

FULLNET COMMUNICATIONS INC  
Form 10-K  
March 31, 2011

---

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2010

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-27031

FULLNET COMMUNICATIONS, INC.  
(Exact name of registrant as specified in its charter)

OKLAHOMA  
(State or other jurisdiction of  
incorporation or organization)

73-1473361  
(I.R.S. Employer Identification No.)

201 Robert S. Kerr Avenue, Suite 210  
Oklahoma City, Oklahoma 73102  
(Address of principal executive offices)

(405) 236-8200  
(Registrant's telephone number)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Title of class

Common Stock, \$0.00001 Par Value

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small reporting company.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The aggregate market value of the Common Stock held by non-affiliates computed by reference to the price at which the Common Stock was last sold, or the average bid and asked price of the Common Stock, as of the last business day (June 30, 2010) of registrant's completed second quarter was \$56,141.

As of March 26, 2011, 7,852,464 shares of the registrant's common stock, \$0.00001 par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: None

---

Table of Contents

FULLNET COMMUNICATIONS, INC.  
FORM 10-K

For the Fiscal Year Ended December 31, 2010

TABLE OF CONTENTS

PART I.

<u>Item 1. Business</u>	4
<u>Item 1A. Risk Factors</u>	11
<u>Item 1B. Unresolved Staff Comments</u>	14
<u>Item 2. Properties</u>	14
<u>Item 3. Legal Proceedings</u>	14

PART II.

<u>Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	15
<u>Item 6. Selected Financial Data</u>	17
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	23
<u>Item 8. Financial Statements and Supplemental Data</u>	23
<u>Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	23
<u>Item 9A. Controls and Procedures</u>	23
<u>Item 9A(T). Controls and Procedures</u>	24

PART III.

<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	25
<u>Item 11. Executive Compensation</u>	27
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	30
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	32
<u>Item 14. Principal Accounting Fees and Services</u>	32
<u>Item 15. Exhibits, Financial Statement Schedules</u>	33

<u>SIGNATURES</u>	38
-------------------	----

<u>Certification Pursuant to Rules 13a-14(a) and 15d-14(a)</u>	
<u>Certification Pursuant to Rules 13a-14(a) and 15d-14(a)</u>	
<u>Certification Pursuant to Section 906</u>	
<u>Certification Pursuant to Section 906</u>	



Table of Contents

Throughout this report the first personal plural pronoun in the nominative case form “we” and its objective case form “us”, its possessive and the intensive case forms “our” and “ourselves” and its reflexive form “ourselves” refer collectively to Fullnet Communications, Inc. and its subsidiaries, and its and their executive officers and directors.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This Annual Report on Form 10-K and the information incorporated by reference may include “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). In particular, we direct your attention to Item 1. Business, Item 1A. Risk Factors, Item 2. Properties, Item 3. Legal Proceedings, Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations, and Item 8. Financial Statements and Supplementary Data. We intend the forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding our expected financial position and operating results, our business strategy, our financing plans and the outcome of any contingencies are forward-looking statements. These statements can sometimes be identified by our use of forward-looking words such as “may,” “believe,” “plan,” “will,” “anticipate,” “estimate,” “expect,” “intend” and other phrases of similar meaning. Known and unknown risks, uncertainties and other factors could cause the actual results to differ materially from those contemplated by the statements. The forward-looking information is based on various factors and was derived using numerous assumptions.

Although we believe that our expectations that are expressed in these forward-looking statements are reasonable, we cannot promise that our expectations will prove to be correct. Our actual results could be materially different from our expectations, including the following:

- We may fail to prevail against AT&T on various disputed billings that total approximately \$7,970,000;
- We may lose subscribers or fail to grow our subscriber base;
- We may not successfully integrate new subscribers or assets obtained through acquisitions, if any;
- We may fail to compete with existing and new competitors;
- We may not adequately respond to technological developments impacting the Internet;
- We may experience a major system failure;
- We may not be able to find needed capital resources.

This list is intended to identify some of the principal factors that could cause actual results to differ materially from those described in the forward-looking statements included elsewhere in this report. These factors are not intended to represent a complete list of all risks and uncertainties inherent in our business, and should be read in conjunction with the more detailed cautionary statements included in this Report under the caption “Item 1A. Risk Factors,” our other Securities and Exchange Commission filings and our press releases.



Table of Contents

PART I

Item 1. Business

General

We are an integrated communications provider offering integrated communications and Internet connectivity to individuals, businesses, organizations, educational institutions and government agencies. Through our subsidiaries, we provide high quality, reliable and scalable Internet access, web hosting, equipment co-location and traditional telephone services. Our overall strategy is to become a successful integrated communications provider for residents and small to medium-sized businesses in Oklahoma.

References to us in this Report include our subsidiaries: FullNet, Inc. (“FullNet”), FullTel, Inc. (“FullTel”), and FullWeb, Inc. (“FullWeb”). Our principal executive offices are located at 201 Robert S. Kerr Avenue, Suite 210, Oklahoma City, Oklahoma 73102, and our telephone number is (405) 236-8200. We also maintain Internet sites on the World Wide Web (“WWW”) at [www.fullnet.net](http://www.fullnet.net), [www.fulltel.net](http://www.fulltel.net) and [www.callmultiplier.com](http://www.callmultiplier.com). Information contained on our Websites is not, and should not be deemed to be, a part of this Report.

Company History

We were founded in 1995 as CEN-COM of Oklahoma, Inc., an Oklahoma corporation, to bring dial-up Internet access and education to rural locations in Oklahoma that did not have dial-up Internet access. We changed our name to FullNet Communications, Inc. in December 1995. Today we are a total solutions provider to individuals and companies seeking a “one-stop shop” in Oklahoma.

Our current business strategy is to become a successful integrated communications provider in Oklahoma. We expect to grow through the acquisition of additional customers for our carrier-neutral co-location space and traditional telephone services, as well as through the acquisition of Internet service providers.

We market our carrier neutral co-location solutions in our network operations center to other competitive local exchange carriers, Internet service providers and web-hosting companies. Our co-location facility is carrier neutral, allowing customers to choose among competitive offerings rather than being restricted to one carrier. Our network operations center is Telco-grade and provides customers a high level of operative reliability and security. We offer flexible space arrangements for customers and 24-hour onsite support with both battery and generator backup.

Through FullTel, our wholly owned subsidiary, we are a fully licensed competitive local exchange carrier or CLEC in Oklahoma. FullTel activates local access telephone numbers for the cities in which we market, sell and operate our retail FullNet Internet service provider brand, wholesale dial-up Internet service; our business-to-business network design, connectivity, domain and Web hosting businesses; and traditional telephone services. At December 31, 2010 FullTel provided us with local telephone access in approximately 232 cities.

Our common stock trades on the OTC Bulletin Board under the symbol FULO. While our common stock trades on the OTC Bulletin Board, it is very thinly traded, and there can be no assurance that our stockholders will be able to sell their shares should they so desire. Any market for the common stock that may develop, in all likelihood, will be a limited one, and if such a market does develop, the market price may be volatile.

Mergers and Acquisitions

Our acquisition strategy is designed to leverage our existing network backbone and internal operations to enable us to enter new markets in Oklahoma, as well as to expand our presence in existing markets, and to benefit from economies of scale.



## Table of Contents

### Our Business Strategy

As an integrated communications provider, we intend to increase shareholder value by continuing to build scale through both acquisitions and internal growth and then leveraging increased revenues over our fixed-costs base. Our strategy is to meet the customer service requirements of retail, business, educational and government Internet users in our target markets, while benefiting from the scale advantages obtained through being a fully integrated backbone and broadband provider. The key elements of our overall strategy with respect to our principal business operations are as follows:

### Target Strategic Acquisitions

The goal of our acquisition strategy is to accelerate market penetration by acquiring Internet service providers in Oklahoma communities and to acquire strategic Internet service providers in Oklahoma City and Tulsa. Additionally, we will continue to build upon our core competencies and expand our technical, customer service staff and sales force in Oklahoma communities. We evaluate acquisition candidates based on their compatibility with our overall business plan of penetrating rural and outlying markets as well as Oklahoma City and Tulsa. When a candidate is acquired, we will integrate our existing Internet, network connectivity and value-added services with the services offered by the acquired company and use either the local sales force or install our own dealer sales force to continue to increase market share. The types of acquisitions targeted by us include Internet service providers located in markets into which we want to expand or to which we may already provide “private-label” Internet connectivity. Other types of targeted acquisitions include local business-only Internet service providers in markets where we have established points of presence and would benefit from the acquired company’s local sale and network solutions sales and technical staff and installed customer base through the potential increase in our network utilization. When assessing an acquisition candidate, we focus on the following criteria:

- o Potential revenue and subscriber growth;
- o Low subscriber turnover or churn rates;
- o Density in the market as defined by a high ratio of subscribers to points of presence (“POPs”);
- o Favorable competitive environment;
- o Low density network platforms that can be integrated readily into our backbone network; and
- o Favorable consolidation savings.

### Generate Internal Sales Growth

We intend to expand our customer base by increasing our marketing efforts. At December 31, 2010, our direct sales force consisted of one individual in our Oklahoma City office coordinating all our business-to-business solutions sales. We currently have independent re-sellers responsible for their individual markets. Our sales force is supported in its efforts by technical engineers and our senior management. In addition, we are exploring other strategies to increase our sales, including other marketing partners such as electric cooperatives. We currently have one of the 20 local Oklahoma electric cooperatives as a marketing partner.

### Increase Rural Area Market Share

We believe that the rural areas of Oklahoma are underserved by Internet service providers, and that significant profitable growth can be achieved in serving these markets by providing reliable Internet connectivity at a reasonable cost to the residents and businesses located in these areas. We believe we can obtain a significant Internet service provider and business-to-business market share in Oklahoma. To that end, through our wholly-owned subsidiary, FullTel, we became a licensed competitive local exchange carrier in Oklahoma. Since March 2003 when we installed our telephone switch, FullTel, as a competitive local exchange carrier, has provided local telephone numbers for Internet access.

## Table of Contents

### Enhance Subscribers' Online Experience

We intend to maximize our subscriber retention and add new subscribers by enhancing our services in the following ways:

- o Ease of Use – During the first quarter of 2001, we implemented a common, easy to use CD-ROM based software package that automatically configures all of the individual Internet access programs after a one-time entry by the user of a few required fields of information such as, name, user name and password.

### Internet Access Services

We provide Internet access services to individual and small business subscribers located in Oklahoma on both a retail and wholesale basis. Through FullNet, we provide our customers with a variety of dial-up and dedicated connectivity, as well as direct access to a wide range of Internet applications and resources, including electronic mail. FullNet's full range of services includes:

- o Private label retail and business direct dial-up connectivity to the Internet and
- o Secure private networks through our backbone network

Our branded and private label Internet access services are provided through a statewide network with points-of-presence in 232 communities throughout Oklahoma. Points-of-presence are local telephone numbers through which subscribers can access the Internet. Our business services consist of high-speed Internet access services and other services that enable wholesale customers to outsource their Internet and electronic commerce activities. We had approximately 800 and 1,200 subscribers at December 31, 2010 and 2009, respectively. Additionally, FullNet sells Internet access to other Internet service providers, who then resell Internet access to their own customers under their private label or under the "FullNet" brand name.

Currently, we offer the following two types of Internet connections:

#### o Dial-Up Connections

The simplest connection to the Internet is the dial-up account. This method of service connects the user to the Internet through the use of a modem and standard telephone line. Currently, FullNet users can connect via dial-up at speeds up to 56 Kbps. We support these users through the use of sophisticated modem banks located in our facility in Oklahoma City that send data through a router and out to the Internet. We support the higher speed 56K, V.92 MOH and Integrated Services Digital Network connections with state-of-the-art digital modems. With a dial-up connection, a user can gain access to the Internet for e-mail, the World Wide Web, file transfer protocol, news groups, and a variety of other useful applications.

#### o Leased Line Connections

Many businesses and some individuals have a need for more bandwidth to the Internet to support a network of users or a busy Website. We have the capacity to sell a leased line connection to users. This method of connection gives the user a full-time high-speed (up to 1.5 mbps) connection to the Internet. The leased line solution comes at greater expense to the user. These lines are leased through the telephone companies at a high installation and monthly fee.



## Table of Contents

We believe that our Internet access services provide customers with the following benefits:

**Fast and Reliable Internet Access-**We have implemented a network architecture providing exceptional quality and consistency in Internet services, making us one of the recognized backbone leaders in the Oklahoma Internet service provider industry. We offer unlimited, unrestricted and reliable Internet access at a low monthly price. We have designed our network such that our users never have to worry about busy signals due to a lack of available modems. Dial-up access is available for the following modem speeds: 14.4K, 28.8K, 33.6K, K56Flex, 56K V.90, v.92 MOH, ISDN 64K and ISDN 128K. Our dial-up access supports all major platforms and operating systems, including MS Windows, UNIX(R), Mac OS, OS/2 and LINUX. This allows simplified access to all Internet applications, including the World Wide Web, email, and news and file transfer protocol.

**Cost-Effective Access-**We offer high quality Internet connectivity and enhanced business services at price points that are generally lower than those charged by other Internet service providers with national coverage. Additionally, we offer pre-bundled access services packages under monthly or prepaid plans.

**Superior Customer Support-**We provide superior customer service and support, with customer care and technical personnel available by telephone and on-line 24 hours per day, 365 days per year.

### CLEC Operations

Through FullTel, our wholly owned subsidiary, we are a fully licensed competitive local exchange carrier or CLEC in Oklahoma. CLECs are new phone companies evolved from the Telecommunications Act of 1996 (Telecommunications Act) that requires the incumbent local exchange carriers or ILECs, generally the regional Bell companies including AT&T, to provide CLECs access to their local facilities, and to compensate CLECs for traffic originated by ILECs and terminated on the CLECs network. By adding our own telephone switch and infrastructure to the existing telephone network in March 2003, we offer certain local Internet access for dial-up services in most of Oklahoma. As a CLEC, we may subscribe to and resell all forms of local telephone service in Oklahoma.

While Internet access is the core focus of growth for us, we plan to also provide traditional telephone service throughout Oklahoma.

A core piece of our marketing strategy is the “cross pollination” between our Internet activities and FullTel’s local dial-up service. By organizing and funding FullTel, we gained local dial-up Internet access to approximately 80% of Oklahoma. In return, FullTel gained access to our entire Internet service provider customer base.

The FullTel data center telephone switching equipment was installed in March 2003. At which time, FullTel began the process of activating local access telephone numbers for every city in Oklahoma within the AT&T service area. At December 31, 2010, FullTel provided us with local telephone access in approximately 232 cities. However, our ability to fully take advantage of these opportunities will be dependent upon the availability of additional capital.

### Sales and Marketing

We focus on marketing our services to two distinct market segments: enterprises (primarily small and medium size businesses) and consumers. By attracting enterprise customers who use the network primarily during the daytime, and consumer customers who use the network primarily at night, we are able to utilize our network infrastructure more cost effectively.

### Competition

The market for Internet connectivity and related services is extremely competitive. We anticipate that competition will continue to intensify as the use of the Internet continues to expand and grow. The tremendous growth and potential market size of the Internet access market has attracted many new start-ups as well as existing businesses from a variety of industries. We believe a reliable network, knowledgeable salespeople and the quality of technical support currently are the primary competitive factors in our targeted market and that price is usually secondary to these factors.

## Table of Contents

Our current and prospective competitors include, in addition to other national, regional and local Internet service providers, long distance and local exchange telecommunications companies, cable television, direct broadcast satellite, wireless communications providers and online service providers. While we believe that our network, products and customer service distinguish us from these competitors, most of these competitors have significantly greater market presence, brand recognition, financial, technical and personnel resources than us.

### Internet Service Providers

Our current primary competitors include other Internet service providers with a significant national presence that focuses on business customers, including Cox Communications and AT&T. These competitors have greater market share, brand recognition, financial, technical and personnel resources than us. We also compete with regional and local Internet service providers in our targeted markets.

### Telecommunications Carriers

The major long distance companies, also known as inter-exchange carriers, including AT&T, Verizon, and Sprint, offer Internet access services and compete with us. Reforms in the federal regulation of the telecommunications industry have created greater opportunities for ILECs, including the Regional Bell Operating Companies or RBOCs, and other competitive local exchange carriers, to enter the Internet connectivity market. In order to address the Internet connectivity requirements of the business customers of long distance and local carriers, we believe that there is a move toward horizontal integration by ILECs and CLECs through acquisitions or joint ventures with, and the wholesale purchase of, connectivity from Internet service providers. The MCI/WorldCom merger (and the prior WorldCom/MFS/UUNet consolidation), GTE's acquisition of BBN, the acquisition by ICG Communications, Inc. of Netcom, Global Crossing's acquisition of Frontier Corp. (and Frontier's prior acquisition of Global Center) and AT&T's purchase of IBM's global communications network are indicative of this trend. Accordingly, we expect that we will experience increased competition from the traditional telecommunications carriers. These telecommunication carriers, in addition to their greater network coverage, market presence, financial, technical and personnel resources also have large existing commercial customer bases.

### Cable Companies, Direct Broadcast Satellite and Wireless Communications Companies

Many of the major cable companies are offering Internet connectivity, relying on the viability of cable modems and economical upgrades to their networks, including Media One and Time Warner Cablevision, Inc., Cox Communications and Tele-Communications, Inc. ("TCI").

The companies that own these broadband networks could prevent us from delivering Internet access through the wire and cable connections that they own. Our ability to compete with telephone and cable television companies that are able to support broadband transmissions, and to provide better Internet services and products, may depend on future regulation to guarantee open access to the broadband networks. However, in January 1999, the Federal Communications Commission declined to take any action to mandate or otherwise regulate access by Internet service providers to broadband cable facilities at this time. It is unclear whether and to what extent local and state regulatory agencies will take any initiatives to implement this type of regulation, and whether they will be successful in establishing their authority to do so. Similarly, the Federal Communications Commission is considering proposals that could limit the right of Internet service providers to connect with their customers over broadband local telephone lines. In addition to competing directly in the Internet service provider market, both cable and television facilities operators are also aligning themselves with certain Internet service providers who would receive preferential or exclusive use of broadband local connections to end users. As high-speed broadband facilities increasingly become the preferred mode by which customers access the Internet, if we are unable to gain access to these facilities on reasonable terms, our business, financial condition and results of operations could be materially adversely affected.

#### Online Service Providers

The dominant online service providers, including America Online, Incorporated, Comcast, AT&T, Road Runner, Verizon and Earthlink, have all entered the Internet access business by engineering their current proprietary networks to include Internet access capabilities. We compete to a lesser extent with these service providers, which currently are primarily focused on the consumer marketplace and offer their own content, including chat rooms, news updates, searchable reference databases, special interest groups and shopping.



## Table of Contents

However, America Online's merger with Time-Warner, its acquisition of Netscape Communications Corporation and related strategic alliance with Sun Microsystems enable it to offer a broader array of Internet -based services and products that could significantly enhance its ability to appeal to the business marketplace and, as a result, compete more directly with Internet service providers like us. CompuServe has also announced that it will target Internet connectivity for the small to medium sized business market.

We believe that our ability to attract business customers and to market value-added services is a key to our future success. However, there can be no assurance that our competitors will not introduce comparable services or products at similar or more attractive prices in the future or that we will not be required to reduce our prices to match competition. Recently, many competitive ISPs have shifted their focus from individual customers to business customers.

Moreover, there can be no assurance that more of our competitors will not shift their focus to attracting business customers, resulting in even more competition for us. There can be no assurance that we will be able to offset the effects of any such competition or resulting price reductions. Increased competition could result in erosion of our market share and could have a material adverse effect on our business, financial condition and results of operations.

## Government Regulations

The following summary of regulatory developments and legislation is not complete. It does not describe all present and proposed federal, state, and local regulation and legislation affecting the Internet service provider and telecommunications industries. Existing federal and state regulations are currently subject to judicial proceedings, legislative hearings, and administrative proposals that could change, in varying degrees, the manner in which our businesses operate. We cannot predict the outcome of these proceedings or their impact upon the Internet service provider and telecommunications industries or upon our business.

The provision of Internet access service and the underlying telecommunications services are affected by federal, state, local and foreign regulation. The Federal Communications Commission or FCC exercises jurisdiction over all facilities of, and services offered by, telecommunications carriers to the extent that they involve the provision, origination or termination of jurisdictionally interstate or international communications. The state regulatory commissions retain jurisdiction over the same facilities and services to the extent they involve origination or termination of jurisdictionally intrastate communications. In addition, as a result of the passage of the Telecommunications Act, state and federal regulators share responsibility for implementing and enforcing the domestic pro-competitive policies of the Telecommunications Act. In particular, state regulatory commissions have substantial oversight over the provision of interconnection and non-discriminatory network access by ILECs. Municipal authorities generally have some jurisdiction over access to rights of way, franchises, zoning and other matters of local concern.

Our Internet operations are not currently subject to direct regulation by the FCC or any other U.S. governmental agency, other than regulations applicable to businesses generally. However, the FCC continues to review its regulatory position on the usage of the basic network and communications facilities by Internet service providers. Although in an April 1998 Report, the FCC determined that Internet service providers should not be treated as telecommunications carriers and therefore should not be regulated, it is expected that future Internet service provider regulatory status will continue to be uncertain. Indeed, in that report, the FCC concluded that certain services offered over the Internet, including phone-to-phone Internet telephony, may be functionally indistinguishable from traditional telecommunications service offerings, and their non-regulated status may require reexamination.

Changes in the regulatory structure and environment affecting the Internet access market, including regulatory changes that directly or indirectly affect telecommunications costs or increase the likelihood of competition from

RBOCs or other telecommunications companies, could have an adverse effect on our business. Although the FCC has decided not to allow local telephone companies to impose per-minute access charges on Internet service providers, and the reviewing court has upheld that decision, further regulatory and legislative consideration of this issue is likely. In addition, some telephone companies are seeking relief through state regulatory agencies. The imposition of access charges would affect our costs of serving dial-up customers and could have a material adverse effect on our business, financial condition and results of operations.

In addition to our Internet service provider operations, we have focused attention on acquiring telecommunications assets and facilities, which is a regulated activity. Fulltel, our subsidiary, has received competitive local exchange carrier or CLEC certification in Oklahoma. The Telecommunications Act requires CLECs not to prohibit or unduly restrict resale of their services; to provide dialing parity, number portability, and nondiscriminatory access to telephone numbers, operator services, directory assistance, and directory listings; to afford access to poles, ducts, conduits, and rights-of-way; and to establish reciprocal compensation arrangements for the transport and termination of telecommunications traffic. In addition to federal regulation of CLECs, the states also impose regulatory obligations on CLECs. While these obligations vary from state to state, most states require CLECs to file a tariff for their services and charges; require CLECs to charge just and reasonable rates for their services, and not to discriminate among similarly-situated customers; to file periodic reports and pay certain fees; and to comply with certain services standards and consumer protection laws. As a provider of domestic basic telecommunications services, particularly competitive local exchange services, we could become subject to further regulation by the FCC or another regulatory agency, including state and local entities.

Table of Contents

The Telecommunications Act has caused fundamental changes in the markets for local exchange services. In particular, the Telecommunications Act and the related FCC promulgated rules mandate competition in local markets and require that ILECs interconnect with CLECs. Under the provisions of the Telecommunications Act, the FCC and state public utility commissions share jurisdiction over the implementation of local competition: the FCC was required to promulgate general rules and the state commissions were required to arbitrate and approve individual interconnection agreements. The courts have generally upheld the FCC in its promulgation of rules, including a January 25, 1999 U.S. Supreme Court ruling which determined that the FCC has jurisdiction to promulgate national rules in pricing for interconnection.

In July 2000, the Eighth Circuit Court issued a decision on the earlier remand from the Supreme Court and rejected, as contrary to the Telecommunications Act, the use of hypothetical network costs, including total element long-run incremental costs methodology (“TELRIC”), which t