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AZ CORP COMMISSION
DOCUMENT CONTROL

July 18, 2006

Via Hand-Delivery

Arizona Corporation Commission
DOCKETED

JUL 19 2006

DOCKETED BY	NR

Arizona Corporation Commission
Docket Control - Utilities Division
1200 W. Washington Street
Phoenix, Arizona 85007

Re: In the Matter of the Application of Navigator Telecommunications, LLC for a Certificate of Convenience and Necessity
Docket No. T-20398A-06-0346

To Docket Control:

Attached are Navigator Telecommunications, LLC's Responses to Staff's Letter of Insufficiency and First Set of Data Requests in the above-referenced docket. If you require any additional information or have any questions, please contact me.

Very truly yours,

Michael T. Hallam

MTH/jw

cc: Original and 13 Copies to Docket Control
Armando Fimbres (Utilities Division)

NAVIGATOR TELECOMMUNICATIONS, LLC
RESPONSES TO FIRST SET OF DATA REQUESTS
Docket No: T-20398A-06-0346
June 19, 2006

Navigator Telecommunications, LLC ("Navigator or Applicant"), hereby submits the following objections and responses to the First Set of Data Requests submitted by the Arizona Corporation Commission Staff ("Staff").

GENERAL OBJECTIONS TO ALL DATA REQUESTS

1. Applicant objects to each and every Request to the extent it seeks information subject to the attorney-client privilege, work product doctrine or any other privilege recognized by the State of Arizona. In responding to these Requests, Applicant does not waive, but preserves, all such privileges.

2. Applicant objects to each and every Request to the extent it seeks information that is confidential, sensitive, competitive in nature or proprietary to them. In responding to these requests, Applicant does not waive, but preserves, its claim that request for customer and market information is confidential.

3. Applicant objects to each and every Request to the extent that it is unreasonably burdensome, overly broad or not reasonably calculated to lead to the discovery of admissible evidence.

4. Applicant objects to each and every one of Staff's definitions and/or instructions to the extent it purports to abrogate any of Applicant's rights, or add to any of Applicant's obligations under, the Arizona Rules of Civil Procedure or the Commission's Rules.

5. Applicant objects to each and every Request to the extent it is overly broad, unduly burdensome or imposes any burden not expressly permitted under Commission's Rules or the Arizona Rules of Civil Procedure.

6. Applicant objects to each and every Request to the extent that it calls for information already in the possession, custody and control of Staff.

7. Applicant objects to each and every Request to the extent it seeks information outside of Applicant's possession, custody or control.

8. Applicant expressly reserves the right to supplement or amend its objections and responses as necessary.

Applicant incorporates the foregoing General Objections into each response as if fully set forth therein.

SPECIFIC RESPONSES TO ALL DATA REQUESTS

STF 1.1. Please explain why Navigator filed separate CC&N applications to provide Resold Long Distance, Resold Local Exchange and Facilities-Based Local Exchange services in Arizona.

Response: Navigator has national customers ready to receive long distance service in Arizona. Navigator filed the interexchange service application first in hope that it could begin to provide that service first, which coincides with its business plan in Arizona.

Respondent: Michael McAlister, General Counsel
Navigator Telecommunications, LLC
8325 Riverwood Park Drive
P.O. Box 13860
North Little Rock, AR 72113

STF 1.2. Does Navigator have any objection to the consolidation of Dockets: T-20398A-05-0551 and T-20398A-06-0346?

Response: Yes. Please see the response to STF 1.1.

Respondent: Michael McAlister, General Counsel
Navigator Telecommunications, LLC
8325 Riverwood Park Drive
P.O. Box 13860
North Little Rock, AR 72113

STF 1.3. Does Navigator intend to offer only Business local exchange services? If "no", please clarify why the tariff submitted as part of (A-9 & Attachment B) does not contain residence service information.

Response: Navigator intends to begin with business service. Given UNE pricing, providing residential service does not make sense at this time, although Navigator does provide residential service in other markets.

Respondent: Michael McAlister, General Counsel
Navigator Telecommunications, LLC
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STF 1.4. Section 3.5.1E in Navigator's tariff contains a Maximum rate "To Change from Residence to Business". Please explain this service and charge since Navigator's tariff does not appear to include the provision of residence service.

Response: This would apply if a customer of another provider receiving residential service were to switch to Navigator and were also to switch its service from residential to business service.

Respondent: Michael McAlister, General Counsel
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STF 1.5. Section 1.8 of the tariff in Attachment B states "The Company will not require a deposit from its business customers." Please clarify why the Company's tariff should not be changed to agree with the statement submitted in (A-15) "Navigator does not collect advances, prepayments, or deposits from its customers."

Response: Navigator believes that the statements are consistent. Section 1.12 of the tariff addresses advance payments. The only type of advance that might apply would relate to a special construction situation.

Respondent: Michael McAlister, General Counsel
Navigator Telecommunications, LLC
8325 Riverwood Park Drive
P.O. Box 13860
North Little Rock, AR 72113

STF 1.6. Please explain how the maximum rates contained in the Attachment A tariff compare to those of Navigator's key competitors specifically in the areas of (1) Basic Local Exchange Service and (2) Directory Assistance.

Response: Navigator's current rates in the tariff compare favorably to those on file by Qwest. Qwest does not submit maximum rates with its tariff, so a comparison of those rates is not appropriate. Other competitor's rates are set forth below.

	Basic Local	Directory Assistance
Navigator	$45.60	$1.73
XO Communications Services, Inc.	$65.00	$1.00
Trinsic Communications, Inc.	----	$1.50

Respondent: Michael McAlister, General Counsel
Navigator Telecommunications, LLC
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STF 1.7. Please explain how the returned check fee in Section 1.7 compares to that charged by Navigator's key competitors.

Response:

Navigator	$35.00 Max.	/ $27.50 current
XO Communications Services, Inc.	$ ------ Max.	/ $20.00 current
Trinsic Communications, Inc.	$35.00 Max.	/ $25.00 current

Respondent: Michael McAlister, General Counsel
Navigator Telecommunications, LLC
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NAVIGATOR TELECOMMUNICATIONS, LLC
RESPONSES TO FIRST SET OF DATA REQUESTS
Docket No: T-20398A-06-0346
June 19, 2006

STF 1.8. Please update "Response to Attachment A-11" with information from April 30, 2006 through May 31, 2006.

Response:

The Company received one complaint during this time period. The complaint was from the Florida Public Service Commission, concerning a customer's complaint disputing the applicability of a repair dispatch charge on the customer's bill. After investigation of the dispute, appropriate credits were issued to the customer's account, and the complaint was resolved without any formal action.

Respondent: Michael McAlister, General Counsel
Navigator Telecommunications, LLC
8325 Riverwood Park Drive
P.O. Box 13860
North Little Rock, AR 72113

STF 1.9. Please provide notes and/or explanatory information for the financial statements in Attachment D.

Response: See attached.

Respondent: Michael McAlister, General Counsel
Navigator Telecommunications, LLC
8325 Riverwood Park Drive
P.O. Box 13860
North Little Rock, AR 72113

Notes to Financial Statements

December 31, 2005 and 2004

1. <u>**Summary of Significant Accounting Policies**</u>

a. **Organization** – Navigator Telecommunications, LLC (the "Company"), is an Arkansas limited liability company, organized on September 9, 1997. The business purpose of the Company is to operate as a reseller/provider of switched local exchange service and long distance service as a competitive local exchange carrier ("CLEC"). The Company is licensed to provide telephone services in 25 states and had approximately 88,000 and 68,000 lines in service at December 31, 2005 and 2004, respectively.

b. **Revenue recognition** – Both toll service revenues and local service revenues are recognized when earned regardless of the period in which they are billed. The Company has participated with Sprint, several Bell Operating Companies and other toll carriers in furnishing local and long distance telephone services.

c. **Trade accounts receivable** – In the normal course of business, the Company extends credit to its customers on a short-term basis. The Company reviews its customer accounts on a periodic basis and records a reserve for amounts that the Company feels will not be collected. Past due status is determined based upon contractual terms. Management uses significant judgment in estimating uncollectible amounts, considering such factors as current overall economic conditions, industry-specific economic conditions, historical customer performance, anticipated customer performance, and date of last payment. While management believes the Company's processes effectively address its exposure to doubtful accounts, changes in economic, industry or specific customer conditions may require adjustment to the allowance recorded by the Company.

d. **Telecommunication infrastructure and depreciation** – Telecommunication infrastructure is stated at cost. Depreciation is provided using tax depreciation methods which does not differ materially from that which would be recorded using a method acceptable under generally accepted accounting principles.

Listed below are the major classes of telecommunication infrastructure in service as of December 31:

	Years	2005	2004
Telecommunication cable	15	$ -	$ 2,048,578
Central office equipment	5 - 10	60,000	16,290
Leasehold improvement	15	70,361	212,886
Furniture and office equipment	5 - 7	145,723	141,084
General purpose computers	3 - 5	781,946	660,403
		$ 1,058,030	$ 3,079,241

Notes to Financial Statements

December 31, 2005 and 2004

1. **Summary of Significant Accounting Policies (cont.)**

e. **Long-lived assets** – The Company reviews the carrying value of long-lived assets for impairment whenever certain triggering events or changes in circumstances indicate that the carrying amounts of any asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the excess of the carrying amount over the fair value of the assets.

In 2005, the Company elected not to renew a contract to provide telecommunications services to certain multi-family housing locations. In conjunction with the expiration of this contract, management determined that it no longer had rights to certain wiring and buried cable. Accordingly, the Company recognized an impairment loss of $1,543,298, which represented the net book value of the abandoned assets. The impairment loss is recorded as a component of operating expenses in the accompanying statement of operations for the year ended December 31, 2005. Based upon management's assessment of the impairment indicators for the remaining assets, management determined that upon testing the expected future net cash flows to be generated from these assets, no additional impairment losses had occurred in the fiscal years ended December 31, 2005 or 2004.

f. **Income taxes** – The Company is structured to be treated as a partnership for federal and state income tax purposes. As such, the Company's taxable income or loss flows through to its members. No income tax provision or benefits are recorded directly by the Company. Management is not aware of any course of action or series of events that have occurred that might adversely affect the Company's tax returns.

g. **Advertising costs** – Costs related to advertising are expensed as incurred. Advertising expense was $38,028 and $76,918 for the years ended December 31, 2005 and 2004, respectively, and is included in selling, general and administrative expenses in the accompanying statements of operations.

h. **Use of estimates** – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

i. **Statements of cash flows** – The Company considers all demand deposits and highly liquid investments with original maturities of three months or less to be cash equivalents.

Cash paid for interest amounted to $536,851 and $559,763 for the years ended December 31, 2005 and 2004, respectively.

1. **Summary of Significant Accounting Policies (cont.)**

Non-cash transactions for 2005 and 2004 consisted of the following:

	2005	2004
Purchase of insurance with note payable	$ 83,582	$ 50,068
Purchase of property and equipment with note payable	60,000	-
Accretion of discount of notes payable	1,511,750	1,465,458
Redemption of note payable in exchange for the issuance of membership units	1,845,504	-
Issuance of membership units as payment of interest	-	50,000
Obligation to repurchase membership units	1,575,000	-

j. **Stock-based compensation** – The Company has granted stock-based employee compensation awards which are described more fully in Note 6. The Company accounts for those grants under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. No stock-based employee compensation cost is reflected in the reported net loss in the accompanying financial statements, as the exercise prices of all rights were in excess of the market value of the units on the dates granted. The following table illustrates the effect on net loss if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board ("FASB") Statement No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation:

	2005	2004
Net loss, as reported	$ (3,641,833)	$ (612,981)
Less: Total stock-based employee compensation expense determined under fair value based method for all awards	(649)	(40,761)
Pro forma net loss	$ (3,642,482)	$ (653,742)

Effective in fiscal 2006, the Company will be required to adopt the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payments," which replaces APB Opinion No. 25. The adoption of SFAS No. 123(R) is not expected to have a material impact on the Company's accounting treatment for this stock-based compensation.

k. **Reclassifications** – Certain 2004 amounts have been reclassified to conform to the 2005 presentation.

2. **Business Condition**

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the ordinary course of business. As shown in the accompanying financial statements, during the years ended December 31, 2005 and 2004, the Company had net losses of $3,641,833 and $612,981, respectively. During these years, the Company generated positive operating cash flow of $853,109 and $1,009,131, respectively. The Company's ability to continue as a going concern is dependent upon its ability to generate sufficient cash flows to meet its obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitable operations.

3. **Notes Payable**

Notes payable consist of the following:

	2005	2004
Note payable to NavTel Partners, LLC; no interest through August 16, 2006, interest due monthly at 10% thereafter; principal payments of $83,333 due monthly beginning January 25, 2007; matures August 15, 2012.	$ 5,634,132	$ -
20% note payable to NavTel Partners, LLC; $7,770,132 due December 31, 2005, net of unamortized discount of $1,802,246 at December 31, 2004, refinanced as of December 31, 2005.	-	5,967,886
10% convertible note payable to Whiz Kid Ventures, LLC, balance repaid in 2005; unsecured.	-	137,500
12% notes payable to individuals; due on demand; unsecured.	145,000	155,000
Non-interest bearing advance; due on demand; unsecured.	150,000	150,000
18% note payable to i3Voice & Data, Inc.; monthly payments of principal and interest of $2,169; matures August 2008.	56,135	-

3. **Notes Payable (cont.)**

	2005	2004
Notes payable to a finance company; unsecured; due in monthly installments; for financing of insurance premiums.	$ 39,487	$ 27,816
	6,024,754	6,438,202
Less current portion	351,794	6,438,202
Notes payable, long-term	$ 5,672,960	$ -

Aggregate maturities of long-term notes payable during the years subsequent to December 31, 2005 are as follows:

Year Ending December 31,	
2006	$ 351,794
2007	1,020,689
2008	1,018,131
2009	999,996
2010	999,996
Thereafter	1,634,148
Total	$ 6,024,754

NavTel Partners, LLC Note Payable

On May 15, 2003, the Company combined its notes payable to several lenders into a single promissory note payable to NavTel Partners, LLC (the "lender") in an amount of $2,590,566. Additional borrowings from the lender increased the principal balance to $3,885,066 at December 31, 2003. The note had a stated due date of December 31, 2003, but could be extended at the Company's option for two additional one-year periods; however, upon the second extension, the lender has the right to call the note. During 2003, the Company requested and was granted an extension of the maturity date of the note to December 31, 2004. During 2004, the Company requested and was granted an additional extension of the maturity date of the note to December 31, 2005. The note bore interest at 20% per year or part of a year on the highest amount outstanding during the year (the stated accrued interest). The note was secured by all of the assets of the Company. Under the terms of the note, from the date of the first one year extension, each lender had the option to receive preferential interest equal to 100% of their principal portion of the note at maturity instead of the stated accrued interest. Unless the lender elected to receive preferential interest, the note principal and stated accrued interest was convertible into membership units at $2.50 per unit at any time prior to payment.

3. **Notes Payable (cont.)**

Management has accounted for these obligations under the most conservative (from the Company's perspective) option available to the lenders, which is for the lender to receive payment of the preferential interest and principal at maturity rather than conversion of principal and stated accrued interest into membership units. Therefore, a beneficial conversion option was not recognized upon issuance of the note and, instead, the 100% preferential interest was recognized ratably as interest expense through accretion of the note to $7,770,132 over the period from May 15, 2003 through December 31, 2005.

On December 31, 2005, one of the lenders elected to convert its portion of the lender's note payable in the amount of $1,845,504, which includes accrued interest at 20% compounded annually, to membership units at $2.50 per unit, or 738,202 units. As discussed above, the Company had historically accounted for this obligation using the lender option that resulted in the most conservative accounting treatment. Accordingly, in conjunction with the lender's election to convert its portion of the NavTel Partners, LLC note payable to membership units, the Company recognized an approximately $290,000 reduction of previously recorded interest expense.

On December 31, 2005, the Company also entered into a Renewed and Amended Secured Promissory Note with the lender for the remaining liability in the amount of $5,634,132. Under the terms of the amended note, no interest accrues prior to August 16, 2006, after which interest accrues at 10% and is due monthly. Monthly principal payments of $83,333 begin on January 25, 2007. Additionally, any capital raised by the Company after February 1, 2006 shall be paid to the lender and beginning in 2007, 50% of the Company's Excess Cash Flow, as defined in the agreement, shall be paid to the lender. All remaining unpaid principal and interest shall be paid on August 15, 2012. In the event of default by the Company, the amended note shall bear interest at 25%. The note principal is convertible into membership units at $2.50 per unit at any time prior to payment.

4. **Notes Payable to Bank**

The Company has borrowed funds under the terms of notes payable to First Arkansas Valley Bank, which notes are secured by all assets of the Company and are guaranteed by certain members. On March 10, 2004, the notes were combined into one note which was due February 8, 2006 and carried an interest rate of 7.0%. During February 2006, the note was extended through February 4, 2007 with interest due at prime plus 2%.

As consideration for the guarantee of the notes payable by certain members, those members have been paid overriding interest payments of 5% of the amount outstanding under the notes. In addition, those members have also received contribution allowances to purchase membership units, as further discussed in Note 6.

5. **Leases**

The Company leases its offices under an operating lease which expires in July 2006. The Company also leases certain office equipment under operating leases. Lease expense was $177,746 and $180,693 during the years ended December 31, 2005 and 2004, respectively. The following is a schedule of minimum lease payments at December 31, 2005:

Year Ending December 31,		
2006	$	113,230
2007		26,529
2008		18,579
2009		8,858
Total	$	167,196

6. **Members' Equity**

On December 31, 2005, one of the lenders elected to convert its portion of the NavTel Partners, LLC note payable in the amount of $1,845,504 to membership units at $2.50 per unit, or 738,202 units (See Note 3). Subsequent to year end, the Company purchased all of the outstanding membership units owned by the lender, or 836,221 units, for $1,575,000, paid $1,500,000 in cash and $75,000 in a note payable.

During 2005, the Company issued 15,188 membership units pursuant to the terms of anti-dilution agreements with two members which own approximately 285,000 membership units or 5.2% of the Company's outstanding membership units. Under the terms of the agreements, these members receive additional units to the extent that the Company sells units for less than $4.25 per unit.

At December 31, 2005, the members held outstanding contribution allowance agreements ("allowances") that will allow them to purchase additional membership units at a specified price per share (ranging from $0.01 to $6.00 per unit) which expire during 2006 through 2010.

Notes to Financial Statements

December 31, 2005 and 2004

6. **Members' Equity (cont.)**

A summary of the status of these allowances at December 31, 2005 and 2004 and changes during the years then ended is presented in the table below:

	2005		2004	
	Units	Weighted - Average Exercise Price	Units	Weighted - Average Exercise Price
Outstanding at beginning of year	2,352,751	$ 3.84	1,909,395	$ 3.96
Granted	25,000	3.00	443,356	3.34
Expired	(40,835)	6.00	-	-
Oustanding at end of year	2,336,916	$ 3.79	2,352,751	$ 3.84
Exercisable at end of year	2,336,916	$ 3.79	2,352,751	$ 3.84

The weighted-average fair value of allowances granted during the year ended December 31, 2005 was $.55. The fair value of each allowance grant was estimated on the date of grant using the Black-Scholes Option-Pricing model with the following weighted-average assumptions used for the year ended December 31, 2005: risk free interest rate of 4.05%; expected dividend yield of zero; expected life of 5 years; and no expected volatility. The fair value of the allowances granted in 2005 was not material to the accompanying financial statements and, accordingly, have not been recognized.

The following table summarizes information about the allowances outstanding at December 31, 2005:

	Contribution Allowances Oustanding and Exercisable		
Range of Exercise Prices	Allowances Outstanding	Weighted - Average Remaining Contractual Life	Weighted - Average Exercise Price
$ 0.01	266,766	1.63 years	$ 0.01
3.00	511,200	2.87 years	3.00
3.50	198,556	4.00 years	3.50
4.25	503,530	1.43 years	4.25
5.00	533,000	2.15 years	5.00
5.50	236,364	0.53 years	5.50
6.00	87,500	0.61 years	6.00
$ 0.01 - $6.00	2,336,916	2.40 years	$ 3.79

7. Employee Membership Unit Plans

The Company sponsors membership unit appreciation plans for its management and its employees. In consideration for the employees continued services, the Company grants the employees certain rights to share in the appreciation of the value of the Company's membership units in the event the Company is sold. Key employees vest in these rights over three years and these rights expire 18 months after termination. Non-key employees vest in these rights immediately and these rights expire upon termination. The unit appreciation right entitles an employee to receive the excess of the fair market value of a unit over an established unit value at the employee's date of grant, in the event of the sale of the Company. The initial rights granted to a member of management, or an employee, are based on their position with the Company. These rights are unsecured.

A summary of the status of the membership unit rights granted to management and employees at December 31, 2005 and 2004 and changes during the years then ended is presented in the tables below:

	2005		2004	
	Units	Weighted - Average Exercise Price	Units	Weighted - Average Exercise Price
Outstanding at beginning of year	774,500	$ 4.00	820,800	$ 4.00
Expired	208,200	4.00	46,300	4.00
Oustanding at end of year	566,300	$ 4.00	774,500	$ 4.00
Exercisable at end of year	561,300	$ 4.00	764,500	$ 4.00

No membership unit rights were granted in 2005 or 2004. The following table summarizes information about the membership unit rights outstanding at December 31, 2005:

	Membership Unit Rights Outstanding		Membership Unit Rights Exercisable	
Range of Exercise Price	Number of Rights Outstanding	Weighted-Average Exercise Price	Number of Rights Exercisable	Weighted-Average Exercise Price
$ 4.00	566,300	$ 4.00	561,300	$ 4.00

8. Commitments

The Company has executed various agency agreements for the marketing and sale of its services. The agreements typically cover an initial five year period. The terms generally provide for automatic one year renewals unless terminated by either party with not less than sixty days notice. In return, the Company pays the agent a monthly marketing and sales commission based on a percentage of its collected revenue from its sale of services to customers. Total commissions for the years ended December 31, 2005 and 2004 amounted to $2,184,733 and $1,599,062, respectively.

9. Warrant Agreement with Significant Customer

The Company entered into a telecommunications services agreement dated October 10, 2005 with a large customer which has operations across the United States (the "Customer"). Revenues earned from the Customer during 2005 approximated 5% of total revenues and management expects the dollar revenues from the Customer to increase in future periods. In conjunction with entering into this service agreement the Company entered into a separate agreement in which it issued warrants to the Customer to purchase up to 1,853,595 membership units at $3 per unit, based upon certain terms and conditions over a three year period.

As of the date of these financial statements, none of the warrants issued to the Customer had been exercised. However, in January 2006, the Customer did purchase 625,000 membership units. This purchase did not reduce the number of units which can be purchased pursuant to the warrant agreement discussed above. The proceeds from this sale were used to fund the repurchase of the membership units as discussed in Note 6 above.

Due to the short duration of the window of time to exercise the warrants pursuant to this agreement and the uncertainty of the number of warrants which may ultimately become exercisable, the Company has not given accounting recognition to these warrants.

10. Telephone Industry Regulations

On December 15, 2004, the Federal Communications Commission (the "Commission") adopted new rules for the network unbundling obligations of incumbent local phone carriers ("ILECs"), in response to the March 2, 2004 decision by the U.S. Court of Appeals for the Washington, D.C. Circuit overturning portions of the Commission's August 21, 2003 Triennial Review Order. The Commission released its Order with the new rules on February 4, 2005 and stipulated that the new rules shall take effect on March 11, 2005. The new rules provide that ILECs have no legal obligation to provide CLECs with unbundled access to mass market local circuit switching ("UNE-P"), but allow competing carriers a 12-month period to transition their existing customer base away from the use of UNE-P. The ILECs can provide UNE-P access through commercial agreements. During the transition, CLECs may not add any new UNE-P customers, but will retain access to the UNE-P platform for the existing customer base at increased rates.

10. **<u>Telephone Industry Regulations</u> (cont.)**

The Company has taken a number of measures to ensure a smooth transition from its UNE-P strategy. The Company has executed commercial and interconnection agreements with each of its ILECs in current markets, as well as expanding markets. Additionally, the Company continues to evaluate and explore the potential availability of switching and other services provided by non-ILEC suppliers, as well as other emerging technologies and applications such as Voice over Internet Protocol ("VoIP").

Although the effect of these changes had a detrimental impact on the cost of providing its services, the Company continues to believe that its strategy will achieve sustainable profitable operations.

11. **<u>Concentrations of Credit Risk</u>**

Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of telecommunication accounts receivable with a variety of customers and cash deposited with financial institutions. The Company generally does not require collateral from its customers. Such credit risk is considered by management to be limited due to the Company's broad customer base and its customers' financial resources.

At December 31, 2005 and 2004 and at various times throughout these years, the Company maintained cash balances with certain financial institutions in excess of the Federal Deposit Insurance limit. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any unusual credit risk beyond the normal credit risk associated with commercial banking relationships.

STF 1.10. Please provide the information for full years 2003 and 2002 comparable to information already provided in Attachment D.

Response: See attached.

Respondent: Michael McAlister, General Counsel
Navigator Telecommunications, LLC
8325 Riverwood Park Drive
P.O. Box 13860
North Little Rock, AR 72113

NAVIGATOR TELECOMMUNICATIONS, LLC

FINANCIAL STATEMENTS

DECEMBER 31, 2003 AND 2002

WITH

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

CONTENTS

Hudson Cisne & Co. LLP
CERTIFIED PUBLIC ACCOUNTANTS

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
Navigator Telecommunications, LLC
North Little Rock, Arkansas

We have audited the accompanying balance sheets of Navigator Telecommunications, LLC as of December 31, 2003 and 2002 and the related statements of operations, changes in members' (deficit) and cash flows for the years then ended. These financial statements are the responsibility of Navigator Telecommunications, LLC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Navigator Telecommunications, LLC as of December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Hudson, Cisne & Co. LLP

February 11, 2004

Hudson, Cisne, & Co. LLP
11412 Huron Lane
Little Rock, AR 72211
Phone: (501) 221-1000
Fax: (501) 221-9236

NAVIGATOR TELECOMMUNICATIONS, LLC

BALANCE SHEETS

DECEMBER 31, 2003 AND 2002

ASSETS

	2003	2002
Current assets:		
Cash and cash equivalents	$ 414,127	$ 128,060
Restricted cash	250,000	200,000
Telecommunication accounts receivable (net of allowance for doubtful accounts of $279,588 in 2003 and $285,351 in 2002)	2,917,642	2,844,934
Accounts receivable – other	1,303,270	925,417
Prepaids	323,634	132,852
Total current assets	5,208,673	4,231,263
Other assets:		
Goodwill	448,058	448,058
Service deposits	14,048	9,998
Total other assets	462,106	458,056
Plant and equipment:		
Telecommunication plant in service	3,261,982	3,165,626
Telecommunication plant under construction	-	31,394
	3,261,982	3,197,020
Less accumulated depreciation	996,645	667,594
Net plant and equipment	2,265,337	2,529,426
	$ 7,936,116	$ 7,218,745

LIABILITIES AND MEMBERS' (DEFICIT)

	2003	2002
Current liabilities:		
Accounts payable	$ 3,457,921	$ 4,332,186
Current portion of capital lease obligations	9,380	9,170
Notes payable – members	797,500	785,100
Notes payable – line of credit	3,030,195	3,080,085
– other	150,000	150,000
Customer deposits	292,872	242,910
Accrued expenses	890,853	173,988
Advance billings	560,741	471,626
Accrued payroll	290,000	185,683
Total current liabilities	9,479,462	9,430,748
Capital lease obligations, less current portion	-	6,659
Long term debt	3,885,066	2,322,500
Members' (deficit)	(5,428,412)	(4,541,162)
	$ 7,936,116	$ 7,218,745

See accompanying notes.

NAVIGATOR TELECOMMUNICATIONS, LLC

STATEMENTS OF OPERATIONS

YEARS ENDED DECEMBER 31, 2003 AND 2002

	2003	2002
Operating revenues:		
Telecommunications services	$ 28,867,293	$ 21,689,055
Operating expense:		
Cost of telecommunications services	19,557,265	15,921,280
Selling, general, and administrative	8,446,373	7,700,747
Depreciation	329,047	317,394
Total operating expense	28,332,685	23,939,421
Income (loss) from operations	534,608	(2,250,366)
Other income (expense):		
Interest income	1,626	54,332
Interest expense	(1,406,855)	(890,423)
Amortization of loan fees	(57,240)	(647,166)
Loss on disposal of assets	(31,394)	-
Total other (expense)	(1,493,863)	(1,483,257)
Net loss	$ (959,255)	$ (3,733,623)

See accompanying notes.

NAVIGATOR TELECOMMUNICATIONS, LLC

STATEMENTS OF CHANGES IN MEMBERS' (DEFICIT)

YEARS ENDED DECEMBER 31, 2003 AND 2002

Balance at January 1, 2002	$ (2,764,797)
Member contributions	1,957,258
Net loss	(3,733,623)
Balance at December 31, 2002	(4,541,162)
Member contributions	72,005
Net loss	(959,255)
Balance at December 31, 2003	$ (5,428,412)

See accompanying notes.

NAVIGATOR TELECOMMUNICATIONS, LLC

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2003 AND 2002

	2003	2002
Cash flows from operating activities:		
Net loss	$ (959,255)	$ (3,733,623)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	329,047	317,394
Amortization of loan fees	57,240	647,166
Net provision for losses on accounts receivable	5,763	(146,322)
Loss on disposal of assets	31,394	-
Changes in assets and liabilities:		
Restricted cash	(50,000)	2,319,725
Telecommunication accounts receivable	(72,708)	(1,023,080)
Accounts receivable – other	(383,616)	(442,855)
Prepaid expenses	(248,023)	(34,392)
Service deposits	(4,050)	-
Accounts payable	(874,265)	149,432
Customer deposits	49,962	121,098
Accrued expenses	716,865	1,942
Advance billings	89,115	111,206
Deferred revenue	-	(19,725)
Accrued payroll	104,318	18,557
Net cash used in operating activities	(1,208,213)	(1,713,477)
Cash flows from investing activities:		
Construction and acquisition of plant	(96,352)	(291,353)
Net cash used in investing activities	(96,352)	(291,353)
Cash flows from financing activities:		
Member contributions	72,005	1,957,258
Payments on capital lease obligations	(6,449)	(14,299)
Payments on long term debt	-	(187,500)
Advances on long term debt	2,125,176	250,000
Payments on notes payable – members	(784,100)	(1,231,933)
Advances on notes payable – members	234,000	1,708,940
Payments on line of credit	(50,000)	(609,940)
Advances on line of credit	-	60,050
Net cash provided by financing activities	1,590,632	1,932,576
Net change in cash and cash equivalents	286,067	(72,254)
Cash and cash equivalents at beginning of year	128,060	200,314
Cash and cash equivalents at end of year	$ 414,127	$ 128,060

See accompanying notes.

NAVIGATOR TELECOMMUNICATIONS, LLC

NOTES TO FINANCIAL STATEMENTS

Note 1: Summary of significant accounting policies

Organization

Navigator Telecommunications, LLC (the Company) is an Arkansas limited liability company, organized September 9, 1997. The business purpose of the Company is to operate as a reseller/provider of switched local exchange service and long distance service as a competitive local exchange carrier (CLEC).

The following is a list of lines in service at December 31:

	2003	2002
Alabama	678	479
Arkansas	8,786	10,353
California	5,258	4,712
Florida	5,492	2,899
Georgia	2,618	1,689
Illinois	1,662	303
Indiana	1,308	554
Kansas	1,929	1,897
Kentucky	1,480	448
Michigan	1,210	385
Mississippi	785	603
Missouri	4,910	4,779
North Carolina	1,557	1,341
Ohio	1,171	313
Oklahoma	3,024	3,057
Pennsylvania	413	396
South Carolina	1,861	1,334
Tennessee	1,557	1,016
Texas	9,629	8,841
Wisconsin	817	504
Total	56,145	45,903

In addition, as of December 31, 2003 and 2002, the Company is licensed to do business in Massachusetts.

Revenue recognition

Both toll service revenues and local service revenues are recognized when earned regardless of the period in which they are billed. The Company has participated with Sprint, Bell Operating Companies and other toll carriers in furnishing local and long distance telephone services.

Use of estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates.

NAVIGATOR TELECOMMUNICATIONS, LLC

NOTES TO FINANCIAL STATEMENTS

Note 1: Summary of significant accounting policies (continued)

Income taxes

The Company is structured to be treated as a partnership for federal and state income tax purposes. As such, the Company's taxable income or loss flows to its members. No income tax provision or benefits are recorded directly by the Company. Management is not aware of any course of action or series of events that have occurred that might adversely affect the Company's tax status.

Basis of presentation

Navigator Telecommunications, LLC maintains its accounting records on the accrual basis in conformity with accounting policies promulgated by the Federal Communication Commission and the Arkansas Public Service Commission with respect to regulated activities.

Telecommunication plant and depreciation

Telecommunication plant in service is stated at cost. The Company provides for depreciation on a straight-line basis at annual rates, based on the estimated useful lives of the related assets. Depreciation for the years ended December 31, 2003 and 2002 was $329,047 and $317,394, respectively.

Listed below are the major classes of telecommunication plant in service as of December 31:

	Years	2003	2002
Outside plant	15	$ 1,989,661	$ 1,989,661
Central office equipment	10	365,151	365,151
Leasehold improvement	15	216,167	207,643
Furniture and office equipment	5-7	190,513	196,393
General purpose computers	5	500,490	406,778
		$ 3,261,982	$ 3,165,626

Concentration of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consists primarily of the telecommunication accounts receivable which are unsecured.

The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any unusual credit risk beyond the normal credit risk associated with commercial banking relationships.

Statements of cash flows

The Company considers all demand deposits and highly liquid investments with original maturities of three months or less to be cash equivalents.

Cash paid for interest amounted to $689,990 and $757,486 for the years ended December 31, 2003 and 2002, respectively.

Noncash transactions for 2003 and 2002 consisted of the following:

	2003	2002
Purchase of insurance for a note payable	$ 70,434	$ 58,814
Refinance of notes payable	1,760,000	-

NAVIGATOR TELECOMMUNICATIONS, LLC

NOTES TO FINANCIAL STATEMENTS

Note 1: Summary of significant accounting policies (continued)

Goodwill

In 2000, two members' interest in the Company were repurchased. This resulted in goodwill being recognized in 2000. Consistent with SFAS 142, goodwill is not being amortized and remains on the books at $448,058.

Reclassification

Certain reclassifications have been made to the 2002 financial statements to conform to the 2003 presentation.

Note 2: Notes payable – members

Notes payable – members consisted of the following, at December 31, 2003 and 2002:

	2003	2002
Louis F. McAlister, demand notes payable, interest at 12.0%, unsecured	$ 105,000	$ 105,000
Stephen L. Parr, notes payable, interest 12.0%, unsecured	130,000	130,000
Whiz Kid Ventures, due November 30, 2004 interest at 10% due semi-annually, unsecured	312,500	-
Billy Simpson, 12.75% note payable in monthly installments, balance due December 29, 2004, unsecured	50,000	-
Jim McDowell, 12.75% not payable in monthly installments, balance due December 29, 2004, unsecured	150,000	-
Travis Parr, 12.75% note payable in monthly installments, balance due December 29, 2004, unsecured	50,000	-
JBJ Lending, 12% note payable due April 9, 2003, secured by pledged revenues	-	550,100
	$ 797,500	$ 785,100

Note 3: Notes payable – line of credit

The Company has lines of credit with First Arkansas Valley Bank which are secured by all assets of the company and the guaranty of certain members. The lines of credit carry varying interest rates and mature as follows:

April 23, 2004 interest at 7.0%	$ 1,050,060
February 28, 2004 interest at 7.5%	550,050
May 26, 2004 interest at 6.5%	700,025
October 10, 2004 interest at 7.0%	730,060
	$ 3,030,195

NAVIGATOR TELECOMMUNICATIONS, LLC

NOTES TO FINANCIAL STATEMENTS

Note 4: Long-term debt

Long-term debt consisted of the following at December 31:

	2003	2002
NavTel Partners, 20% note payable due January 31, 2005, secured by all assets of the Company (the majority of the NavTel Partners are members of the Company)	$ 3,885,066	$ -
BX, LLC, due June 29, 2006, interest at 9% due quarterly, secured by all assets of the company	-	960,000
F. William Hackmeyer, Jr. due August 28, 2006 interest at 9% due quarterly, secured by all assets of the company	-	800,000
TK Investors, Inc., due November 30, 2004, interest at 10% due semi-annually, unsecured	-	312,500
Billy Simpson, 12.75% note payable due in monthly installments, due January 29, 2004, unsecured	-	50,000
Jim McDowell, 12.75% note payable due in monthly installments, due January 29, 2004, unsecured	-	150,000
Travis Parr, 12.75% note payable due in monthly installments, due January 29, 2004, unsecured	-	50,000
	$ 3,885,066	$ 2,322,500

Note 5: Leases

The Company has various leased property under capital leases that are included in general purpose computers in the accompanying financial statements as follows:

Computer equipment	$ 45,821
Less accumulated depreciation	41,470
	$ 4,351

The Company leases its offices under an operating lease.
Following is a schedule of minimum lease payments at December 31, 2003:

	Capital leases	Operating leases
2004	$ 9,380	$ 63,770
		-
Total minimum lease payments	$ 9,380	$ 63,770

Note 6: Members' equity

At December 31, 2003, membership units issued and outstanding totaled 5,549,675.

At December 31, 2003, the members held outstanding contribution allowance agreements that will allow them to purchase 1,909,395 additional units at a specified price per share (ranging from $.01 to $6.00 per share) which expire during 2005 through 2008.

NAVIGATOR TELECOMMUNICATIONS, LLC

NOTES TO FINANCIAL STATEMENTS

Note 7: Membership unit plan

The Company sponsors membership unit appreciation plans for its employees. In consideration for the employees continued services, the Company grants the employees certain rights to share in the appreciation of the value of the Company's membership units in the event the Company is sold. Full vesting in these rights begins immediately up to three years of service in these plans. The unit appreciation right entitles an employee to receive the excess of the fair market value of a unit over an established unit value at the employee's date of grant, in the event of the sale of the Company. The initial rights granted to an employee are based on employee classification. There is an established unit value of $4 for these membership units for purposes of calculating their unit appreciation rights. These rights are unsecured and have various termination dates up to 18 months from the employee's separation date. As of December 31, 2003 and 2002, there were 820,800 and 794,100 membership unit rights granted for employees.

Note 8: Commitments

The Company has executed various agency agreements. The agreements designate the agent to act exclusively for Navigator Telecommunications, LLC for the marketing and sale of its services to specified apartment communities managed by the agents. The agreements cover an initial five year period. The terms provide for automatic one year renewals unless terminated by either party with not less than sixty days notice. In return, the Company pays the agent a monthly marketing and sales commission based on a percentage of its collected revenue from its sale of services to customers. Total commissions paid for the years ended December 31, 2003 and 2002, amounted to $1,327,057 and $934,673, respectively.

Note 9: Telephone industry regulations

In recent years, various state and federal laws were enacted that significantly affected the telephone industry. In 1996, Congress passed the Telecommunications Act of 1996 which assists in implementing the national policy of opening the local telecommunications market to competition on fair and equal terms. On February 4, 1998 the State of Arkansas General Assembly passed the Telecommunication Regulatory Reform Act of 1998 (Act 77) to provide for a system of regulation of telecommunication services consistent with the Federal Act. The purpose of the Act is to allow for fair competition, modify and eliminate unnecessary regulations and to preserve and advance universal service within the State. As such, the Act directs the Arkansas Public Service Commission to take into consideration the vast differences in operating conditions between the large and small incumbent local exchange carriers and the regulatory burdens placed on small carriers when the Commission promulgates rules and regulations within the Telephone industry.

Act 77 also established the Arkansas Universal Service Fund (AUSF) to assure the availability of universal telephone service at rates that are reasonable and affordable and to provide for comparable services and rates between rural and urban areas. The cost of funding the AUSF is borne by the telecommunication providers and the Act allows them to surcharge their customers to recover their costs. The Act establishes procedures for administering the Fund through an appointed Administrator.

The entry of Navigator Telecommunications, LLC as a CLEC is consistent with the requirements of the Telecommunications Act of 1996 and the Arkansas' Act 77 to increase customer's choices for telecommunications services.

NAVIGATOR TELECOMMUNICATIONS, LLC

NOTES TO FINANCIAL STATEMENTS

Note 10: Liquidity

The Company's current liabilities exceed its current assets by approximately $4.3 million as of December 31, 2003. The Company has improved its operations over the past year to the point of generating positive EBITDA for 2003 of approximately $860,000. The Company believes these improvements will continue as lines in service increase in areas where profitable UNEP margins are available while continuing to drive efficiencies during 2004. Management feels these factors will enable it to fund and improve operations over the next twelve months along with continuing to pay down a portion of its debt.