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Z TEL TECHNOLOGIES INC
Form SC TO-I/A
October 21, 2004

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

AMENDMENT NO. 1
TO
SCHEDULE TO

TENDER OFFER STATEMENT UNDER SECTION 14(D) (1) OR SECTION 13(E) (1)
OF THE SECURITIES EXCHANGE ACT OF 1934

Z-TEL TECHNOLOGIES, INC.
(Name of Subject Company)

Z-TEL TECHNOLOGIES, INC.
(Name of Filing Person)

Series D Convertible Preferred Stock,
8% Convertible Preferred Stock, Series E, and
12% Junior Redeemable Convertible Preferred Stock, Series G
(Title of Class of Securities)

N/A
(CUSIP Number of Class of Securities)

Andrew L. Graham, Esq.
Corporate Counsel
Z-Tel Technologies, Inc.
601 South Harbour Island Boulevard, Suite 220
Tampa, Florida 33602
(813) 273-6261
(Name, Address and Telephone Number of Person
Authorized to Receive Notices and Communications on Behalf of Filing Person)

With a copy to:

Gary A. Brooks, Esq.
Cahill Gordon & Reindel LLP
80 Pine Street
New York, New York 10005
(212) 701-3000

CALCULATION OF FILING FEE

Transaction Valuation	Amount of Filing Fee
\$115,142,180*	\$14,589**

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* Estimated solely for the purpose of calculating the registration fee and based on the product of (a) the average of the high and low prices of the Company's common stock as reported on the Nasdaq SmallCap Market on September 28, 2004 (\$0.49) and (b) the maximum number shares of common stock, assuming all outstanding shares of preferred stock are tendered and accepted, to be issued in the exchange offer (234,984,041 shares).

** The amount of the filing fee was calculated in accordance with Rule 0-11 of the Securities Exchange Act of 1934 and equals \$126.70 for each \$1,000,000 of the value of the transaction.

Check the box if any part of the fee is offset as provided by Rule 0-11(a)(2) and identify the filing with which the offsetting fee was previously paid. Identify the previous filing by registration statement number or the Form or Schedule and the date of its filing.

Amount Previous Paid: \$23,029
Form or Registration No.: Schedule TO (File No. 005-57653)

Filing Party: Z-Tel Technolog
Date Filed: September 30, 200

Check the box if the filing relates solely to preliminary communications made before the commencement of a tender offer.

Check the appropriate boxes below to designate any transactions to which the statement relates:

- third-party tender offer subject to Rule 14d-1.
- issuer tender offer subject to Rule 13e-4.
- going-private transaction subject to Rule 13e-3.
- amendment to Schedule 13D under Rule 13d-2.

Check the following box if the filing is a final amendment reporting the results of the tender offer:

This Amendment No. 1 to the Tender Offer Statement on Schedule TO ("Schedule TO") amends and supplements the Tender Offer Statement on Schedule TO filed with the Securities and Exchange Commission on September 30, 2004 by Z-Tel Technologies, Inc., a Delaware corporation (the "Company"), and relates to an offer by the Company to exchange (the "Exchange Offer") shares of its common stock for shares of its outstanding series of preferred stock as set forth herein on the terms and subject to the conditions described in the offer to exchange (as amended, the "Offer to Exchange"). The terms and conditions of the Exchange Offer are set forth in the Offer to Exchange and the accompanying Letter of Transmittal, which are exhibits (a)(1)(A) and (a)(2)(B) hereto.

The information set forth in the Offer to Exchange, including the exhibits thereto, the accompanying Letter of Transmittal and the Preliminary Proxy Statement, is hereby expressly incorporated herein by reference in response to all items required in this Schedule TO.

Item 1. Summary Term Sheet.

See the section of the Offer to Exchange, dated October 21, 2004, attached hereto as Exhibit a(1)(A) (the "Offer to Exchange"), captioned "Summary."

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Item 2. Subject Company Information.

(a) The name of the Company to which this Schedule TO relates is Z-Tel Technologies, Inc., a company organized under the laws of the State of Delaware (the "Company"). The address of the principal office of the Company is 601 South Harbour Island Boulevard, Suite 220, Tampa, Florida 33602 and its telephone number is (813) 273-6261.

(b) The titles of the classes of equity securities to which this Schedule TO relates are:

- i. Series D Convertible Preferred Stock (the "Series D Preferred Stock"),
- ii. 8% Convertible Preferred Stock, Series E (the "Series E Preferred Stock"), and
- iii. 12% Junior Redeemable Convertible Preferred Stock, Series G (the "Series G Preferred Stock").

As of September 27, 2004, there were 3,976,723 shares of Series D Preferred Stock, 4,166,667 shares of Series E Preferred Stock, and 171.214286 shares of Series G Preferred Stock outstanding.

(c) See the section of the Offer to Exchange captioned "Market for Common Stock and Preferred Stock."

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Item 3. Identity and Background of Filing Person.

(a) This Schedule TO is being filed by Z-Tel Technologies, Inc. The address of the Company's principal office is 601 South Harbour Island Boulevard, Suite 220, Tampa, Florida 33602 and its telephone number is (813) 273-6261. For the executive officers and directors of the Company, see the section of the Offer to Exchange captioned "Management." The business address and telephone numbers of each executive officer and director are the same as are listed above for the Company.

Item 4. Terms of the Transaction.

(a) See the sections of the Offer to Exchange captioned "Summary," "Risk Factors," "The Offer to Exchange," "Description of Our Preferred Stock," "Description of Our Common Stock," "Material United States Federal Income Tax Consequences," and "Certain Securities Laws Considerations."

(b) See the section of the Offer to Exchange captioned "Interests of Directors and Officers."

Item 5. Past Contacts, Transactions, Negotiations and Agreements.

(a) See the section of the Offer to Exchange captioned "Agreements Involving Our Securities."

Item 6. Purposes of the Transaction and Plans or Proposals.

(a) See the sections of the Offer to Exchange captioned "Summary" and "Reasons for the Offer to Exchange."

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(b) See the section of the Offer to Exchange captioned "Use of Proceeds."

(c) See the sections of the Offer to Exchange captioned "Summary," "Reasons for the Offer to Exchange," "Risk Factors," "Business Overview," and "Use of Proceeds."

Item 7. Source and Amount of Funds or Other Consideration.

(a) See the sections of the Offer to Exchange captioned "Summary" and "The Offer to Exchange."

(b) See the section of the Offer to Exchange captioned "The Offer to Exchange-Conditions."

(d) Not Applicable.

Item 8. Interest in Securities of the Subject Company.

(a) See the sections of the Offer to Exchange captioned "Interests of Directors and Officers" and "Security Ownership."

(b) See the sections of the Offer to Exchange captioned "Interests of Directors and Officers" and "Security Ownership of Certain Beneficial Owners and Management."

Item 9. Persons/Assets Retained, Employed, Compensated or Used.

(a) See the section of the Offer to Exchange captioned "Fees and Expenses."

Item 10. Financial Statements.

(a) Incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003; Quarterly Report on Form 10-Q for the quarter ended March 31, 2004; and Quarterly Report on Form 10-Q for the quarter ended June 30, 2004.

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(b) See the section of the Offer to Exchange captioned "Financial Information."

Item 11. Additional Information.

(a) See the sections of the Offer to Exchange captioned "Interest of Directors and Officers," "Agreements Involving our Securities" and "Certain Legal Matters; Regulatory Approvals."

(b) Not applicable.

Item 12. Exhibits.

Exhibit No.	Description
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(a) (1) (A) Amended Offer to Exchange, dated October 21, 2004.

(a) (1) (B) Form of Letter of Transmittal, dated October 21, 2004, relating to the Amended Offer to Exchange.

(a) (2) Preliminary Proxy Statement, filed with the Securities and Exchange

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Commission on October 21, 2004.

Item 13. Information Required by Schedule 13E-3.

Not applicable.

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SIGNATURE

After due inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

Z-TEL TECHNOLOGIES, INC.

By: /s/ Horace J. Davis, III

Name: Horace J. Davis, III
Title: Acting Chief Executive Officer

Dated: October 21, 2004

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Exhibit (a) (1) (A)

Z-TEL TECHNOLOGIES, INC.

AMENDED OFFER TO EXCHANGE
SHARES OF
SERIES D CONVERTIBLE PREFERRED STOCK,
8% CONVERTIBLE PREFERRED STOCK, SERIES E, AND
12% JUNIOR REDEEMABLE CONVERTIBLE PREFERRED STOCK, SERIES G,
FOR SHARES OF COMMON STOCK

THIS AMENDED OFFER TO EXCHANGE WILL EXPIRE AT 5:00 P.M., NEW YORK CITY TIME, ON TUESDAY, NOVEMBER 23, 2004, UNLESS EXTENDED PURSUANT TO THE TERMS HEREOF (THE "EXPIRATION DATE"). HOLDERS OF SHARES OF PREFERRED STOCK MUST VALIDLY TENDER THOSE SHARES ON OR PRIOR TO THE EXPIRATION DATE IN ORDER TO BE ELIGIBLE TO RECEIVE THE EXCHANGE OFFER CONSIDERATION.

We are offering you the opportunity to voluntarily exchange any or all of your shares of our outstanding preferred stock as follows (subject in each case to the impact of any reverse stock split):

- o for shares of our Series D Convertible Preferred Stock (the "Series D

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Preferred Stock"), which as of September 27, 2004 have a liquidation preference (representing original investment plus accrued and unpaid dividends) of \$16.55 per share and conversion price of \$8.47 per share, to exchange 25.69030 shares of our common stock, par value \$0.01 per share (the "Common Stock"), for each share of our Series D Preferred Stock (representing an exchange price of approximately \$0.644 per share);

- o for shares of our 8% Convertible Preferred Stock, Series E (the "Series E Preferred Stock"), which as of September 27, 2004 have a liquidation preference of \$16.26 per share and conversion price of \$8.08 per share, to exchange 25.24216 shares of our Common Stock for each share of our Series E Preferred Stock (representing an exchange price of approximately \$0.644 per share); and
- o for shares of our 12% Junior Redeemable Convertible Preferred Stock, Series G (the "Series G Preferred Stock" and, together with the Series D Preferred Stock and the Series E Preferred Stock, the "Preferred Stock"), which as of September 27, 2004 have a liquidation preference of \$144,975.90 per share and conversion price of \$1.28 per share, to exchange 161,469.4 shares of our Common Stock for each share of our Series G Preferred Stock (representing an exchange price of approximately \$0.898 per share).

On October 20, 2004, the closing price for the Common Stock on the Nasdaq SmallCap Market was \$0.39 per share.

We intend to call a special meeting (the "Special Meeting") of our stockholders to be held on November 16, 2004 to approve consummation of this offer to exchange, as amended (the "Exchange Offer") and certain related matters. We expect to promptly commence a proxy solicitation of our stockholders, including holders of Preferred Stock, by means of a separate proxy statement in connection the Special Meeting. At the special meeting we will ask our stockholders to, among other things, (1) approve consummation of this Exchange Offer, (2) amend the terms of the Series D Preferred Stock to remove certain restrictive provisions provided for in the certificate of designation governing the Series D Preferred Stock, (3) amend our charter to terminate the certificate of designation governing the Series D Preferred Stock if all of the outstanding Series D Preferred Stock is tendered for exchange in this Exchange Offer, (4) amend our charter to terminate the certificate of designation governing the Series E Preferred Stock, (5) amend the terms of the Series G Preferred Stock to remove certain restrictive provisions provided for in the certificate of designation governing the Series G Preferred Stock, (6) amend our charter to terminate the certificate of designation governing the Series G Preferred Stock if all of the outstanding Series G Preferred Stock is tendered for exchange in this Exchange Offer, (7) authorize our board of directors to adopt one of several reverse stock split proposals with respect to the Common Stock, within their discretion, and (8) approve a new management equity incentive plan and the reservation of shares of Common Stock for issuance thereunder (collectively, the "Special Meeting Matters"). We intend to file a press release immediately following the Special Meeting to advise our stockholders of the result of the votes on the Special Meeting Matters. If we decide to postpone the Special Meeting and proceed with the Exchange Offer, we will extend the Exchange Offer to the close of business on the fifth business day following the Special Meeting date.

CONSUMMATION OF THE EXCHANGE OFFER IS CONDITIONED UPON THE APPROVAL BY OUR STOCKHOLDERS OF THE SPECIAL MEETING MATTERS AND UPON THE TENDER BY THE 1818 FUND III, L.P. ("THE 1818 FUND") OF ALL PREFERRED STOCK THAT IT OWNS (AND THE

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ACCEPTANCE BY US OF SUCH SHARES) IN THE EXCHANGE OFFER. REPRESENTATIVES OF THE 1818 FUND HAVE INDICATED THAT THEY INTEND TO TENDER ALL OF THE 1818 FUND'S SHARES OF PREFERRED STOCK IN THE OFFER IF SUBSTANTIALLY ALL OF THE SHARES OF PREFERRED STOCK OWNED BY OTHER HOLDERS ARE TENDERED IN THE OFFER. CONSUMMATION OF THE EXCHANGE OFFER IS ALSO SUBJECT TO THE OTHER CONDITIONS DESCRIBED HEREIN.

We will announce, by means of a press release, the amount of each series of Preferred Stock tendered as of the close of business (1) on the second business day preceding the date of the Special Meeting and (2) on the second business day prior to expiration of the Exchange Offer. We will also announce, by means of a press release, when The 1818 Fund has tendered its shares of Preferred Stock. If necessary, we will extend the Exchange Offer to the close of business on the fifth business day following the date upon which The 1818 Fund tenders its shares of Preferred Stock.

We will accept shares of Preferred Stock ("Preferred Shares") validly tendered for exchange and not withdrawn as of the Expiration Date, upon the terms and conditions set forth

herein and in the Letter of Transmittal (the "Letter of Transmittal") attached hereto as Exhibit A. This Offer to Exchange and the Letter of Transmittal together constitute the "Offer."

THE ACTUAL NUMBER OF SHARES OF COMMON STOCK TO BE ISSUED IN EXCHANGE FOR THE PREFERRED STOCK TENDERED IN THE EXCHANGE OFFER WILL AUTOMATICALLY BE ADJUSTED BY A REVERSE STOCK SPLIT TO BE EFFECTED PRIOR TO THE CONSUMMATION OF THE EXCHANGE OFFER. FOR ADDITIONAL INFORMATION ON THE REVERSE STOCK SPLIT, SEE "THE OFFER TO EXCHANGE--NUMBER OF SHARES."

See "Risk Factors" beginning on page 9 and "Material United States Federal Income Tax Consequences" beginning on page 40 for a discussion of certain factors that you should consider in connection with the Offer.

You may direct questions and requests for assistance or additional copies of this Offer to Exchange, the Letter of Transmittal, the Notice of Guaranteed Delivery and other related documents to Andrew L. Graham, the Exchange and Information Agent, at the address and telephone numbers set forth on the last printed page of this Offer to Exchange.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved this transaction or determined if this document is accurate or complete.

We are not, and our Board of Directors, our employees and the Exchange and Information Agent are not, making any recommendation to you as to whether you should tender or refrain from tendering your Preferred Shares. You must make the decision whether to tender your Preferred Shares and, if so, how many Preferred Shares to tender.

THE DATE OF THIS AMENDED OFFER TO EXCHANGE IS OCTOBER 21, 2004.

IMPORTANT INFORMATION REGARDING THE OFFER

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We are making this Offer in reliance upon the exemption from registration provided by Section 3(a)(9) of the Securities Act of 1933, as amended (the "Securities Act"). We are not aware of any jurisdiction where making the Offer to Exchange is not in compliance with applicable law. If we become aware that the Offer to Exchange is not in compliance with any jurisdiction's applicable law, we will make a good faith effort to comply with such law. If with our good faith efforts, we cannot comply with such law, the Offer to Exchange will not be made to (nor will tenders be accepted from or on behalf of) the holders of Preferred Shares residing in such jurisdiction.

You should rely only on the information incorporated by reference or provided in this Offer to Exchange. We have not authorized anyone to provide you with different information or to solicit or seek tenders of Preferred Stock pursuant to the Offer. You should not assume that the information in this Offer to Exchange or any supplement is accurate as of any date other than the date on the cover of this Offer to Exchange.

As described on the cover of this Exchange Offer, we expect to commence a proxy solicitation providing for, among other things, alternative reverse stock splits of our Common Stock. The information included in and incorporated by reference into this Offer to Exchange does not give effect to any such reverse stock split. For additional information on the reverse stock split, see "The Offer to Exchange--Number of Shares."

The contents of this Offer to Exchange should not be construed as legal, business or tax advice. You should consult your own attorney, business advisor and tax advisor as to such matters.

CAUTION AS TO UNAUTHORIZED STATEMENTS

WE HAVE NOT AUTHORIZED ANY PERSON TO MAKE ANY RECOMMENDATION ON OUR BEHALF AS TO WHETHER YOU SHOULD TENDER OR REFRAIN FROM TENDERING PREFERRED SHARES UNDER THE OFFER TO EXCHANGE. WE HAVE NOT AUTHORIZED ANYONE TO GIVE ANY INFORMATION, TO MAKE ANY REPRESENTATION OR TO SOLICIT ANY TENDERS IN CONNECTION WITH THE OFFER TO EXCHANGE OTHER THAN WHAT IS CONTAINED IN THIS OFFER TO EXCHANGE OR IN THE LETTER OF TRANSMITTAL.

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Exhibits

Exhibit A Letter of Transmittal

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SUMMARY

This general summary is provided solely for your convenience. You should read the entire Offer to Exchange and the related Letter of Transmittal before you decide whether to participate in the Offer.

Shares Eligible for Exchange..... The Offer applies to all shares of our outstanding Preferred Stock, which is comprised of the following three series:

- o Series D Convertible Preferred Stock, par value \$.01 per share,
- o 8% Convertible Preferred Stock, Series E, par value \$.01 per share, and
- o 12% Junior Redeemable Convertible Preferred Stock, Series G, par value \$.01 per share.

Reason for the Offer..... The purpose of the Offer is (i) to improve and simplify our capital structure, thereby enabling us to potentially attract necessary additional financing for our business plan, (ii) to provide holders of Preferred Stock with a means to gain greater liquidity by issuing to them Common Stock and (iii) to increase the aggregate market value of our Common Stock to maintain our listing on the Nasdaq

SmallCap Market.

Overview of the Offer to Exchange.....

We are offering to all holders of our Preferred Shares the right to tender those shares in exchange for newly issued shares of our Common Stock (the "Common Shares"). The exchange ratio (the "Exchange Ratio") and consideration (the "Exchange Consideration") for each series of Preferred Stock will be as follows (subject in each case to the impact of any reverse stock split):

- o For each share of our Series D Preferred Stock, we will issue 25.69030 Common Shares (representing an effective conversion price of approximately \$0.644 per share);

- o For each share of our Series E Preferred Stock, we will issue 25.24216 Common Shares (representing an effective conversion price of approximately \$0.644 per share); and

- o For each share of our Series G Preferred Stock, we will issue 161,494.4 Common Shares (representing an effective conversion price of approximately \$0.898 per share).

As of September 27, 2004 there were approximately 38.8 million shares of Common Stock outstanding.

The actual number of shares of Common Stock to be issued in exchange for the Preferred Stock tendered in the Exchange Offer will automatically be adjusted by a reverse stock split to be effected prior to the consummation of the Exchange Offer. For additional information on the reverse stock split, see "The Offer

to Exchange--Number of Shares."

Assuming the tender of all outstanding Preferred Stock in the Exchange Offer, the exercise of all outstanding options (other than management options outstanding prior to the Exchange Offer), warrants and other rights to acquire Common Stock and the inclusion of all shares of Common Stock expected to be reserved for issuance under the new management equity incentive plan (a "Fully Diluted Basis"), after giving effect to the Exchange Offer:

- o the former holders of Series D Preferred Stock would own approximately 34.0% of the Common Stock on a Fully Diluted Basis;

- o the former holders of Series E Preferred Stock would own approximately 35.0% of the Common Stock on a Fully Diluted Basis;

- o the former holders of Series G Preferred Stock would own approximately 9.2% of the Common Stock on a Fully Diluted Basis;

- o the current holders of Common Stock would own approximately 13.8% of the Common Stock on a Fully Diluted Basis; and

- o approximately 8.0% of Common Stock, on a Fully Diluted Basis, would have been available for issuance under the new management equity incentive plan.

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Expiration Date.....

The Offer will expire on Tuesday, November 23, 2004, at 5:00 p.m., New York City time, unless we extend the Offer.

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Number of Shares to Be Exchanged.....

The Offer applies to all our outstanding Preferred Shares. As of September 27, 2004, there were:

- o 3,976,723 shares of Series D Preferred Stock outstanding;
- o 4,166,667 shares of Series E Preferred Stock outstanding; and
- o 171.214286 shares of Series G Preferred Stock outstanding.

There is no minimum number of shares that must be tendered in the Offer. You may tender some, all, or none of your Preferred Shares. However, consummation of the Offer is conditioned upon the tender by The 1818 Fund of all Preferred Shares that it owns (and the acceptance by us of such shares) in the Offer. Representatives of The 1818 Fund have indicated that they intend to tender all of The 1818 Fund's Preferred Shares in the Offer if substantially all of the Preferred Shares owned by other holders are tendered in the Offer. We will announce, by means of a press release, the number of shares of each series of Preferred Stock tendered as of the close of business (1) on the second business day preceding the date of the Special Meeting and (2) on the second business day prior to expiration of the Exchange Offer. We will also announce, by means of a press release, when The 1818 Fund has tendered its shares of Preferred Stock. If necessary, we will extend the Exchange Offer to the close of business on the fifth business day following the date upon which The 1818 Fund tenders its shares of Preferred Stock.

Fractional shares will not be issued. In the event that a fraction of a Common Share becomes issuable upon consummation of the Offer to Exchange, we will pay you an amount in cash equal to the closing price of our Common Stock on the business day preceding such consummation (as adjusted to reflect the impact of any reverse stock split), multiplied by such fraction of a Common Share.

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Conditions.....	Consummation of the Exchange Offer is conditioned upon the approval by stockholders of the Special Meeting Matters and upon the tender by The 1818 Fund of all Preferred Stock that it owns in the Exchange Offer and the acceptance by us of such shares. In addition, we will not be required to accept the tender of any Preferred Shares, and may terminate, postpone, or amend the Offer, if, among other things, any action or proceeding is commenced that threatens the Offer or if the other conditions described under the heading "The Offer to Exchange--Conditions" are not met.
Exchange Date.....	We will exchange your Preferred Shares for the Exchange Consideration (or return your Preferred Shares to you if the Offer is not consummated or such shares are not accepted) promptly after the Expiration Date.
Exchange and Information Agent.....	Andrew L. Graham, our Corporate Counsel
Withdrawal Rights.....	You may withdraw tendered Preferred Shares at any time prior to the Expiration Date.
Federal Income Tax Consequences.....	Based upon discussions with our tax counsel, we believe

the Offer will qualify as a reorganization for federal income tax purposes. However, we did not seek or obtain any tax opinion with respect to the tax consequences of the Offer. Assuming the Offer qualifies as a reorganization for federal income tax purposes, you will not recognize gain or loss on the receipt of the Exchange Consideration, in exchange for the face amount of your Preferred Shares. However, to the extent that Common Shares are received for accrued but unpaid dividends on Preferred Shares, this portion will be treated as the payment of a dividend distribution, but only to the extent that the fair market value of the aggregate Common Shares received in the exchange exceeds the aggregate issue price of the Preferred Shares surrendered. For additional information on certain of the U.S. federal income tax consequences of the Exchange Offer, see "Material United States Federal Income Tax Consequences."

For a complete description of the rights and preferences of the Preferred Shares and the Common Shares, see "Description of Our Preferred Stock," "Description of Our Common Stock" and "Certain Securities Laws Considerations."

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REASONS FOR THE OFFER TO EXCHANGE

Our business has been adversely affected by a number of factors in recent years that have also adversely affected the trading price of our Common Stock. We have developed a business plan that we believe can create long-term opportunities for our business, but the execution of that business plan requires us to obtain additional financing. We have had difficulty in attracting the financing we will need in part due to the existence of the Preferred Stock (particularly the mandatory redemption features thereof). Management believes that the conversion of the Preferred Stock into Common Stock is essential for it to be able to implement its business plan.

We are making this Offer because we believe that it will:

- o Improve and simplify our capital structure by eliminating all or

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substantially all of the approximately \$158.4 million aggregate liquidation preference of Preferred Stock in exchange for Common Stock, thereby enabling us to potentially attract necessary additional financing for our business plan.

- o Eliminate all or substantially all of the dividends payable to holders of Preferred Stock and the related dilutive effect on holders of Common Stock (and increase the equity and earnings attributable to Common Stock).
- o Reduce or eliminate the mandatory redemption payments on our Preferred Stock, which will be due in 2006 on the Series G Preferred Stock and in 2008 on the Series D Preferred Stock and Series E Preferred Stock.
- o Give the holders of Preferred Stock a means to gain greater liquidity by issuing Common Shares, which subject to securities law restrictions applicable to our affiliates, will be freely tradable and eligible for listing or quotation on the stock market or quotation system on which our Common Stock is then listed or quoted. The Preferred Stock does not currently trade on any exchange or stock market.
- o Give the holders of Preferred Stock an opportunity to receive more shares of Common Stock than they would be entitled to receive under the existing conversion provisions of the Preferred Stock. Each share of Series D Preferred Stock is currently convertible into 1.95 shares of Common Stock, each share of Series E Preferred Stock is currently convertible into 2.01 shares of Common Stock, and each share of Series G Preferred Stock is currently convertible into 113,262 shares of Common Stock.
- o Increase the aggregate market value of our Common Stock, which is currently below the \$35 million minimum amount required to maintain listing on the Nasdaq SmallCap Market, to an amount substantially in excess of the minimum amount required to maintain listing of the Common Stock on the Nasdaq SmallCap Market.

Notwithstanding the fact that the Exchange Offer is conditioned upon the approval by our stockholders of the Special Meeting Matters we are distributing the Offer to Exchange to holders of our Preferred Stock prior to the Special Meeting because under applicable law the Offer is re-

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quired to be kept open for a minimum of 20 business days and we believe we should attempt to synchronize the Exchange Offer period and the notice period for the Special Meeting so that they run concurrently, with an overall view towards most expeditiously and efficiently consummating the Offer and transactions contemplated by the Special Meeting Matters.

BUSINESS OVERVIEW

Z-Tel Technologies, Inc. is a communications service provider. We provide innovative and cost effective telecommunications services to consumers, business and other communications companies by integrating our own enhanced communications systems and advanced operational support systems with access to communication networks. Our systems have the capability to integrate with wireline, wireless, cable, Internet and other communications transport networks. Our current generation of services relies primarily on access to local and long distance telephone networks. A recent court ruling has created legal uncertainty

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regarding our access to local telephone networks. See "Risk Factors--Risks Related to Our Business and Financial Condition." We recently launched a new generation of services using voice over Internet protocol ("VoIP").

We provide services on both a retail and wholesale basis. Our principal retail services are Z-LineHOME(R), Z-LineBUSINESS(R) and Touch 1 Long Distance. Z-LineHOME and Z-LineBUSINESS are residential and business versions, respectively, of our flagship offering, the Z-Line(R). The Z-Line is local telephone service, typically bundled with long distance and enhanced features, including a suite of our proprietary Internet-accessible and voice-activated functions. The enhanced features include voicemail, "Find Me" call forwarding and our recently introduced Personal Voice Assistant(TM), or "PVA," which utilizes voice-recognition technology so that users can access secure, online address books from any phone using simple voice commands in order to send voice emails, find contact information and dial numbers, among other things. Touch 1 Long Distance is a residential long distance telephone service.

Our principal executive offices are located at 601 South Harbour Island Boulevard, Suite 220, Tampa, Florida, 33602, and our telephone number at that address is (813) 273-6261. Our website address is www.ztel.com. Information on our website does not constitute part of this Offer to Exchange.

For additional information about us, see "Financial Information" and the documents incorporated by reference into this Offer to Exchange.

FINANCIAL INFORMATION

Our Summary Historical Consolidated Financial Information

The following table sets forth summary historical consolidated financial and operating information of Z-Tel. Except for the six months ended June 30, 2004 and 2003, and the property information, the summary historical financial information is derived from audited consolidated financial statements of Z-Tel for each period presented. The summary historical data are only a summary, and should be read in conjunction with the historical financial statements and related notes contained in the annual and quarterly reports of Z-Tel incorporated herein by reference.

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	Years Ended December 31,					
	2003	2002	2001	2000 (1)	1999	

	(In thousands, except share and per share da					
Revenues.....	\$289,180	\$238,397	\$280,350	\$177,668	\$6,615	\$13
Operating expenses:						
Network operations (2).....	135,097	94,474	159,617	107,077	6,518	6
Sales and marketing.....	18,753	12,327	31,243	45,018	8,898	6
General and administrative (3)	127,018	122,579	156,107	99,606	20,055	6
Asset impairment charge (4)...	--	1,129	59,247	--	--	--
Wholesale development costs (5)	--	1,018	--	--	--	--
Restructuring charge (6).....	--	1,861	--	--	--	--
Depreciation and amortization.	23,449	23,936	23,277	17,166	4,372	1

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Total operating expenses....	(304,317)	257,324	429,491	268,867	39,843	15
Operating loss.....	(15,137)	(18,927)	(149,141)	(91,199)	(33,228)	(1
Non-operating income (loss):						
Interest and other income.....	2,086	3,509	6,862	5,475	608	
Interest and other expense....	(3,076)	(4,137)	(3,789)	(2,313)	(3,351)	(
Total non-operating income (loss).....	(990)	(628)	3,073	3,162	(2,743)	(
Net loss.....	(16,127)	(19,555)	(146,068)	(88,037)	(35,971)	(2
Less mandatorily redeemable convertible preferred stock dividends and accretion.....	(17,480)	(15,589)	(15,059)	(3,644)	(1,654)	(
Less deemed dividend related to beneficial conversion feature	(186)	(186)	(9,356)	(20,027)	--	
Net loss attributable to common stockholders.....	\$ (33,793)	\$ (35,330)	\$ (170,483)	\$ (111,708)	\$ (37,625)	\$ (2
Weighted average common shares outstanding.....	35,396,922	34,951,720	33,908,374	33,066,538	15,099,359	36,3
Basic and diluted net loss per share.....	\$ (0.95)	\$ (1.01)	\$ (5.03)	\$ (3.38)	\$ (2.49)	
Consolidated Balance Sheet Data						
Cash and cash equivalents (7) (8)	\$12,013	\$16,037	\$18,892	\$46,650	\$101,657	\$
Working capital (deficit).....	(31,038)	(19,380)	(11,983)	59,245	95,315	(4
Total assets.....	89,453	106,711	116,737	246,461	137,677	\$8
Total debt.....	5,531	10,144	15,766	20,417	14,134	
Mandatorily convertible redeemable preferred stock (8)	144,282	127,631	112,570	84,585	--	1
Total stockholder's equity (deficit).....	(131,019)	(99,284)	(67,172)	89,100	114,378	(
Other Financial Data						
Net cash provided by (used in) operating activities.....	11,956	18,399	(21,846)	(96,862)	(32,681)	(
Net cash used in investing activities.....	(10,996)	(15,600)	(15,615)	(40,602)	(5,182)	(
Net cash provided by (used in) financing activities.....	(4,984)	(5,654)	9,701)	82,455	131,547	1

- (1) We completed the acquisition of Touch 1 on April 14, 2000. We used the purchase accounting method for our acquisition of Touch 1. Therefore, our discussions of the results of operations and liquidity and capital resources do not include any discussions regarding Touch 1 prior to our acquisition of Touch 1, which is treated as being closed for accounting purposes, on April 1, 2000.
- (2) During 2002, we received a \$9.0 million retroactive rate reduction for the unbundled network elements we acquired from Verizon as a result of a settlement approved by the New York Public Service Commission.
- (3) Included in the 2001 general and administrative expense was a write-off of accounts receivable that resulted in \$29.9 million of additional bad debt expense.

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- (4) We recorded a \$1.1 and \$59.2 million expense related to impaired assets in 2002 and 2001, respectively. This expense was the result of management's decision to reduce various customer growth initiatives, most notably telemarketing activity levels. In 2001, a majority of the operations and assets of telemarketing centers acquired from Touch 1 was either voluntarily closed or sold. In addition to the goodwill impairment of \$54.9 million, we recorded a \$4.3 million charge associated with the impairment of assets, composed of \$3.0 million relating to unrealizable software and development projects, \$0.9 million of a worthless telemarketing property and equipment, and \$0.4 million of securities deemed to be worthless. As a result of management's decision in the second quarter of 2002 to enhance future cash flow and operating earnings, we closed the remaining call centers in North Dakota and recorded a \$1.1 million asset impairment. We also incurred restructuring charges as a result of this decision during 2002 as discussed in note (1).
- (5) During 2002, we began to provide our services on a wholesale basis. We recorded start-up costs for developing this new service offering of approximately \$1.0 million. All wholesale related costs after our initial wholesale services contract signed on March 20, 2002 are included in the operating expenses line items, rather than being segregated.
- (6) During 2002, we closed two call centers in North Dakota and our New York sales office. As discussed in note (4) above, these expenses consisted primarily of termination benefits, lease abandonment and lease settlement costs.
- (7) Included in the December 31, 1999 cash balance was approximately \$109.1 million of net proceeds from our December 15, 1999 initial public offering. This cash was obtained through the sale of 6,900,000 shares (including the underwriters' over-allotment option) of our common stock at \$17.00 per share.
- (8) During 2000, we issued series D and E preferred stock for approximately \$56.3 and \$50.0 million, respectively. During 2001, we issued series G preferred stock for approximately \$17.5 million.

Summary Pro Forma Consolidated Financial Information of Z-Tel

The following unaudited pro forma information presents the effects of the Offer assuming all of our outstanding Preferred Shares are exchanged for the Exchange Consideration as if the exchange occurred as of June 30, 2004 for the unaudited balance sheet data. There would be no pro forma adjustments to our income statement data for either the year ended December 31, 2003 or the six months ended June 30, 2004 if the exchange occurred as of the first day of such periods. In the quarter in which the exchange is approved, a dividend charge will be recorded that will impact net earnings. It is expected that this dividend will reduce net earnings, assuming our Common Stock price remains below the effective exchange price. Earnings per share attributable to Common Stock will be adjusted due to the dividend and will show an even greater loss per Common Share outstanding. The pro forma information does not include costs of this Offer or a dividend charge that we will incur as a result of the Offer.

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Consolidated Pro Forma Balance Sheets
(In thousands, except share and per share data)
(Unaudited)

	June 30, 2004	Pro Forma Adjustments
Assets		
Current assets:		
Cash and cash equivalents	\$ 8,196	\$ --
Accounts receivable, net of allowance for doubtful accounts	28,672	
Prepaid expenses and other current assets	4,804	
Total current assets	41,672	--
Property and equipment, net	34,298	
Intangible assets, net	1,372	
Other assets	3,227	
Total assets	\$ 80,569	\$ --

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Consolidated Pro Forma Balance Sheets
(In thousands, except share and per share data)
(Unaudited)

	June 30, 2004	Pro Forma Adjustments
Liabilities, preferred stock and deficit		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 63,745	\$ --
Deferred revenue	8,357	
Current portion of long-term debt and capital lease obligations	14,697	
Total current liabilities	86,799	
Long-term deferred revenue	221	
Long-term debt and capital lease obligations	205	--
Total liabilities	87,225	--
Mandatorily redeemable convertible preferred stock	152,366	(152,366)
Stockholders' deficit:		
Common stock	373	2,538
Notes receivable from stockholders	(930)	
Additional paid-in capital	183,281	149,828
Accumulated deficit	(341,358)	--
Treasury stock	(388)	--
Total stockholders' deficit	(159,022)	152,366
Total liabilities, preferred stock and deficit	\$ 80,569	\$ --

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Risk Factors

You should carefully consider the risks described below, in addition to the other information in this Offer to Exchange, before making a decision to tender. Each of these risk factors could adversely affect our business, financial condition and operating results as well as adversely affecting the value of an investment in our Common Stock.

Risks Related to the Offer

By participating in the Offer, you will give up the special rights of a holder of Preferred Stock.

The holders of Preferred Shares have various rights which are better than the rights of holders of Common Stock. Those rights include:

- o the right to receive dividends at the rate of 8% per year (or 12% per year, in the case of the Series G Preferred Stock);
- o the right to have the Preferred Stock redeemed in 2008 at \$12.00 per share (or \$100,000.00 per share in the case of Series G Preferred Stock) plus all accrued and unpaid dividends;
- o in the case of the Series E Preferred Stock, the right to vote as a separate class on mergers and certain other transactions;

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- o the right to receive a preferential payment of \$12.00 per share (or \$100,000.00 per share in the case of Series G Preferred Stock) plus accrued and unpaid dividends if we liquidate; and
- o the right to vote, as a class, to block the issuance of any series of stock having preferential dividend or liquidation rights.

You will lose these rights if your Preferred Shares are exchanged in the Offer. The Common Stock does not have any special rights.

By participating in the Offer, you will give up the seniority that you have over holders of Common Stock or any other class of stock which is junior to your Preferred Stock.

Holders of Preferred Shares are entitled to receive dividends and other distributions before holders of Common Stock are entitled to receive them, including any distributions that might be made in liquidation or bankruptcy. If you exchange your Preferred Shares in the Offer, you will no longer have that seniority over holders of Common Stock. Holders of Series D Preferred Stock and Series E Preferred Stock are entitled to receive dividends and other distributions before holders of Series G Preferred Stock are entitled to receive them, including any distributions that might be made in liquidation or bankruptcy. If you exchange your shares of Series D Preferred Stock or Series E Preferred Stock in the Offer, you will no longer have that seniority over holders of the Series G Preferred Stock.

Prior to the consummation of the Exchange Offer certain of the terms of the Preferred Stock may be amended.

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If the proposed amendments contemplated in the Special Meeting Matters that will be described in the proxy statement to be prepared for the Special Meeting are adopted, the terms of those series of Preferred Stock will change significantly and holders of such Preferred Stock that is not tendered in the Offer will cease to have certain preferential rights that they had prior to the Offer.

If you do not participate in the Offer, your ownership percentage and voting power may be diluted.

Consummation of the Offer will result in holders of Preferred Shares acquiring a higher percentage of our ownership than they possessed prior to the Offer, resulting in the dilution of the ownership of the preferred stockholders who do not participate. In the case of the holders of Series D Preferred Stock and Series E Preferred Stock, consummation of the Offer will result in holders of Series D Preferred Stock and Series E Preferred Stock acquiring a higher percentage of voting power than they possessed prior to the Offer, resulting in the dilution of the voting power of the holders of Series D Preferred Stock and Series E Preferred Stock who do not participate.

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Risks Related to Our Business and Financial Condition

Our business depends on the availability and favorable pricing of unbundled network components.

Our current generation of local telephone services, which produces approximately 95% of our revenue, relies on access to local telephone networks. Our access to these networks is based upon the Telecommunications Act of 1996 (the "Telecommunications Act"), which imposes a variety of duties upon the traditional local telephone companies ("incumbent local exchange carriers" or "ILECs"), including the duty to provide competitive local exchange companies, like us, with access to the individual components of their networks. Our business strategy depends on a continued availability of ILEC unbundled network components and on states maintaining and adopting favorable pricing rules for ILEC unbundled network components. The FCC has issued rules regarding access to key components of the ILEC networks, including transport and switching. A recent court ruling, however, has created considerable legal uncertainty regarding this access. In *United States Telecom Ass'n v. FCC*, Nos. 00-1012, 00-1015, 03-1310 et al. (D.C. Cir. March 2, 2004) ("USTA II"), the D.C. Circuit Court ordered that the FCC's unbundled transport and switching rules be vacated after sixty days or upon denial of a petition for rehearing, whichever occurs later. Both the U.S. Solicitor General and the FCC have declined to appeal the case. U.S. Supreme Court Chief Justice William Rehnquist on June 14, 2004 refused to issue a stay of the decision.

On August 20, 2004, the Federal Communications Commission issued a Notice of Proposed Rulemaking ("NPRM") seeking comment on unbundling rules to implement obligations under section 251(c)(3) of the Telecommunications Act and to respond to the D.C. Circuit's vacatur in USTA II of the rules that the FCC adopted in the Triennial Review Order. The FCC also released an order setting forth a two-phase plan to govern the provision of unbundled network elements ("UNEs") while the FCC considers permanent rules. Under the first phase of the interim plan, ILECs must continue to make available dedicated transport, mass market switching and enterprise loops in accordance with the rates, terms and conditions set forth in their interconnection agreements as of June 15, 2004. Under the second phase of the plan, ILECs would be required for an additional six months to continue to provide such UNEs to requesting carriers for the

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embedded customer base subject to the rate increases specified in the FCC's order. We do not believe these rate increases will impede our short-term business plans. In its NPRM, the FCC seeks comment on how to establish sustainable new unbundling rules in response to the D.C. Circuit's decision. Specifically, the FCC seeks comment on how various ILEC offerings and obligations fit into the unbundling framework, how best to define the relevant markets to develop unbundling rules and how to make determinations on access to individual network elements.

The uncertainty the ruling and the order have created could have material adverse effects upon us and our operations. Certain potential adverse effects from this ruling and the uncertainty it has created are set forth below. This list is not exhaustive as a listing of all the potential adverse effects would be impossible.

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- o ILECs, after some period of time, could deny us access to their networks in violation of interconnection agreements and essentially destroy our ability to provide our services.
- o ILECs could refuse new service orders, including repair and change orders. We would not be able to add new customers. Our business would diminish because of normal customer churn -- that is, the normal loss of existing customers over time.
- o Our customer churn could increase as our customers return to ILEC services in response to the uncertainty.
- o ILECs could significantly raise the prices they charge for access to their networks. We would be forced to raise our rates to non-competitive levels.
- o Vendors, including long distance companies, could alter the terms under which they do business with us, such as credit terms, thereby increasing our costs and diminishing our cash flow and liquidity.
- o We may be unable to obtain new financing at acceptable rates. We have already encountered difficulty in attempting to obtain financing from one particular lender.
- o We may lose prospective customers that otherwise would have become our customers. We believe we have already lost at least one large prospective customer (over 5,000 lines) because of the uncertainty.
- o Our wholesale customers may decline to expend marketing resources to increase their customer bases.
- o We could lose major marketing partners and potential marketing partners as they decline to expend resources in marketing our services.
- o We could lose key personnel, as they seek security in offers from other prospective employers.
- o The cost of litigation and of participation in administrative proceedings relating to interconnection agreements and new regulations could be excessively burdensome.

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The availability of favorable pricing rules for unbundled network components is another key element of our business strategy.

The public utilities commissions of certain states have adopted pricing rules for unbundled network components. In general, ILECs are required to provide us with access to their networks at forward-looking, long-run incremental cost-based prices. However, we cannot be certain that unbundled network components will continue to be available at favorable prices in those states or that other states will ever adopt favorable pricing, particularly in light of the recent D.C. Circuit Court ruling referred to above.

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Because we are in an emerging industry sector, we could encounter unforeseen issues that may adversely affect our operations.

VoIP is a new, emerging sector of the telecommunications industry. Our experience, as well as the experience of others, in this sector is limited. As a result we will likely encounter numerous unforeseen difficulties and challenges.

We will almost certainly need to raise additional capital.

We will need to raise additional capital from debt or equity sources in order to finance our operations and our VoIP rollout and may need additional capital if we enter into other lines of business. On April 22, 2004, we obtained a \$25 million credit facility pursuant to a Loan and Security Agreement with Textron Financial Corporation. The facility has a three-year term and as of September 27, 2004 we had borrowings of approximately \$15.4 million outstanding; this is the maximum amount permitted to be outstanding thereunder based on our current borrowing base availability. It replaced our previous accounts receivable facility with RFC Corporation. In addition, we have also obtained a facility from The 1818 Fund, an affiliate of one of our stockholders, providing for borrowings of up to \$15 million. We have borrowed \$5 million under this facility, but additional borrowings thereunder are at the discretion of The 1818 Fund. Representatives of The 1818 Fund have told us that, in any event, they do not intend to make additional loans unless the Exchange Offer is successfully completed. There cannot, however, be any assurance that we will be able to meet the conditions to borrowing under either of these facilities. If we cannot obtain required financing on acceptable terms or at all, we may be required to modify, delay or abandon our current business plan, which is likely to materially and adversely affect our business and, as a result, the value of our Common Stock.

We may not be able to efficiently expand our network infrastructure.

We must continue to develop, expand and adapt our network infrastructure as the number of our users and the amount of information they wish to access and transfer increases and as our customers' demands change. We cannot be sure that we will be able to develop, expand or adapt the network infrastructure to meet additional demand or our customers' changing requirements on a timely basis, at a commercially reasonable cost, or at all. If we fail to expand our network infrastructure on a timely basis or adapt it to either changing customer requirements or evolving industry standards, these failures could cause our business to perform poorly.

Our business is dependent upon our ability to resell long distance services.

We offer long distance telephone services as part of our service packages. We currently have agreements with various long distance carriers to provide

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transmission and termination services for all of our long distance traffic. Recently, several long distance carriers have encountered financial difficulties, including both carriers utilized by us. Financial difficulties encountered by any of our carriers could cause disruption of service to our customers and could diminish the value of any receivables or credits that may be due to us from such carriers. Our agreements with long distance carriers generally provide for the resale of long distance services on a per-minute basis and contain minimum volume commitments. In cases in which we have agreed to minimum volume commitments and fail to meet them, we will be obligated to pay underutili-

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zation charges. In some instances, if we incur underutilization charges, our basic rate will increase, which could further adversely affect our operating results. We recently settled a dispute by agreeing to a higher rate. In addition, if our sales fall from their historical levels, our business could be materially and adversely affected. We cannot guarantee you that we will be able to maintain these historical sales levels.

Software failures and errors may have a material adverse impact on our business.

The software that we use and the software that we have developed internally and are continuing to develop may contain undetected errors. Although we have extensively tested our software, errors may be discovered in the software during the course of its use. Any errors may result in partial or total failure of our network, loss or diminution in service delivery performance, additional and unexpected expenses to fund further product development or to add programming personnel to complete or correct development, and loss of revenue because of the inability of customers to use our products or services, which could adversely affect our business condition.

Our inability to protect our proprietary technology could adversely affect our revenues.

We currently rely on a combination of copyright, trademark and trade secret laws and contractual confidentiality provisions to protect the proprietary information that we have developed. Our ability to protect our proprietary technology is limited, and we cannot assure you that our means of protecting our proprietary rights will be adequate or that our competitors will not independently develop similar technology. Also, we cannot be certain that the intellectual property that incumbent local exchange carriers or others claim to hold and that may be necessary for us to provide our services will be available on commercially reasonable terms. If we were found to be infringing upon the intellectual property rights of others, we might be required to enter into royalty or licensing agreements, which may be costly or not available on commercially reasonable terms. If successful, a claim of infringement against us and our inability to license the infringed or similar technology on terms acceptable to us could adversely affect our business.

We depend on certain information systems, which if failed, may have a material adverse affect on our business.

Our billing, customer service and management information systems are newly developed and we may face unexpected system difficulties, which would adversely affect our service levels and, consequently, our business. Sophisticated information and processing systems are vital to our ability to monitor costs, render monthly invoices for services, process customer orders and achieve operating efficiencies. We rely on internal systems and third party vendors,

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some of which have a limited operating history, to provide our information and processing systems. If our systems fail to perform in a timely and effective manner and at acceptable costs, or if we fail to adequately identify all of our information and processing needs or if our related processing or information systems fail, these failures could have a material adverse effect on our business.

In addition, our right to use third party systems is dependent upon license agreements. Some of these agreements are cancelable by the vendor, and the cancellation or nonrenewal of these agreements could seriously impair our ability to process orders or bill our customers. As

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we continue to provide local telephone service, the need for sophisticated billing and information systems will also increase significantly and we will have significant additional requirements for data interface with incumbent local exchange carriers and others. We cannot be certain that we will be able to meet these additional requirements.

Our business could be adversely affected in the event of a network failure.

The successful operation of our network will depend on a continuous supply of electricity at multiple points. Our system is dependent on the availability of electrical power to manage data and calls and to offer enhanced services, such as voicemail and call forwarding, and although it has been designed to operate under extreme weather conditions (including hurricanes, tropical storms, heavy rain, wind and snow), like all other telecommunications systems, our network could be adversely affected by such conditions. Our network, however, is equipped with a back-up power supply and our existing network operations center is equipped with both a battery backup and an on-site emergency generator. Certain of our back-up systems, however, have failed in the past. We are working to correct those failures. However, a power failure could negatively impact our operations and damage our systems.

Our network also may be subject to physical damage, sabotage, tampering or other breaches of security (by computer virus, break-ins or otherwise) that could impair its functionality. In addition, our network is subject to unknown capacity limitations that may cause interruptions in service or reduced capacity for our customers. Any interruptions in service resulting from physical damage or capacity limitations could cause our systems to fail.

We depend on local exchange carriers as a key component for our business.

We rely on incumbent local exchange carriers to supply key unbundled components of their network infrastructure to us on a timely and accurate basis, and in the quantities and quality demanded by us. We may from time to time experience delays or other problems in receiving unbundled services or facilities which we request, and there can be no assurance that we will be able to obtain such unbundled elements on the scale and within the time frames required by us. Any failure to obtain these components, services or additional capacity on a timely and accurate basis could adversely affect us.

We depend on third party vendors to supply our telecommunications equipment, and any interruption in such supply could adversely affect our business.

We currently purchase the majority of our telecommunications equipment as needed from third party vendors, including Lucent Technologies, Inc., Sonus Networks, Inc., Dialogic Communications Corporation, Hewlett-Packard Company,

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Compaq Computer Corporation, Sun Microsystems, Inc., EMC Corporation, and Cisco Systems, Inc. In addition, we currently license our software from third party vendors, including Oracle Corporation, INPRISE Corporation, Mercator Software, Inc., Microsoft Corporation, Nuance Communications, Inc., SpeechWorks International, Inc., Telution, Inc., AMS, Inc., Netscape Communications, Inc. and Accenture. We typically do not enter into any long-term agreements with our telecommunications equipment or software suppliers. Any reduction or interruption in supply from our equipment suppli-

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ers or failure to obtain suitable software licensing terms could have a disruptive effect on our business and could adversely affect our results of operations.

Our business is dependent on our management and key personnel.

We depend on a limited number of key personnel who would be difficult to replace. If we lose the services of some of our key personnel, our business could suffer. We also depend on a limited number of key management, sales, marketing and product development personnel to manage and operate our business. In particular, we believe that our success depends to a significant degree upon our ability to attract and retain highly skilled personnel, including our engineering and technical staff. In the last several months we have experienced significant employee attrition and some of those employees who have departed are among our key personnel. If we are unable to replace the employees who have departed and attract and retain our key employees, the value of our Common Stock could suffer.

We are subject to government regulation and legal uncertainties that could adversely affect our business.

We are subject to varying degrees of federal, state, and local regulation. We must also comply with various state and federal obligations that are subject to change, such as the duty to contribute to universal service subsidies, the impact of which we cannot assess on a going-forward basis as the rates change periodically. Our failure to comply with regulatory requirements may result in fines or other penalties being imposed on us, including loss of certification to provide services.

Decisions of the FCC and state regulatory commissions providing incumbent local exchange carriers with increased flexibility in how they price their services and with other regulatory relief, could have a material adverse effect on our business and that of other competitive local exchange carriers. Future regulatory provisions may be less favorable to competitive local exchange carriers and more favorable to their competitors. If incumbent local exchange carriers are allowed by regulators to engage in substantial volume and term discount pricing practices for their end-user customers, or charge competitive local exchange carriers higher fees for interconnection to the incumbent local exchange carriers' networks, our business, operating results and financial condition could be materially, adversely affected. Incumbent local exchange carriers may also seek to delay competitors through legal or regulatory challenges, or by recalcitrant responses to requirements that they open their markets through interconnection and unbundling of network elements. Our legal and administrative expenses may be increased because of our having to actively participate in rate cases filed by incumbent local exchange carriers, in which they seek to increase the rates they can charge for the unbundled network element platform components. Our profitability may be adversely affected if those carriers prevail in those cases. Pending court cases in which certain

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provisions of the Telecommunications Act will be conclusively interpreted may result in an increase in our cost of obtaining unbundled network elements.

We are also subject to federal and state laws and regulations prohibiting "slamming," which occurs when specific procedures are not followed when a customer changes telecommunications services. Although we attempt to diligently comply with all such laws and regulations and have procedures in place to prevent "slamming," if violations of such laws and regulations

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occur, we could become subject to significant fines and penalties, legal fees and costs, and our business reputation could be harmed.

Our inability to successfully compete within our industry could adversely affect our business.

The telecommunications and information services markets are intensely competitive and rapidly evolving. We expect competition to increase in the future. Many of our potential competitors have longer operating histories, greater name recognition, larger customer bases and substantially greater financial, personnel, marketing, engineering, technical and other resources than us. We believe the principal competitive factors affecting our business operations will be price, the desirability of our service offering, quality and reliability of our services, innovation and customer service. Our ability to compete effectively will depend upon our ability to maintain high quality, market-driven services at prices generally equal to or below those charged by our competitors. Competitor actions and responses to our actions could, therefore, materially and adversely affect our business, financial condition and results of operations.

We face competition from a variety of participants in the telecommunications market. The largest competitor for local service in each market in which we compete is the incumbent local exchange carrier serving that market. Incumbent local exchange carriers have established networks, long-standing relationships with their customers, strong political and regulatory influence, and the benefit of state and federal regulations that favor incumbent local exchange carriers. In the local exchange market, the incumbent local exchange carriers continue to hold near-monopoly positions. The long distance telecommunications market in which we compete has numerous entities competing for the same customers and a high average churn rate as customers frequently change long distance providers in response to the offering of lower rates or promotional incentives.

Prices in the long distance market have declined significantly in recent years and are expected to continue to decline. We will face competition from large interexchange carriers. Other competitors are likely to include incumbent local exchange carriers providing out-of-region (and, with the removal of regulatory barriers, in-region) long distance services, other incumbent local exchange carriers, other competitive local exchange carriers, cable television companies, electric utilities, wireless telephone system operators, microwave and satellite carriers and private networks owned by large end users.

The Telecommunications Act facilitates such entry by requiring incumbent local exchange carriers to allow competing providers to acquire local services at wholesale prices for resale and to purchase unbundled network elements at cost-based prices. A continuing trend toward combinations and strategic alliances in the telecommunications industry, including potential consolidation among incumbent local exchange carriers or competitive local exchange carriers,

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or transactions between telephone companies and cable companies outside of the telephone company's service area, or between interexchange carriers and competitive local exchange carriers, could give rise to significant new competitors.

The enhanced and information services markets are also highly competitive and we expect that competition will continue to intensify. Our competitors in these markets will include

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information service providers, telecommunications companies, on-line service providers and Internet service providers.

We face risks associated with unauthorized transactions and the theft or abuse of our services.

We may be the victim of fraud or theft or abuse of services. From time to time, callers have obtained our services without rendering payment by unlawfully using our access numbers and personal identification numbers. We attempt to manage these theft and fraud risks through our internal controls and our monitoring and blocking systems. If these efforts are not successful, the theft of our services may cause our revenue to decline significantly. To date, we have not encountered material fraud or theft of our service. From time to time, we encounter users that exploit provisions of our tariffs or terms of service for their own profit. As a regulated common carrier we are required to offer our services on a non-discriminatory manner. Such use of our services may not be fraudulent but is abusive. We manage the risks of abuse through our internal controls and our monitoring and blocking systems and by rapid reaction.

Risks Related to Our Common Stock

Future sales of our Common Stock could depress our stock price.

We cannot predict the effect that future sales of our Common Stock will have on the market price of our Common Stock. As of September 27, 2004, we had 38,776,343 shares of Common Stock outstanding. Shares of Common Stock that we issue in the Offer or other shares of our Common Stock that we issue in the future may become available for resale in the public market from time to time. Sales of substantial amounts of our Common Stock, or the perception that such sales may occur, could adversely affect the market price of our Common Stock or our ability to raise capital by offering equity securities.

Our Common Stock may be delisted from the Nasdaq SmallCap Market.

By letter dated July 28, 2004, the Nasdaq Stock Market, Inc. notified us that for 10 consecutive days, the market value of our Common Stock on the Nasdaq Small Cap Market was not \$35 million or more, as required for continued inclusion on the Nasdaq Small Cap Market by the Nasdaq rules. The market value of our Common Stock remained below the minimum market value, and as a result the Nasdaq staff provided us with written notification that our Common Stock will be delisted. Currently we are appealing the staff's decision to a Listing Qualifications Panel primarily on the basis that we believe, following consummation of the Exchange Offer, that the market value of our Common Stock will substantially exceed the minimum required amount. The Listing Qualifications Panel may not grant our request to defer a determination of delisting until after the Exchange Offer is consummated. In that event our Common Stock will be delisted, our Common Stock will only be traded over the counter on the Nasdaq Bulletin Board and the liquidity and price of our Common

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Stock may be negatively affected. Even if our request is granted, we cannot assure you that we will achieve the necessary market value for our Common Stock following the Exchange Offer or that our Common Stock will maintain the necessary market value for any length of time. If we fail to achieve and maintain the market value for our Common Stock above that required by the Nasdaq rules, our Common Stock will ultimately be delisted from the Nasdaq SmallCap Market.

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We have also been advised by the Nasdaq staff that our Common Stock does not currently meet the minimum bid price per share of \$1.00 necessary to maintain listing on the Nasdaq SmallCap Market as required by the Nasdaq rules. Although we believe that the reverse stock split proposal, if adopted at the Special Meeting, will allow us to regain compliance, we cannot assure you that the Common Stock will achieve the necessary bid price per share following the reverse stock split or that our Common Stock will maintain the necessary minimum bid price for any length of time. If we fail to achieve and maintain a bid price for our Common Stock above that required by the Nasdaq rules, our Common Stock will ultimately be delisted from the Nasdaq SmallCap Market.

We may experience volatility in our stock price that could affect your investment.

The price of our Common Stock has been, and may continue to be, highly volatile in response to various factors, many of which are beyond our control, including:

- o developments in the industries in which we operate;
- o actual or anticipated variations in quarterly or annual operating results;
- o speculation in the press or investment community; and
- o announcements of technological innovations or new products by us or our competitors.

Our Common Stock's market price may also be affected by our inability to meet analyst and investor expectations and failure to achieve projected financial results, including those set forth in this Offer to Exchange, or as a result of the issuance of the shares of Common Stock in the Offer and the dilution of the currently outstanding shares of Common Stock. Any failure to meet such expectations or projected financial results, even if minor, could cause the market price of our Common Stock to decline.

In addition, assuming the tender of all outstanding Preferred Stock in the Offer, The 1818 Fund, will own approximately 47% of our Common Stock which may reduce the amount of shares of our Common Stock that are traded on a daily basis and potentially increase the volatility of the price thereof.

Furthermore, stock markets have generally experienced a high level of price and volume volatility, and the market prices of equity securities of many companies have experienced wide price fluctuations not necessarily related to the operating performance of such companies. These broad market fluctuations may adversely affect our Common Stock's market price. In the past, securities class action lawsuits frequently have been instituted against such companies following periods of volatility in the market price of such companies' securities. If any such litigation is instigated against us, it could result in substantial costs

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and a diversion of management's attention and resources, which could have a material adverse effect on our business, results of operations, and financial condition.

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After completion of the Exchange Offer one stockholder who is represented on our board of directors will control a significant percentage of our Common Stock and may cause us to take actions that are adverse to your interests.

If all the Preferred Shares are tendered in the Exchange Offer, after the completion thereof, The 1818 Fund, which is represented on our board of directors, in the aggregate will beneficially own approximately 47% of our Common Stock. As a result, The 1818 Fund can significantly influence all matters requiring stockholder approval, including the election and removal of directors and approval of significant corporate transactions such as mergers, consolidations, and sales of assets. It also could dictate the management of our business and affairs. This concentration of ownership could have the effect of delaying, deferring, or preventing a change in control or impeding a merger or consolidation, takeover, or other business combination, which could cause the market price of our Common Stock to fall or prevent you from receiving a premium in such a transaction.

Anti-takeover provisions in our certificate of incorporation and bylaws and provisions of Delaware law could delay or prevent a change of control that you may favor.

Certain provisions of our certificate of incorporation and bylaws may inhibit changes in control of us not approved by the board of directors. These provisions include: (i) a prohibition on stockholder action through written consents; (ii) a requirement that special meetings of stockholders be called only by the board of directors; (iii) advance notice requirements for stockholder proposals and nominations; (iv) limitations on the ability of stockholders to amend, alter or repeal the bylaws; and (v) the authority of the board of directors to issue, without stockholder approval, preferred stock with such terms as the board of directors may determine. We will also be afforded the protections of Section 203 of the Delaware General Corporation Law, which could have similar effects. The foregoing provisions could delay or make more difficult transactions involving a change in control of us or our management.

SPECIAL FACTORS RELATING TO THE OFFER TO EXCHANGE

In addition to the other information set forth herein, holders of Preferred Shares should carefully consider the following information:

Special Committee of the Board of Directors

Because certain members of our Board of Directors either hold or are affiliated with holders of Preferred Stock, our Board of Directors formed a special committee (the "Special Committee") of its independent directors comprised of Messrs. John K. Aurell, W. Andrew Krusen, Jr. and Richard F. LaRoche, Jr., to evaluate the fairness, from a financial point of view, of the Exchange Offer to the holders of Common Stock. The Special Committee retained the services of a financial advisor, Morgan Keegan & Company, Inc. ("Morgan Keegan"). Morgan Keegan has rendered an opinion to the Special Committee as to the fairness, from a financial point of view, of the Exchange Offer to the holders of Common Stock. NONE OF THE SPECIAL COMMITTEE, MORGAN KEEGAN OR THE BOARD OF DIRECTORS HAS EVALUATED THE FAIRNESS OF THE EXCHANGE OFFER TO THE

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HOLDERS OF PREFERRED STOCK. ACCORDINGLY, NEITHER THE SPECIAL COMMITTEE

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NOR THE BOARD OF DIRECTORS IS MAKING ANY RECOMMENDATION WHATSOEVER AS TO WHETHER HOLDERS OF PREFERRED STOCK SHOULD PARTICIPATE IN THE EXCHANGE OFFER.

Prior to this Offer, members of the Special Committee discussed the possibility of the Exchange Offer with The 1818 Fund to ascertain its interest in participating in the transaction. The 1818 Fund is our largest holder of Preferred Stock and owns all of our outstanding Series E Preferred Stock, and approximately 73% of our outstanding Series G Preferred Stock. We have been advised by The 1818 Fund that it currently intends to tender all of its Preferred Stock in the Exchange Offer and to vote in favor of the Special Meeting Matters, subject to our receiving tenders of substantially all of the Preferred Stock in the Exchange Offer, in its sole judgment. The 1818 Fund has not advised us what level of tenders would, in its judgment, constitute "substantially all" of the Preferred Stock. The 1818 Fund is not obligated to participate in the Exchange Offer or to vote in favor of the Special Meeting Matters and may decide not to do so at any time for any reason. However, because this Offer is contingent upon The 1818 Fund tendering all of its Preferred Stock and because The 1818 Fund will determine the vote of holders of Series E Preferred Stock and Series G Preferred Stock at the Special Meeting, the Exchange Offer will not occur unless The 1818 Fund tenders, and we accept, all of its Preferred Stock in the Exchange Offer and votes in favor of the Special Meeting Matters.

Two of our directors are associated with The 1818 Fund: Andrew C. Cowen is a Senior Vice President of and Lawrence C. Tucker is a General Partner of Brown Brothers Harriman & Co., a private investment banking firm that manages The 1818 Fund. In addition, Mr. Charles D. Hyman, one of our directors, owns approximately 0.5% of the outstanding Series D Preferred Stock.

On the basis of its discussions with The 1818 Fund and the opinion of Morgan Keegan as to the fairness of the Exchange Offer, from a financial point of view, to the holders of Common Stock, and the potential failure to be able raise additional financing required for our new business plan as long as the Preferred Stock remains outstanding, the Special Committee recommended to the Board of Directors that we pursue the Exchange Offer. In structuring the terms of the Exchange Offer, the Special Committee considered the rights and preferences of the Preferred Shares, including the dividend rate; the relative preferences and other terms relative to the Common Shares; the fact that acceptance of the Offer is not mandatory and that each holder of the Preferred Stock may participate in its sole discretion; recent market prices for our Common Stock; the lack of attractive alternatives available to us in lieu of the Exchange Offer; the assumed pro forma effect of the Offer to Exchange on our consolidated capitalization; the United States federal income tax consequences of the Offer to Exchange on us and on the holders of our Preferred Stock; and the fairness opinion of Morgan Keegan.

For the following reasons our Board of Directors determined to accept the recommendation of the Special Committee and proceed with the Exchange Offer: it will improve and simplify our capital structure and increase our net book value; it will reduce or eliminate the dividends and mandatory redemption obligation on our Preferred Stock; it is within the discretion of each holder of Preferred Stock to determine whether it should participate in the Exchange Offer; it will give holders of our Preferred Stock an opportunity to effectively convert their Preferred

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Stock to Common Stock at a substantial premium to the conversion rates presently in effect for the Preferred Stock; it will give holders of our Preferred Stock an opportunity to obtain greater liquidity on their investment; it should significantly increase the aggregate market value of our Common Stock and facilitate our continued listing on the Nasdaq SmallCap Market; and the failure to convert the Preferred Stock into Common Stock will continue to be an impediment to financing our new business plan.

Determining Whether or Not to Tender

NONE OF THE SPECIAL COMMITTEE, MORGAN KEEGAN OR THE BOARD OF DIRECTORS HAS EVALUATED THE FAIRNESS OF THE EXCHANGE OFFER TO THE HOLDERS OF PREFERRED STOCK. ACCORDINGLY, NEITHER THE SPECIAL COMMITTEE NOR THE BOARD OF DIRECTORS IS MAKING ANY RECOMMENDATION WHATSOEVER AS TO WHETHER HOLDERS OF PREFERRED STOCK SHOULD PARTICIPATE IN THE EXCHANGE OFFER.

The decision to tender Preferred Shares pursuant to the Offer to Exchange should be made by holders of Preferred Shares after considering the value of the Preferred Shares they are tendering, the value of the Common Shares they are ultimately receiving, individual investment objectives and other factors affecting such holders individually, including any federal, state, local or foreign tax consequences of tendering Preferred Stock. Holders of Preferred Stock should consider the current market price of the Common Shares as well as their view of the future market price of the Common Shares. Holders of Preferred Stock are urged to evaluate carefully all information contained or incorporated by reference in this Offer to Exchange and to consult their own financial and tax advisors to make their own decisions concerning whether to tender Preferred Shares in the Offer to Exchange. See "Risk Factors," "Description of Our Preferred Stock," "Description of Our Common Stock," "Market for Common Stock" and "Material United States Federal Income Tax Consequences."

MANAGEMENT

The following table sets forth information about our directors and executive officers as of the date of this Offer to Exchange:

Name	Position
Horace J. Davis, III	Acting Chief Executive Officer, Treasurer and Senior Vice President -- Chief Financial Officer
Frank Grillo	Chief Operating Officer
Paul Kohler	Chief Technology Officer
Doug Jackson	Senior Vice President Consumer Services
Mike Slauson	Senior Vice President Customer Service and Support Operations
John Tomljanovic	Senior Vice President Business Operations
John K. Aurell	Director
Andrew C. Cowen	Director
Charles D. Hyman	Director

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Name	Position
W. Andrew Krusen, Jr.	Director
Richard F. LaRoche, Jr.	Director
Lawrence C. Tucker	Director

For additional information regarding our directors and officers, reference is hereby made to our definitive Proxy Statement on Schedule 14A filed on April 29, 2004.

USE OF PROCEEDS

We will not receive any cash proceeds from this Offer. Preferred Shares surrendered in exchange for Common Shares will be retired and returned to the pool of authorized but unissued Preferred Shares.

THE OFFER TO EXCHANGE

This Offer to Exchange and the related Letter of Transmittal are being mailed to record holders of Preferred Shares and will be furnished to brokers, banks and similar persons whose names, or the names of whose nominees, appear on our stockholder lists or, if applicable, who are listed as participants in a clearing agency's security position listing for subsequent transmittal to beneficial owners of Preferred Shares.

Number of Shares

Upon the terms and subject to the conditions of this Offer to Exchange, we will exchange all of the Preferred Shares outstanding, or such lesser number of Preferred Shares as are validly tendered and not withdrawn prior to the Expiration Date, for Common Shares as follows (subject in each case to the impact of any reverse stock split):

- o We will exchange 25.69030 shares of our Common Stock for each share of our Series D Preferred Stock, of which there were 3,976,723 shares outstanding as of September 27, 2004 (representing an exchange price of approximately \$0.644 per share);
- o We will exchange 25.24216 shares of our Common Stock for each share of our Series E Preferred Stock, of which there were 4,166,667 shares outstanding as of September 27, 2004 (representing an exchange price of approximately \$0.644 per share); and
- o We will exchange 161,469.4 shares of our Common Stock for each share of our Series G Preferred Stock, of which there were 171.214286 shares outstanding as of September 27, 2004 (representing an exchange price of approximately \$0.898 per share).

The actual number of shares of Common Stock to be issued in exchange for the Preferred Stock tendered in the Exchange Offer may be adjusted by the reverse stock split which is part of the Special Meeting Matters. Subject to the approval by our stockholders, our Board of Direc-

tors will be authorized to amend our certificate of incorporation to effect a 3 for 1, 4 for 1, 5 for 1, 6 for 1, 7 for 1 or 8 for 1 reverse stock split of the

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outstanding shares of our Common Stock, with the actual implemented ratio to be determined by our Board of Directors in its discretion. If approved by our stockholders, the reverse stock split would become effective shortly before consummation of the Exchange Offer or on any other date selected by our Board of Directors prior to our next annual meeting of stockholders. Our Board of Directors may effect only one reverse stock split. In determining the reverse stock split ratio, our Board of Directors will consider numerous factors including the historical and projected performance of our Common Stock, the requirements for continued listing on the Nasdaq SmallCap Market, prevailing market conditions and general economic trends, and will place emphasis on the expected closing price of our Common Stock in the period following the effectiveness of the reverse stock split. The purpose of selecting a range is to give our Board of Directors the flexibility to provide for a post reverse stock split market price that may allow us to maximize our ability to support future growth. Even if the stockholders approve the reverse stock split, our Board of Directors will reserve the right not to effect the reverse stock split if the Board of Directors does not deem it to be in our or our stockholders' best interest to effect the reverse stock split. Accordingly, the actual number of shares of Common Stock outstanding will be adjusted by dividing such number of shares by the split ratio, if any, approved by our stockholders and ultimately effected.

As of September 27, 2004, if all of the outstanding Preferred Stock was converted into Common Stock at the then prevailing conversion rates:

- o the former holders of Series D Preferred Stock would own approximately 10.4% of our Common Stock on a fully diluted basis;
- o the former holders of Series E Preferred Stock would own approximately 11.3% of our Common Stock on a fully diluted basis;
- o the former holders of Series G Preferred Stock would own approximately 26.1% of our Common Stock on a fully diluted basis; and
- o the current holders of Common Stock would own approximately 52.2% of our Common Stock on a fully diluted basis.

As of the same date, if all of the outstanding Preferred Stock is exchanged in the Exchange Offer:

- o the former holders of Series D Preferred Stock would own approximately 34.0% of the Common Stock on a Fully Diluted Basis;
- o the former holders of Series E Preferred Stock would own approximately 35.0% of the Common Stock on a Fully Diluted Basis;
- o the former holders of Series G Preferred Stock would own approximately 9.2% of the Common Stock on a Fully Diluted Basis;

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- o the current holders of Common Stock would own approximately 13.8% of the Common Stock on a Fully Diluted Basis; and
- o approximately 8.0% of the Fully Diluted Common Stock would have been reserved for issuance under the new management equity incentive plan.

We will not issue fractional shares. In the event that a fraction of a

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Common Share becomes issuable upon consummation of the Offer to Exchange, we will pay you an amount in cash equal to the closing price of our Common Stock on the business day preceding such consummation (as adjusted to reflect the impact of any reverse stock split), multiplied by such fraction of a Common Share.

Expiration Date

The term "Expiration Date" means 5:00 p.m., New York City time, on Tuesday, November 23, 2004, unless and until we, in our sole discretion, extend the period of time during which the Offer to Exchange will remain open, in which event the term "Expiration Date" shall refer to the latest time and date at which the Offer to Exchange shall expire. See "--Extension of the Tender Period; Termination; Amendment" below.

Procedures for Tendering Preferred Shares

A holder who wishes to tender Preferred Shares for exchange pursuant to the Offer to Exchange must transmit a properly completed and duly executed Letter of Transmittal, or a facsimile thereof, together with certificates for such Preferred Shares and any other required documents, to the Exchange and Information Agent prior to 5:00 p.m., New York City time, on the Expiration Date.

To be effectively tendered, Preferred Shares, the Letter of Transmittal and other required documents must be received by the Exchange and Information Agent at the address set forth on the last printed page of this Offer to Exchange prior to 5:00 p.m., New York City time, on the Expiration Date.

The tender by a stockholder will constitute an agreement between that stockholder and us in accordance with the terms and subject to the conditions contained in this Offer to Exchange and in the Letter of Transmittal.

The method of delivery of Preferred Shares and all other required documents is at your election. If you deliver your Preferred Shares by mail, we recommend registered mail, properly insured, with return receipt requested. In all cases, you should allow sufficient time to assure timely delivery. Please send all certificates representing Preferred Shares and Letters of Transmittal to the Exchange and Information Agent for the Offer to Exchange, at the address set forth on the last printed page of this Offer to Exchange. Please do not send these materials to us.

If the Letter of Transmittal is signed by a person other than the registered holder of any Preferred Shares listed therein, these Preferred Shares must be endorsed or accompanied by a properly completed stock power and signed by the registered holder as the registered holder's name appears on the Preferred Share certificates.

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If the Letter of Transmittal or Preferred Shares or stock powers are signed by trustees, executors, administrators, guardians, attorneys-in-fact, officers of corporations or others acting in a fiduciary or representative capacity, these persons should so indicate when signing, unless waived by us. If we waive any condition or matter with respect to any holder of Preferred Stock, we will similarly waive such condition or matter for all holders of Preferred Stock. Evidence satisfactory to us of their authority so to act must be submitted with the Letter of Transmittal.

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Signatures on a Letter of Transmittal or a notice of withdrawal, as the case may be, must be guaranteed by an Eligible Institution unless the Preferred Shares tendered pursuant thereto are tendered:

- o by a registered holder who has not completed the box entitled "Special Issuance Instructions" or "Special Delivery Instructions" on the Letter of Transmittal, or
- o for the account of an Eligible Institution.

In the event that signatures on a Letter of Transmittal or a notice of withdrawal, as the case may be, are required to be guaranteed, such guarantee must be by a member firm of a registered national securities exchange or of the National Association of Securities Dealers, Inc., a commercial bank or trust company having an office or correspondent in the United States or an "eligible guarantor institution" within the meaning of Rule 17Ad-5 under the Exchange Act (an "Eligible Institution").

We will determine all questions as to the validity, form, eligibility, including time of receipt, acceptance and withdrawal of tendered Preferred Shares in our sole discretion, which determination shall be final and binding. We reserve the absolute right to reject any and all Preferred Shares not properly tendered or any Preferred Shares, our acceptance of which would, in the opinion of our counsel, be unlawful. We also reserve the right to waive any defects, irregularities or conditions of tender as to particular Preferred Shares; provided that any such waiver shall similarly apply to all holders of Preferred Stock. Our interpretation of the terms and conditions of the Offer to Exchange, including the instructions in the Letter of Transmittal, shall be final and binding on all parties. Unless waived, any defects or irregularities in connection with the tender of Preferred Shares must be cured within the time as we shall determine. Neither we, the Exchange and Information Agent nor any other person shall incur any liability for failure to give notice of any defect or irregularity with respect to any tender of Preferred Shares. Tenders of Preferred Shares will not be deemed to have been made until such defects or irregularities have been cured or waived. Any Preferred Shares received by the Exchange and Information Agent that are not properly tendered and as to which the defects or irregularities have not been cured or waived will not be deemed to have been properly tendered. Any Preferred Shares received by the Exchange and Information Agent that are not properly tendered and as to which the defects or irregularities have not been cured or waived will be returned by the Exchange and Information Agent to the tendering stockholder, unless otherwise provided in the Letter of Transmittal, promptly following the Expiration Date.

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Conditions

Consummation of the Exchange Offer is conditioned upon the approval of stockholders of the Special Meeting Matters and upon the tender by The 1818 Fund of all Preferred Stock that it owns in the Exchange Offer and our acceptance of those shares. In addition, notwithstanding any other provision of this Offer to Exchange, we shall not be required to accept for exchange any Preferred Shares tendered, and may terminate or amend the Offer or may postpone the acceptance for exchange of any Preferred Shares tendered, if at any time on or before the expiration of the Offer, any of the following events shall have occurred which, in our reasonable judgment, makes it inadvisable to proceed with the Offer to Exchange or with such exchange:

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- o any action or proceeding is instituted or threatened in any court or by or before any governmental agency with respect to the Offer, or any material adverse development has occurred in any existing action or proceeding with respect to us or any of our subsidiaries, which, in our reasonable judgment, might materially impair our ability to proceed with the Offer;
- o any law, statute, rule or regulation is proposed, adopted or enacted which, in our reasonable judgment, might materially impair our ability to proceed with the Offer; or
- o any governmental approval has not been obtained, which approval we, in our reasonable judgment, shall deem necessary for the consummation of the Offer as contemplated hereby.

The foregoing conditions may be asserted by us regardless of the circumstances giving rise to any such condition or may be waived by us in whole or in part. With the exception of those dependent on the receipt of necessary governmental approvals, all of the foregoing conditions must be satisfied or waived on or before the Expiration Date. We will promptly terminate the Offer or issue a press release stating our intentions upon becoming aware of any condition that may not be satisfied. Any determination by us concerning the foregoing conditions shall be final and binding on all parties.

If we determine in our reasonable discretion that any of the conditions are not satisfied, we may:

- o refuse to accept the Preferred Shares and return all tendered shares to the tendering holders;
- o extend the Offer and retain all Preferred Shares tendered prior to the expiration of the Offer, subject, however, to the rights of holders to withdraw their tendered shares (see "--Withdrawal of Tenders"); or
- o waive the unsatisfied conditions with respect to the Offer and accept all properly tendered Preferred Shares that have not been withdrawn. If such a waiver constitutes a material change to the Offer, we will promptly disclose this waiver by means of an Offer supplement that will be distributed to the record holders of Preferred Shares. We will also extend the Offer for a period of five to ten business days, depending

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upon the significance of the waiver and the manner of disclosure to the record holders, if the Offer would otherwise expire during such five to ten business day period.

Acceptance of Preferred Shares for Exchange; Delivery of Common Shares

For purposes of the Offer, we shall be deemed to have accepted properly tendered Preferred Shares for exchange when, as and if we have given oral or written notice thereof to the Exchange and Info