that Meet the Needs of our Customers. Our goal is to provide solutions that improve our customers' daily productivity, simplify their networks and provide them with control of their network. We focus on developing high-value integrated voice and data solutions that can be provided over our existing network infrastructure and increase profitability per customer location. We proactively develop solutions that meet the needs of our business customers, including offering bundled packages of IP-based telecommunications services as well as customized offerings, which we believe increase customer retention and provide revenue growth opportunities. In addition, we believe customer retention is further improved as customers increase the number of services they purchase from us and become increasingly reliant on us for a greater portion of their communication needs.

Considering Potential Strategic Transactions. We may supplement our organic growth by acquiring assets that would allow us to gain market share and expand into markets that complement our existing network. In considering strategic transactions, we focus on those assets that operate in our markets or adjacent markets, serve similar customers and offer complementary products and services. Alternatively, we may divest certain assets or markets that are no longer core to our business strategy. For example, on March 9, 2007, we completed the sale of certain assets comprising our ATS cable and telephony business, which we refer to as ATS, to ImOn Communications, LLC for a purchase price of approximately $16 million. ATS provides cable television services in and around Cedar Rapids and Marion, Iowa, and was not core to our continuing telecommunications business. We expect to use proceeds from the ATS sale to redeem a portion of our outstanding $10^{1}/_{2}$% senior second secured notes due 2011, which we refer to as our $10^{1}/_{2}$% notes.

Company Strengths

Extensive IP-Based and Fiber Optic Infrastructure. We believe we have a large addressable market opportunity within our facilities-based network and extensive collocation footprint. We operate an advanced IP-based network that spans approximately 13,000 intercity and 4,000 metropolitan local fiber route miles. We have installed "soft switches" and related network equipment, such as media gateways, signaling gateways and applications servers, which we collectively refer to as converged network elements. These converged network elements enable the switching and routing of voice calls over our IP network. The converged network elements are collectively smaller and more cost-effective than traditional circuit-switched elements, enabling us to offer traditional voice telephony services across our VoIP platform and to develop future communications solutions that address the needs of our customers. By using our own network to provide services, we believe we are able to ensure service quality and reliability, have greater control over customer care and reduce our exposure to regulatory uncertainty associated with leasing network connectivity and facilities from the RBOCs.

Comprehensive Suite of IP-Based Communications Solutions. We provide our customers with a comprehensive suite of networking and telecommunications services, including IP-based integrated data and voice services, internet services, private data networking, VPNs, hosting services and local and long distance voice services. Through an ongoing assessment of our markets, we leverage the scalability and flexibility of our infrastructure to introduce new products and bundled solutions that address the increasingly complex communications needs of our customers.

Industry Leading Customer Service. We believe that a key element of our success is our ability to satisfy the service needs of our customers. According to independent customer surveys, overall satisfaction of our customers was 91% during 2006. We believe these ratings are the result of our award-winning StarQuality® employee training and certification program, reliable network and ability to provide high-value communications solutions in cost-effective bundles that meet the needs of our customers. In addition, we believe that consistently offering our customers a high level of service enables us to retain and expand existing customer relationships, as well as attract new ones. We believe we provide a higher level of customer service and dedicated sales support than RBOCs provide to small- and medium-sized enterprise customers.

Capital Efficiency Derived From Sizeable Network Assets. We have invested over $3 billion since our inception to create one of the largest and most advanced facilities-based networks maintained by a competitive carrier in the United States. Through our prior investments, we have converged our IP-based backbone, which consists of 14 soft-switches and 24 backbone routers, with our traditional circuit based voice network, which includes over one million intercity backbone fiber miles, 38 voice switches and approximately 650 collocations located across our 20 state footprint. As a result, we are able to provide a full suite of communications solutions with minimal incremental investment and maintain one of the lowest ratios of capital expenditures as a percentage of revenues within our industry.

Experienced Management Team. Our team of senior executives has substantial experience in the telecommunications industry and extensive knowledge of our markets. Our management team is led by our Chief Executive Officer, Royce Holland, who has over 30 years of managerial experience, including over 18 years of experience in the telecommunications industry. Our executive management team includes key personnel who have held positions at major communications companies, including Allegiance Telecom, Ameritech, Citizens Communications, Frontier Communications, ICG, MCI, MFS Communications, Verio and Wiltel Communications and who combined have over 150 years of telecommunications experience.

For a discussion of the industry in which we operate, please see "Business Industry Overview."

Business Risks

Our business and our ability to execute our business strategy are subject to a number of risks. Please see "Risk Factors" beginning on page 9 for a discussion of risks that we face.

Recent Developments

On March 9, 2007, we completed the ATS sale for a purchase price of approximately $16 million. ATS provides cable television services in and around Cedar Rapids and Marion, Iowa, and was not core to our continuing telecommunications business. We expect to use proceeds from the ATS sale to redeem a portion of our outstanding $10^1/_2$% notes.

Our Corporate Information

We were incorporated in Delaware as McLeod, Inc. in 1993 and changed our name to McLeodUSA Incorporated in 1997. Our principal executive offices are located at One Martha's Way, Hiawatha, Iowa 52233, and our telephone number is (319) 790-7800. Our website address is www.mcleodusa.com. We have included our website address as an inactive textual reference only. The information contained on, or that can be accessed through, our website is not a part of this prospectus.

In this prospectus, unless otherwise stated or the context otherwise requires, references to "McLeodUSA," "we," "us," "our" and similar references refer to McLeodUSA Incorporated.

The Offering

Common stock offered by McLeodUSA	shares
Common stock offered by the selling stockholders	shares
Common stock to be outstanding after this offering	shares
Over-allotment option	shares
Use of proceeds	We intend to use a portion of the net proceeds of this offering to redeem a portion of our outstanding $10^1/_2$% notes and a portion for the continued expansion of our IP platform and network and general corporate purposes. We may also use a portion of the net proceeds to acquire or invest in businesses, technologies and products complementary to our operations. See "Use of Proceeds" for additional information. We will not receive any proceeds from the sale of shares by the selling stockholders.
Dividend Policy	We intend to retain all future earnings, if any, to fund the development and growth of our business. We do not anticipate paying cash dividends on our common stock.
Proposed Nasdaq Global Market symbol	"MUSA"

The number of shares of our common stock that will be outstanding immediately after the offering is based on shares outstanding as of December 31, 2006, but does not include:

- 437,800 shares of common stock issuable upon the exercise of options outstanding and vested as of December 31, 2006 under our 2006 Omnibus Equity Plan, which we refer to as our 2006 plan, at a weighted average exercise price of $8.38 per share;
- 1,163,400 shares of common stock issuable upon the exercise of options outstanding, but not vested, as of December 31, 2006 under our 2006 plan, at a weighted average exercise price of $8.38 per share; and
- 648,800 shares of common stock available for future issuance under our 2006 plan as of December 31, 2006.

Unless otherwise indicated, the information contained in this prospectus assumes:

- *no exercise by the underwriters of their over-allotment option;*
- *the filing of an amendment to our restated certificate of incorporation to increase the number of authorized shares of our common stock; and*
- *the issuance and sale by us of shares of common stock in this offering.*

McLeodUSA® and StarQuality® are our registered trademarks. Other trademarks, trade names or service marks appearing in this prospectus are the property of their respective owners.

SUMMARY CONSOLIDATED FINANCIAL DATA

The following tables set forth our selected consolidated financial data for the periods ended and dates indicated. The selected consolidated financial data for January 1, 2006 and the years ended December 31, 2004, 2005 and 2006 and as of December 31, 2005 and 2006 have been derived from, and should be read together with, our audited consolidated financial statements beginning on page F-1 of this prospectus.

The summary and selected historical financial information set forth below is not necessarily indicative of the results of future operations and should be read in conjunction with, and is qualified in its entirety by, the discussion under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and notes thereto included elsewhere in this prospectus.

Unaudited pro forma information in the consolidated balance sheet data table reflects our sale of shares of common stock in this offering at an assumed initial public offering price of $ per share, after deducting estimated underwriting discounts and commissions and estimated offering expenses. Pro forma as adjusted information in the consolidated balance sheet data table further reflects our use of a portion of the proceeds of this offering to redeem a portion of our outstanding 10 1/2% notes.

	Predecessor McLeodUSA			Reorganized McLeodUSA
	Years Ended December 31,			
	2004	2005	January 1, 2006(1)	Year Ended December 31, 2006
	(dollars in millions)			
Income Statement Data:				
Revenue	$ 716.2	$ 635.0	$	$ 544.7
Operating Expenses:				
Cost of service(2)	393.8	362.1		315.8
Selling, general and administrative(2)	268.4	217.4		181.7
Depreciation and amortization	356.8	212.9		60.1
Reorganization charges, net		20.2	(18.5)	
Restructuring, asset impairment and other charges (adjustments)	262.9	301.7		2.4
Total operating expenses (income)	1,281.9	1,114.3	(18.5)	560.0
Operating (loss) income	(565.7)	(479.3)	18.5	(15.3)
Interest expense, net	(48.2)	(65.3)		(12.7)
Other (expense) income	(10.6)	9.8		(0.3)
Gain on cancellation of debt			728.1	
Net (loss) income	(624.5)	(534.8)	746.6	(28.3)
Preferred stock dividend	(2.9)	(1.3)		
(Loss) income applicable to common shares	$ (627.4)	$ (536.1)	$ 746.6	$ (28.3)

	December 31, 2006		
	Actual	Pro Forma	Pro Forma As Adjusted
	(in millions)		
Balance Sheet and Other Data:			
Cash and cash equivalents	$ 64.8	$	$
Property and equipment, net	306.3	306.3	306.3
Working capital (deficiency) (excluding assets held for sale)	11.5		
Total assets	479.0		
Total debt(3)	120.0		
Stockholders' equity (deficiency)	217.1		
Weighted average common shares outstanding:			
Basic	30.0		
Diluted	30.0		

(1) On October 28, 2005, we filed a voluntary petition for bankruptcy relief under Chapter 11. On January 6, 2006 we emerged from those bankruptcy proceedings pursuant to the terms of a plan of reorganization. Upon emergence, we adopted the fresh start accounting provisions of SOP 90-7. The adoption of fresh start accounting had a material effect on our financial statements. As a result, our financial statements for periods after January 1, 2006 are not comparable to our financial statements for earlier periods. Specifically, interest expense, due to the substantial cancellation of debt, and depreciation and amortization expense, due to the adjustment of the carrying values of property, equipment and intangibles to their estimated fair market values, have significantly changed after the application of SOP 90-7.

(2) Exclusive of depreciation and amortization.

(3) Pro forma total debt and pro forma total debt as adjusted reflects our use of proceeds from the ATS sale to redeem a portion of our outstanding $10^1/_2$% notes.

	Year Ended December 31, 2006
Selected Operating Data:	
Capital expenditures	$ 31.9
Deferred line installation costs(1)	17.0
Retail residential POTS line churn	3.54%
Retail business POTS line churn	3.17%
Retail T-1 circuit churn	1.32%
Retail DYIA unit churn	0.59%

	As of December 31, 2006
Retail residential POTS lines in service	101,900
Retail business POTS lines in service	283,500
Retail T-1 circuits in service	14,300
Quota bearing field sales representatives	210
Quota bearing inside sales representatives	42
Total employees	1,588

(1) Deferred line installation costs represent success-based costs that are driven by new sales and include equipment, internal labor for installation and provisioning of equipment and service and non-recurring costs paid to the RBOCs for provisioning unbundled loops or T-1s.

RISK FACTORS

Investing in our common stock involves a high degree of risk. You should carefully consider the following risk factors and all other information contained in this prospectus before purchasing our common stock. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect us.

If any of the following risks occur, our business, financial condition or results of operations could be materially and adversely affected. In that case, the trading price of our common stock could decline, and you may lose some or all of your investment.

Risks Relating to Our Industry and Business

We have never been profitable and we may not be profitable in the future.

We have experienced significant net and operating losses in the past. For the years ended December 31, 2004, 2005 and 2006, we recorded net losses of $624.5 million, $534.8 million and $28.3 million, respectively, and operating losses of $565.7 million, $479.3 million and $15.3 million. We have only recently generated sufficient cash flow from operations to fund our expenses and may not continue to do so in the future. We have never been profitable on an operating basis and may not be in the future.

We face intense and growing competition from other providers of communications services that have significantly greater resources than we do. Several of these competitors are better positioned to engage in competitive pricing, which may make it difficult for us to attract new customers.

The market for communications services is highly competitive and we expect the competition to intensify. We compete with many types of communications providers, including traditional local telephone companies, cable companies, new IP-based service providers and other managed service providers with similar business models to our own. Our current or future competitors may provide services that are comparable or superior to those that we provide, or at lower prices, or adapt more quickly to evolving industry trends or changing market requirements.

Our target customers are small- and medium-sized enterprises and multi-location customers within our geographic footprint. The success of our business depends in part on our ability to attract these potential customers to leave their current providers. Many of these providers have competitive advantages over us, including substantially greater financial, personnel and other resources, better access to capital, brand name recognition and long-standing relationships with customers. These resources may place us at a competitive disadvantage in our current markets and limit our ability to expand into new markets. Because of their greater financial resources, some of our competitors can also afford to reduce prices for their services and engage in aggressive promotional activities, which could have an adverse effect on our business. If we are required to reduce our prices to remain competitive, or if we lose customers as a result of these factors, our revenue will decrease.

We may not be successful in implementing our new business strategy, or in realizing its anticipated benefits, which could adversely affect our business.

In the past, we focused on delivering a broad portfolio of products to a wide spectrum of customer segments including residential, small- and medium-sized enterprises, other carriers and internet service providers, and, to a lesser extent, large corporate enterprises. This strategy resulted in a large base of small and lower margin customers with monthly billings of up to $200 per month per location. Upon our January 2006 emergence from our second bankruptcy, we shifted our business strategy to focus on providing higher value bundles of integrated voice, broadband internet access and other data services to enterprise customers with average monthly telecommunications bills of $500 to $5,000 per location. In order to better target small- and medium-sized enterprise customers, we also changed our sales and marketing strategy to emphasize direct sales and agent channels with less reliance on telemarketing and yellow pages advertising.

Our new business strategy represents a significant change from our historic practices. We may not be able to implement our new strategy successfully, and its success is dependent on a number of factors, including our ability to:

- sell bundled products and services to voice- and data-intensive small- to medium-sized enterprise customers;
- scale our operations;
- maximize network utilization;
- evaluate our network and monitor technological developments;
- retain our existing customer base by reducing churn;
- allocate greater sales and marketing and company resources to offering a broad set of value-added services;
- expand, train and incentivize our sales force; and
- retain access to the last mile access loops and other necessary network elements and collocations leased from the regional Bell operating companies, or RBOCs, at rates that enable us to competitively price our products.

In order for us to become profitable, we must achieve objectives in a timely and cost-effective manner. In our effort to become profitable, our revenues have decreased and may continue to do so, which could adversely affect our financial condition, results of operations and cash flows. We may not achieve our objectives, and if we fail to achieve one or more of our objectives, we may not become profitable on an operating basis, our results of operations and cash flows could be negatively impacted and we could be forced to seek alternatives for our business.

Failure to raise necessary capital could restrict our ability to support our network infrastructure, develop or enhance our products, take advantage of future opportunities, operate and expand our business or respond to competitive pressures.

Our capital resources may not be sufficient to enable us to fund the capital expenditures required to:

- deploy network assets currently not in service;
- construct, purchase, develop and improve communications assets in target markets; and
- improve our business infrastructure and systems to support a more efficient telecommunications company.

We also require substantial funds for general corporate and other expenses and may require additional funds for working capital fluctuations. Failure to generate or raise sufficient

funds may require us to delay or abandon some of our plans or expenditures, which could harm our business and competitive position.

We expect to meet our funding needs through various sources, including existing cash balances, cash flow from future operations, and proceeds from sales of excess fiber or other excess inventory. While the indenture governing our $10^1/_2$% notes allows us to enter into a senior secured credit facility and, subject to the satisfaction of a leveraged based ratio test, incur additional indebtedness to fund future liquidity needs, we may not be able to obtain such funds on satisfactory terms, or at all.

Our historic financial difficulties, including our two bankruptcies, could adversely affect our image, ability to compete, liquidity and financial results.

In August 2001, we initiated a broad financial and operational restructuring, and in April 2002, we emerged from Chapter 11. We filed another voluntary petition for relief under Chapter 11 in October 2005, and on January 6, 2006, we again emerged from bankruptcy. Our past financial difficulties and two bankruptcies have diminished our ability to obtain capital and have adversely affected the willingness of potential customers, including larger, more sophisticated business customers that we are now targeting, to purchase telecommunications services from us. Our financial position may continue to adversely affect the willingness of potential customers to purchase their communications services from us.

We may also lose revenues to the extent other carriers reduce the amount of business they transact with us as a result of their perception of our financial condition. Some of our critical suppliers of network services such as the RBOCs and their affiliated interexchange carriers, or IXCs, have sought in the past and may seek in the future to impose burdensome security deposits or require letters of credit that may negatively impact our liquidity position. There is no guarantee that these vendors will not be successful in imposing these requirements or that the size of such deposit requirements would not have a material adverse affect on our liquidity and financial condition.

Continuing decreases in prices for our services may result in declining revenues.

The prices that we charge for some of our communications services have been decreasing, and we expect to continue to experience decreasing prices for certain of our communications services:

- as we and our competitors increase transmission capacity on existing and new networks;

- as a result of the continuing convergence of various technological means to provide similar services to customers in our markets;

- as a result of our current agreements with customers which often contain volume based pricing or other contractually agreed upon decreases in prices during the term of the agreement;

- through technological advances or otherwise; and

- as a result of changes in regulatory policy.

We may be unable to compensate for declining revenues and, accordingly, our historical revenue may not be indicative of future revenue based on comparable traffic volumes. If the prices for our communications services decrease, and if we are unable to offer additional services from which we can derive additional revenue or otherwise reduce our operating expenses, our operating results will decline and our business and financial results will suffer.

The success of our communications services will depend on our ability to keep pace with rapid technological changes affecting our industry.

The communications industry has experienced, and we believe will continue to experience, rapid and significant changes in technology. Technological changes, such as the use of wireless network access, could render aspects of our technology suboptimal or obsolete and provide a competitive advantage to new or larger competitors who might more easily be able to take advantage of these opportunities. Some of our competitors, including the local telephone companies, have much longer operating histories, more experience in making upgrades to their networks and greater financial resources than we do. We may not be able to obtain access to new technologies as quickly or on the same terms as our competitors, and we may not be able to apply new technologies to our existing networks without incurring significant costs or at all. In addition, responding to demand for new technologies would require us to increase our capital expenditures, which may require additional financing. If we are unable to keep pace with these technological changes, we could face difficulties in attracting and retaining customers.

Government regulation may increase our costs, decrease our revenues, adversely impact our ability to provide services and/or subject our services to additional competitive pressures.

Our facilities and services are subject to federal, state and local regulations. The time and expense of complying with these regulations could increase our costs of providing services and subject us to additional competitive pressures. One of the primary purposes of the Telecommunications Act was to open the local telephone services market to competition. While this has presented us with opportunities to enter local telephone markets, it also provided important competitive and other benefits to the RBOCs, such as the ability to provide long distance service to customers in their respective regions. In addition, we need to obtain and maintain licenses, permits and other regulatory approvals in connection with some of our services. Any of the following could adversely affect our business:

- failure to comply with federal and state tariff requirements;
- failure to maintain proper federal, state and municipal certifications or authorizations;
- failure to comply with federal, state or local laws and regulations;
- failure to obtain and maintain required licenses and permits;
- failure to properly classify revenues and any misclassification's impact on surcharge collection and remittance;
- burdensome license or permit requirements to operate in public rights-of-way; and
- burdensome or adverse regulatory requirements.

Regulatory developments have enhanced the ability of other companies to compete against us, including by providing the RBOCs with increased pricing flexibility for many services, decreasing the RBOCs' access charges, decreasing the requirements to make unbundled network elements, or UNEs, available, and altering the levels and types of support and ancillary services the RBOCs are required to provide, and requiring us to reduce our charges for certain services, such as intercarrier compensation. Future regulatory changes affecting intercarrier compensation, including changes to the access charge regime, could also materially reduce our revenues and increase our cost of interconnection.

State and federal regulations to which we are subject require prior approval for a range of different corporate activities, such as transfers of direct and indirect control of authorized telecommunications carriers, certain corporate reorganizations, acquisitions of telecommunications operations, assignment of carrier assets, certain stock offerings and incurrence by carriers of significant debt obligations. The failure to obtain such required approvals could adversely affect us and our operations.

Certificates of authority can generally be conditioned, modified, canceled, terminated or revoked by state regulatory authorities for failure to comply with state law or the rules, regulations and policies of state regulatory authorities. State utility commissions generally have authority to supervise telecommunications service providers in their states and to enforce state utility laws and regulations. Fines or other penalties also may be imposed for violations. We have been fined for violations in the past. State utility commissions or third parties could challenge our compliance with applicable laws or regulations, which could have a material adverse effect on our business, results of operations and financial condition.

The Federal Communications Commission, or FCC, has an open docket proposing to reform all forms of intercarrier compensation. An industry task force produced a proposal named the "Missoula plan" that was filed with the FCC on July 24, 2006. The Missoula Plan would impose a uniform compensation rate applicable to all types of traffic that a carrier terminates, change the rules of interconnection and transiting and partially preempt state authority over intrastate access rates. If the Missoula plan is adopted as proposed, we would experience a significant reduction in access revenues and increased costs of interconnection after the plan is fully implemented over a proposed three-year period, which would have a materially adverse affect on us.

The legislative and regulatory environment in which we operate continues to undergo significant changes. Many of the developments discussed in this prospectus are subject to further legislative and regulatory actions as well as litigation and court review. Our business may be adversely affected by future legislation, regulatory change or court decisions.

Additional Liabilities May Arise in Connection with the Federal Universal Service Program

The FCC has established a "universal service" program that is intended to ensure that affordable, quality basic telecommunications services are available to all residents of the United States. Like other telecommunications providers, we are required to make contributions to support federal and state universal service goals. Our contribution to federal universal service support programs is assessed against our interstate and international end-user telecommunications gross revenue. Our contribution was 10.9% of such revenue in both 2005 and 2006. We paid approximately $6.6 million to the federal program in 2005 and approximately $6.3 million in 2006.

On March 8, 2007, the Universal Service Administration Company, which administers the federal universal service program on behalf of the FCC, completed an audit of our contributions to the federal universal service program based upon our 2005 revenues. The audit report, which is not yet final, tentatively concludes that we underreported or misclassified certain telecommunications service revenues, resulting in a contribution shortfall of approximately $4.4 million. We believe that the audit report is erroneous in some respects and we intend to seek modification of the audit findings before the report is finalized. If our efforts are unsuccessful, we have the right to appeal the audit findings to the FCC. In the event that the tentative audit findings are upheld, however, we may be required to pay the contribution shortfall with respect to 2005 revenues, and we also may have additional unanticipated liabilities with respect to our 2006 and 2007 revenues. To satisfy any such additional contribution obligations, we would either need to impose billing surcharges on our customers, thereby increasing our prices, or to absorb these obligations as additional costs.

RBOC consolidation and advancing deregulation of RBOCs makes it more difficult for us to compete with the RBOCs and increase revenues.

It has become increasingly difficult to compete against large, financially strong competitors with well known brands. Recently, FCC actions have changed the terms and conditions of our access to RBOC local exchange facilities. Consolidation in the communications industry has accelerated in the wake of these new policies and other changes in market conditions. RBOCs have also successfully achieved broader deregulation of their retail offerings in many states. With the recent merger and deregulatory activity in the telecommunications industry, we believe that the RBOCs will likely become even stronger competitors.

Our dependence on the RBOCs to provide many of our communications services could make it harder for us to offer our services at a profit.

We depend on the RBOCs to provide many elements of our services, including the "last mile" connections to most of our customers. At the same time, the RBOCs are our largest competitors. Today, without using the UNEs and communications services of these companies, we could not economically provide services to most of our customers. Because of this dependence, our communications services are highly susceptible to changes in the conditions for access to RBOC facilities and to possible inadequate service quality provided by the RBOCs. Therefore, we may have difficulty offering our services on a profitable and competitive basis. Qwest and AT&T, including its wholly-owned subsidiaries AT&T Midwest Corporation and Southwestern Bell Telephone Company, are the primary suppliers of UNEs, network elements and communications services that allow us to initiate and complete calls and transmit data. The communications facilities of our suppliers allow us to provide local, long distance, internet services and private lines dedicated to our customers' uses. If these RBOCs or other companies are legally entitled to deny or limit our access to their UNEs, network elements or communications services, or if regulatory decisions allow them to charge higher rates for these elements or services, we may not be able to offer communications services at profitable rates. For example, in September 2005 the FCC granted forbearance relief to Qwest that has resulted in our loss of access to UNEs at cost-based rates in nine central offices in the Omaha MSA where we have collocated equipment and customers. Qwest has since proposed substantially increasing the prices for all network elements that we use to provide services in the nine affected central offices. Although AT&T has committed not to seek forbearance from the UNE loop and transport obligations before mid-2010, Qwest has made no such commitment, and could petition the FCC for relief from offering UNEs in other markets we serve. Similarly, FCC rules currently permit RBOCs to unilaterally retire copper loop facilities that we use as the last mile connection to our customer without any regulatory oversight. As RBOCs deploy more fiber loop facilities that the FCC has declared are not subject to unbundling obligations, the RBOCs may be able to eliminate our access to last mile facilities that we require to serve our customers. Verizon has filed more than 80 notifications of copper plant retirement affecting several of its exchanges. AT&T and Qwest have not yet filed a notification of copper plant retirement in any exchange in which we use their last mile facilities. Several competitive local exchange carriers, or CLECs, including us, petitioned the FCC in January 2007, to change the rules governing copper plant retirement to protect our access to these last mile copper facilities. The FCC has solicited public comments on this petition but has not yet made any decision.

In order to interconnect our network equipment and other communications facilities to UNEs controlled by the RBOCs, we must enter into, maintain and renew interconnection agreements, or ICAs, with them. Interconnection obligations imposed on the RBOCs by the

Telecommunications Act have been and continue to be subject to a variety of legal proceedings. In addition, the mergers of SBC and AT&T, Verizon and MCI, and AT&T and BellSouth, could significantly impact the availability of acceptable ICAs without incurring the expense of lengthy negotiations and arbitrations with an RBOC in each state. Former standalone IXCs AT&T and MCI both dedicated significant internal and external resources to negotiate and arbitrate ICAs that many competitive local exchange carriers, or CLECs, used as model agreements, and resources are no longer available since the mergers of AT&T and MCI with RBOCs. On March 2, 2007, Qwest provided notice that it was terminating all current ICAs with us. The termination notice begins a 160-day period for negotiation of new ICAs for each of the states. If we cannot successfully negotiate new agreements with Qwest for each state, or find existing ICAs that Qwest has with other CLECs that meet our network and operating requirements and that we can opt into, then we will be required to arbitrate all unresolved issues before each state commission. We may not be able to obtain ICAs on terms that would continue to permit us to offer services using our own communications network facilities in combination with the local network elements of the RBOCs at profitable and competitive rates.

When FCC decisions eliminate our access to elements of RBOC networks at cost-based prices, RBOCs may choose or be required to offer those elements on a commercial rather than a regulated basis, and these commercial terms may make these elements uneconomical for us to use. For example, we have signed a commercial agreement with Qwest for a replacement of the unbundled network element platform, or UNE-P, which formerly enabled us to use a combination of UNEs to serve customers in markets where we did not have our own local network facilities. Qwest's commercial replacement product, QPP, enables us, at a higher cost, to continue offering similar service through 2008 to our end-users in the affected markets. However, we have been unable to reach a comparable agreement with AT&T for a similar commercial replacement product in the AT&T region, and we have been unable to reach an agreement with Qwest for replacement of high capacity facilities in the Omaha central offices affected by the FCC forbearance decision. In these central offices, we have the option of purchasing RBOC special access services in lieu of UNEs, but the FCC has granted the RBOCs substantial pricing flexibility for these services and in many cases they are much more costly than the UNEs they would replace. We may not be able to obtain commercial agreements or special access services on terms that would continue to permit us to offer local services using AT&T and Qwest network facilities at profitable and competitive rates, which may lead us to exit such markets and decrease our customer base and revenues.

Actions by the RBOCs may make it more difficult for us to offer our communications services.

We anticipate that the RBOCs will continue to pursue litigation, forbearance, retirement of copper loop facilities, changes in regulations and legislation to reduce regulatory oversight over their networks, rates and operations. If the RBOCs are successful, these initiatives will make it more difficult for us to challenge RBOC actions in the future, which will adversely affect our business.

The RBOCs are also pursuing actions to make it more difficult for us to act as a wholesale provider of communications services. For example, AT&T and Qwest are attempting to limit CLECs to using UNEs to serve only their own end-user customers, which would eliminate our ability to provide local wholesale services to other CLECs. Both AT&T and Qwest are also trying to impose new network configuration requirements that prohibit use of local interconnection service trunks for terminating anything but local traffic from a CLEC's end-user customers, which would impact our DYIA services. If successful, the RBOCs will make it more costly for us to serve customers and act as a wholesale provider of communications services.

The RBOCs are also actively pursuing federal legislative and regulatory initiatives and litigation that could have the effect of decreasing the benefits to us of certain provisions in the Telecommunications Act and various state laws, and increasing the competition that we face from the RBOCs in data services, including by limiting the RBOCs' obligations to provide access to their UNEs, including elements necessary to support our DYIA services. If successful, these initiatives could make it more difficult for us to compete with the RBOCs and to offer services on a profitable and competitive basis. Please see "Regulatory Environment."

If RBOCs are allowed to offer bundled local and long distance services in our markets, we could continue to lose customers and revenue.

The RBOCs are now allowed to provide long distance services to customers in all states. The RBOCs have generally been successful in gaining significant market share for such services, and in the case of AT&T and Verizon, have now acquired the most significant IXCs. In addition, the ability of the RBOCs to expand their service offerings enhances their competitive position for local and other services. As a result of their obtaining long distance authority, the RBOCs' ability to offer bundled local and long distance services could continue to cause us to lose customers and revenues and make it more difficult for us to compete.

Developments in the wireless telecommunications industry could make it more difficult for us to compete.

The wireless telecommunications industry is experiencing increasing competition, consolidation, significant technological change and rapid growth. Wireless internet services, high-speed data services and other more advanced wireless services are also gaining in popularity. These developments may make it more difficult for us to gain and maintain our share of the communications market, which may facilitate the migration of wireline usage to wireless services. We could also face additional competition from users of new wireless technologies including, but not limited to, currently unlicensed spectrum. In addition, some governmental entities are contracting with individual companies to construct and operate government subsidized wireless networks using WiMax technology to offer high-speed internet connectivity throughout a city or county.

Many of the wireless carriers and governmental entities have financial and other resources far greater than we have and have more experience testing and deploying new or improved products and services. The largest wireless carriers, AT&T and Verizon Wireless, both have common ownership interests with RBOCs. As a result, RBOCs are better positioned to offer both wireless and landline telecommunications services and can offer bundled services that may be more attractive to our customers than landline offerings alone. Mobile wireless is also reducing demand for our long distance services local landline installations. In addition, several wireless competitors operate or plan to operate wireless telecommunications systems that encompass most of the United States, which could give them a significant competitive advantage.

Changes in FCC unbundling requirements will continue to affect our business.

Several times in recent years, the FCC has revised its rules defining the UNEs that the RBOCs are required to sell to CLECs, such as us, at total element long run incremental cost, or TELRIC, rates, which reflect efficient costs plus a reasonable profit. We depend on access to these UNEs in order to provide services to our customers.

These FCC decisions, among other things, eliminated access to UNE-P, and eliminated unbundled access to high capacity loops in certain central offices depending on the amount of business access lines and number of fiber collocators in a wire center. To date, 17 wire centers in our 20-state network footprint are affected by the revised loop unbundling rules. We have been required to replace unbundled high capacity loops and transport facilities in the affected wire centers with services provided by a third-party supplier, or with higher priced special access services or other commercially priced offerings from an RBOC. Our business could be adversely affected by the FCC's revised unbundling rules, future changes to those rules, new legislation passed in response to the new unbundling rules or any court decisions relating to the unbundling rules.

The mergers of AT&T and MCI with RBOCs may impact our ability to challenge the RBOCs in federal and state proceedings that will determine our ability to offer services and our cost of services.

In late 2005, SBC and AT&T and Verizon and MCI completed their respective mergers, and in December 2006, AT&T and BellSouth completed their merger. Since enactment of the Telecommunications Act, MCI and AT&T had been the primary opponents of the RBOCs in federal and state legislative and regulatory forums that related to the Telecommunications Act, FCC rules implementing the Telecommunications Act, and state laws fostering competition in local exchange markets, and served as the primary source of funding for a variety of CLEC coalitions that fought the actions of the RBOCs before state and federal legislators, and in state and federal regulatory and judicial proceedings. AT&T and MCI also dedicated significant internal resources to federal and state regulatory and court proceedings such as interconnection arbitrations and TELRIC dockets in which the costs of UNEs were set by state agencies. As a result of the merger of SBC and AT&T and the merger of Verizon and MCI, the primary source of opposition to RBOC regulatory and legislative actions affecting the ability of CLECs to compete in virtually every key regulatory and legislative forum has been eliminated. We and the remainder of the independent CLEC industry may not have the resources to replace the loss of internal and external resources provided by AT&T and MCI, and as a result our business could be harmed.

The loss of key personnel could weaken our technical and operational expertise, hinder the development of our markets, lower the quality of our service and harm our ability to implement our new business strategy.

We believe that our ability to implement our new business strategy depends, in part, on our experienced management team, including Royce J. Holland, who has served as our president and chief executive officer since January 2006. For various reasons including our recent emergence from Chapter 11, we may not be able to retain experienced and innovative management, technology and sales personnel. The loss of the services of key personnel, or the inability to attract additional qualified personnel, could cause us to make less successful strategic decisions, which could hinder the development of our markets. We could also be less prepared for technological or marketing problems, which could reduce our ability to serve customers and lower the quality of services. As a result, our financial condition could be adversely affected and we may not be able to implement our new business strategy.

Failure to obtain and maintain necessary permits and rights-of-way could interfere with our network infrastructure and operations.

To obtain and maintain rights-of-way and similar rights and easements needed to install, operate and maintain our fiber optic cable and other network elements, we must negotiate and manage agreements with state highway authorities, local governments, transit authorities, local telephone companies and other utilities, railroads, IXCs and other parties. The failure to obtain or maintain any rights-of-way could interfere with our operations, interfere with our network infrastructure and our use of that infrastructure and adversely affect the business. For example, if we lose access to a right-of-way, we may need to spend significant sums to remove and relocate our facilities.

The success of our DYIA services is dependent on the growth and public acceptance of IP telephony and public policy that enables us to offer IP-based services using network elements and commercial services purchased from the RBOCs.

The success of our DYIA services is dependent upon future demand for IP-based telephony and data services. The growth of the internet telephony market is dependent on several factors. We must continue to have access to the last mile digital circuits at economical prices that enable us to offer IP-based services using these leased facilities. We also must continue to have the ability to terminate VoIP calls using existing local interconnection facilities. In addition, IP providers must continue to improve quality of service for real-time communications so that toll-quality service can be provided. IP telephony equipment and services must achieve a similar level of reliability that users of the public switched telephone network have come to expect from their telephone service, including emergency calling features and capabilities. IP telephony service providers must offer cost and feature benefits to their customers that are sufficient to cause the customers to switch away from traditional telephony service providers. If any or all of these factors fail to occur, our IP-based services business may not grow. In addition, IP telephony service is a relatively new technology and we may encounter difficulties, including regulatory hurdles and other problems that we may not anticipate, that may adversely affect the success of our IP-based services.

The effects of increased regulation of IP-based service providers are unknown.

The FCC has to date generally treated internet service providers as enhanced service providers subject to less stringent regulatory oversight than traditional common carriers. Recently, the FCC has begun imposing regulatory burdens on voice services offered over the internet that connect with the conventional telephone network. In 2005, the FCC imposed E911 obligations on VoIP providers and required them, along with providers of facilities-based internet access services, to upgrade certain network capabilities required by the Communications Assistance for Law Enforcement Act, or CALEA, at potentially significant costs. In June 2006 the FCC required such providers to contribute to the Universal Service Fund. Some states have imposed taxes, fees or surcharges applicable to VoIP telephony services. Congress has to date not sought to heavily regulate, or exempt from regulation, the provision of IP-based services. The FCC, Congress and the states are considering proposals that involve greater regulation of IP-based service providers. The imposition of such regulation could have a material adverse affect on us.

For example, a Federal District Court in Missouri ruled in January 2007 that the Missouri Public Service Commission is not preempted from regulating IP-based voice services offered by a cable company. Under this ruling, we may be required to follow state regulations concerning tariff requirements and service quality to offer DYIA services. Other state utility commissions may begin to require providers of IP-based voice services to comply with state regulations that affect the cost of providing DYIA services.

In March 2004, the FCC issued a Notice of Proposed Rulemaking, or NPRM, regarding IP-enabled services that could result in the loss of access to last mile access loops on an unbundled basis at TELRIC prices. If the FCC classifies all IP-based services as information services, this could eliminate the RBOCs' obligations to provide UNE T-1 circuits to CLECs for the provisioning of IP-based services. Such an interpretation could have a material adverse affect on us.

Our business requires the implementation and continued development of effective business support systems to implement customer orders and to provide and bill for services.

Our business depends on our ability to continue to implement effective business support systems. This is a complicated undertaking requiring significant resources and expertise and support from third-party vendors. Business support systems are needed for:

- implementing customer orders for services;
- provisioning, installing and delivering these services; and
- monthly billing for these services.

Because we plan to increase the number and volume of services we offer, there is a need to continue to develop these business support systems. The failure to continue to develop effective business support systems could materially adversely affect our relationships with customers and our ability to maintain and expand our business.

We may lose customers if we experience system failures that significantly disrupt the availability and quality of the services that we provide.

Our customers depend on our ability to provide services on a 24 hours a day, seven days a week, 365 days a year schedule, and to avoid and mitigate any interruptions in service or reduced capacity. Interruptions in service or performance problems, for whatever reason, could undermine confidence in our services and cause us to lose customers or make it more difficult to attract new ones. In addition, because many of our services are critical to the businesses of many of our customers, any significant interruption in service could result in lost profits or other loss to customers. Although we attempt to disclaim liability in our service agreements and in our tariffs, certain state laws prohibit such limitations and courts might not enforce a limitation on liability, which could expose us to financial loss. In addition, we often provide our customers with service level commitments. If we are unable to meet these service level commitments as a result of service interruptions, we may be obligated to provide credits, generally in the form of free service for a short period of time, to our customers, which could negatively affect our operating results, or permit customers to terminate their service agreements with us.

The failure of any equipment or facility on our network, including the network management center and network data storage locations, could result in the interruption of customer service until necessary repairs are effected or replacement equipment is installed. Network failures, delays and errors could also result from natural disasters, terrorist acts, power losses, security breaches and computer viruses. These failures, faults or errors could cause delays, service interruptions, expose us to customer liability or require expensive modifications that could significantly hurt our business.

Network costs may significantly increase over time, which could significantly affect our ability to become profitable.

We use a variety of least cost router entities, or LCRs, to route our long haul and interoffice traffic primarily to and from locations where we do not have our own fiber. LCRs typically provide this service at a rate that is lower than the rate offered by other carriers. Some LCRs in the industry have been accused of converting traditional long distance traffic to IP format and terminating such traffic as local traffic to avoid access charges that would otherwise apply to long distance traffic. If the FCC or a court determines that all traffic carried by LCRs is subject to terminating access charges, then LCRs may exit the market or the prices charged to us by the remaining carriers for transport and transiting services could significantly increase.

Adverse rulings on disputes with AT&T and Qwest would have a significant adverse effect on our cash reserves and we face other litigation risk that could materially adversely affect our business, financial condition and results of operations.

We are involved in certain disputes with AT&T and Qwest and are subject to other litigation risk which, if they resulted in adverse outcomes for us, could materially adversely affect our business, financial condition and results of operations. In December 2005, shortly before the confirmation hearing regarding our plan of reorganization, AT&T petitioned the bankruptcy court for a cure payment of $35 million or a $24 million permanent deposit from us as adequate assurance. This dispute is ongoing and, to date, AT&T has not issued a deposit demand to us or sought relief from state or federal regulators as contemplated by the bankruptcy court ruling. Additionally, as a result of AT&T's insistence that we agree to a deposit as a condition of purchasing services under a commercial agreement, we and AT&T have never agreed on a price for services where we use AT&T's local switching facilities to provide local service to our customers after RBOCs were permitted to withdraw UNE-P. In March 2006, AT&T unilaterally increased the price to $37 per line, which we have disputed. We have paid AT&T a lesser amount and deposited the difference into an escrow account pending resolution of the matter. Our business and cash reserves could be materially adversely affected by adverse rulings by state agencies, the FCC, the bankruptcy court or other courts in these pending matters.

As a result of a settlement we reached with Qwest prior to our emergence from Chapter 11, we filed complaints against Qwest with several state utility commissions related to a colloca