BEFORE THE
TENNESSEE REGULATORY AUTHORITY

00 AUG 23 PM 2 53

In the Matter of	)	
	)	
Birch Telecom of the South, Inc.	)	Docket No. 00-00347
	)	
Application for a Certificate of Convenience and Necessity to Operate as a Competing Telecommunications Service Provider Within the State of Tennessee	)	

APPLICATION FOR CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY

Birch Telecom of the South, Inc. ("Birch" or "Applicant"), pursuant to T.C.A. § 65-4-201 et seq., hereby submits its application to the Tennessee Regulatory Authority ("TRA") for a Certificate of Public Convenience and Necessity authorizing Birch to provide resold and facilities-based local exchange and interexchange telecommunications services as a competing telecommunications service provider in the State of Tennessee. In support of its application, Birch hereby provides the following information:

I. INTRODUCTION

1. Applicant's Name and Principal Business Address

Birch Telecom of the South, Inc.
2020 Baltimore Avenue
Kansas City, Missouri 64108
Voice (816) 300-3000
Fax (816) 300-3247

POSTED 8-28-00

1135476 v1; _C5001!.DOC

2. Contact Persons Regarding This Application

Valerie M. Furman, Esq.
Colin M. Alberts, Esq.
Dickstein Shapiro Morin & Oshinsky LLP
2101 L Street, N.W.
Washington, D.C. 20037
Voice (202) 955-6658
Fax (202) 887-0689

Counsel for Birch Telecom of the South, Inc.

3. Company Contact for Regulatory and Legal Matters Post-Certification

Gregory C. Lawhon, Esq.
Senior Vice President of Public Policy and General Counsel
Birch Telecom of the South, Inc.
2020 Baltimore Avenue
Kansas City, Missouri 64108
Voice: (816) 300-3000
Fax: (816) 300-3247

With a copy to:

Valerie M. Furman, Esq.
Colin M. Alberts, Esq.
Dickstein Shapiro Morin & Oshinsky LLP
2101 L Street, N.W.
Washington, D.C. 20037
Voice: (202) 955-6658
Fax: (202) 887-0689

Counsel for Birch Telecom of the South, Inc.

4. Corporate Information

Birch is a newly-formed corporation, incorporated in the State of Delaware on February 8, 2000. A certified copy of Birch's certificate of incorporation is attached hereto as Exhibit A. Birch is a privately-held, wholly-owned subsidiary of Birch Telecom, Inc., which is also a Delaware corporation.

5. Authorization to Transact Business in the State of Tennessee

Birch is registered as a foreign corporation in the State of Tennessee. Birch's certificate of authorization to transact business in the State of Tennessee is attached hereto as Exhibit B.

6. Resident Agent

Birch's resident agent for the State of Tennessee is:

Corporation Service Company
500 Tallan Building
Two Union Square
Chattanooga, Tennessee 37402-2571
Telephone: (800) 927-9800
Facsimile: (302) 636-5454

7. Description of Proposed Services

Birch is an integrated telecommunications provider that intends to offer facilities-based and resold local exchange telecommunications services, as well as resold interexchange (toll) telecommunications services, to business and residential customers in the State of Tennessee. Birch will offer state-of-the-art voice and data services to its customers, including local and long distance telephone service, calling card services, toll-free numbers, Internet access (using DSL, T-1, ISDN and/or other high-speed facilities), Web hosting, integrated voice and data transmission over broadband lines, and customer premises equipment sales and services. Birch will provide the above-referenced services to its customers through a combination of leased and owned network facilities and resold services. Using an unbundled network element platform ("UNE-P") strategy, Birch will lease substantially all of the unbundled network elements necessary to provide service to customers from incumbent telephone companies, and use Birch advanced back-office systems to combine these elements into integrated Birch-branded voice services. Employing the UNE-P strategy will allow Birch to offer voice services throughout its markets and regions at gross margins averaging approximately fifty-percent (50%), minimize current capital expenditures, and maintain design flexibility for the next generation of telecommunications technology.

Birch's sister corporations -- Birch Telecom of Missouri, Inc., Birch Telecom of Kansas, Inc., and Birch Telecom of Texas Ltd., L.L.P. -- currently offer these state-of-the-art telecommunications services to customers located throughout the states of Missouri, Kansas and Texas. Birch's sister corporations are currently deploying collocations and transmission equipment throughout the Missouri, Kansas and Texas markets to deliver digital subscriber line service, which will support dedicated high-speed Internet access. Birch's sister corporations expect to have over 130 collocations operational by the end of this year in the Missouri, Kansas and Texas markets. Birch intends to replicate the service offerings and operations of its sister corporations in the State of Tennessee.

8. Geographic Service Area

<u>Resold Interexchange (Toll) Services</u>

Birch intends to resell interexchange (toll) telecommunications services on a statewide-basis throughout the State of Tennessee.

Resold Local Exchange Service

Birch intends to resell the local exchange telecommunications services of BellSouth in BellSouth's exchange areas throughout the State of Tennessee.

Facilities-Based Local Exchange Services

Birch intends to provide service using its UNE-P strategy in various as-yet-undetermined locations throughout the State of Tennessee. In addition, Birch plans in the future to enter into agreements with other incumbent local exchange carriers to permit Birch to resell local exchange service in additional service areas within the state. Birch may also in the future deploy its own facilities for the provision of local exchange service. Accordingly, Birch requests that the TRA authorize Birch to provide resold and facilities-based local exchange services on a statewide basis at this time, to afford Birch the flexibility to easily and quickly expand its operations and/or install its own facilities as Birch deems necessary or desirable consistent with its business plans. Authorizing Birch to provide facilities-based local exchange services on a statewide basis at this time is in the public interest, because it will eliminate the need for the TRA and Birch to engage in repeated (and essentially redundant) "site-by-site" review proceedings, thereby conserving both the TRA's and Birch's resources.

II. REQUIRED ELEMENTS

T.C.A. § 65-4-201 requires an applicant for a certificate of public convenience and necessity to show that it possesses sufficient managerial, financial, and technical abilities to provide the applied-for services. Birch satisfies each of these requirements.

9. Managerial and Technical Expertise and Operations in Other States

Birch's officers and directors have extensive experience providing telecommunications services and operating telecommunications companies. As stated above, Birch's sister corporations are currently authorized to provide local exchange and long distance services within the states of Missouri, Kansas, Texas and Oklahoma, and currently provide such services in the states of Missouri, Kansas and Texas. In addition, Birch currently has applications for authority to provide resold and facilities-based local exchange and long distance services pending in the states of Kentucky and Louisiana. The services proposed in Birch's pending applications are the same as those proposed herein. Birch has attached hereto as Exhibit C biographical descriptions of the company officers who will have primary management responsibility for Birch's business operations, as evidence that Birch's management team possesses more than sufficient technical and managerial expertise to provide the local exchange telecommunications services proposed herein to customers in the State of Tennessee.

Tennessee customers will not be required to purchase CPE which could not be used with BellSouth or other ILEC systems, should a Birch customer decide to return to BellSouth or another ILEC.

10. Financial Capabilities

Birch has attached hereto as Exhibit D its most recent audited annual financial statement, in the form of its 1998 SEC Form 10-K/A and its SEC Form 10-Qs for the first three quarters of 1999, as evidence of its more than sufficient financial resources and qualifications to provide the local exchange telecommunications services proposed herein within the State of Tennessee. Birch has access to substantial financial resources through its corporate parent. Birch Telecom, Inc. intends to use its current capitalization and operations to fund Birch's investments in order to furnish services throughout the state.

The financial statements and other financial information attached as Exhibit D confirm that Birch has the financial resources necessary for its proposed Tennessee operations. Birch will shortly forward to the TRA projected financial statements including income, capital budgeting and cash flow, over the next three (3) years, to supplement this Application.

III. MISCELLANEOUS

11. Customer Service Plan

A. Deposits

Birch reserves the right to examine the credit record of all service applicants as stated above and require a security deposit, not to exceed two month's estimated recurring charges, when determined to be necessary to assure future payment. The security deposit will be computed by Birch in accordance with TRA rules and regulations.

Deposits held will accrue interest at a rate which is equal to a rate of one percent (1%) above the prime lending rate as published in The Wall Street Journal. This amount shall be adjusted annually by using the prime lending rate published in The Wall Street Journal for the last business day of September of each year with the revised rate to be implemented on the first of October of each year.

If a Customer pays all undisputed charges for 12 consecutive billing cycles, the deposit shall be promptly refunded along with accrued interest, or credited to future charges on subsequent bills.

Birch may require a Customer or applicant for service to make an advance payment (1) if the applicant is unable to establish that he had a previous account with a telephone utility for a period of at least 12 months for which all undisputed charges were satisfactorily paid, or (2) if the applicant has had no previous telephone service or has had previous telephone service of less than 12 months, the applicant's credit record will be accessed and evaluated by means of a mechanized retrieval system between Birch and national recognized credit bureaus. No security payment will be required of those applicants who meet Birch's criteria, as evaluated by the scoring model. The criteria used in assessing a score is as follows: collection judgments, written-off accounts, outstanding collection accounts, various degrees of delinquency history from 30-180 days and not paid in full or current at the time of scoring, bankruptcies, liens, other public records. The advance payment will not exceed an amount equal to all nonrecurring charges and two month's estimated recurring charges, as a condition of continued or new service.

B. Complaint Procedures

Birch will make service available to customers 24 hours per day, 7 days per week throughout the year. Customer inquiries and complaints will be handled by representatives at Birch's Customer Service Center, which is staffed 24 hours per day, 7 days per week.

The toll-free number for Birch's Customer Service Center is (800) 772-4724. This number will be printed on customer bills. Customer service matters and complaints may also be directed to Birch's customer service contact person by writing to:

Charles Fuller
Senior Vice President of Customer Service
Birch Telecom of the South, Inc.
2020 Baltimore Avenue
Kansas City, Missouri 64108

Birch's customer service representatives are prepared to respond to a broad range of service matters, including inquiries regarding Birch's service offerings and associated rates monthly statements, problems and concerns regarding a customer's service.

12. Proposed Initial Tariffs

Proposed initial tariffs containing the terms, conditions and rates to be charged by Birch for the provision of the services proposed herein are attached hereto as Exhibit E.

13. Small and Minority-Owned Telecommunications Business Participation Plan

Birch has attached, as Exhibit F, its small and minority-owned telecommunications business participation plan in compliance with T.C.A. § 65-5-212.

14. IntraLATA Toll Dialing Parity Plan

Birch hereby attaches as Exhibit G, a copy of its proposed IntraLATA Toll Dialing Parity Plan.

15. Policies, Rules and Orders

Birch will comply with all applicable statutes, rules and orders concerning the provision of telecommunications services in Tennessee, including all provisions of rule 1220-4-8-.04. Specifically, Birch will, either directly or through arrangements with other carriers or companies:

a. Provide access to 911 and E 911 emergency service;

b. Provide white page directory listings and directory assistance;

c. Provide consumer access to and support for the Tennessee Relay Center in the same manner as incumbent local exchange telephone companies;

d. Provide free blocking service for 900, 976 type services in accordance with TRA policy;

e. Provide Lifeline and Link-up services to qualifying citizens of this state;

f. Provide educational discounts in existence as of June 6, 1995.

16. Service of Notice of Application

Notice of the filing of the instant application has been served on all eighteen (18) incumbent local exchange telephone companies in Tennessee. A sample copy of the notice, and a Certificate of Service verifying such service, is attached hereto as Exhibit H.

17. Request for Waiver of Reporting Requirements

Birch hereby requests a waiver of the TRA's requirement for monthly filing of the Wireline Activity Report. Birch also requests a waiver of any additional reporting requirements which, although applicable to ILECs such as BellSouth, are not applicable to

Birch because such requirements (1) are not consistent with the demands of the competitive marketplace, and/or (2) constitute an undue burden on a competitive provider, thereby requiring an inefficient allocation of its limited resources. In addition, Birch reserves the right to seek any regulatory waivers which may be required for Birch to compete effectively in the Tennessee local exchange market.

18. TRA's Grant of Birch's Application to Provide Competing Telecommunications Service is in the Public Interest

Birch submits that TRA approval of its application to provide competiting telecommunications services in the State of Tennessee is in the public interest, as Birch's market entry will bring a host of benefits to the State's telecommunications users. Included among those benefits are the following:

(i) increased diversity in the supply of telecommunications providers, which will offer additional and new consumer choices;

(ii) the entry of new telecommunications providers into the State's telecommunications marketplace, which will have no adverse impact upon prices; instead, it will introduce competitive pressures that will foster lower prices;

(iii) the entry of new telecommunications providers into the State's telecommunications marketplace, which will enhance competitive pressures that will foster higher quality service from all providers.

19. Exhibits

In support of its application, Birch hereby submits the following exhibits:

Exhibit A Birch's Articles of Incorporation and Certificate of Incorporation

Exhibit B Birch's Certificate of Authorization to Transact Business in the State of Tennessee

Exhibit C Biographies of the Birch Officers Who Will Have Primary Management Responsibility for Birch's Business Operations

Exhibit D Information Regarding Birch's Financial Resources and Qualifications

Exhibit E Birch's Proposed Initial Tariffs

Exhibit F Birch's Small and Minority–Owned Telecommunications Business Participation Plan

Exhibit G Birch's IntraLATA Toll Dialing Parity Plan

Exhibit H Birch's Sample Notice of Application and Certificate of Service

IV. CONCLUSION

Wherefore, Birch Telecom of the South, Inc. respectfully requests that the Tennessee Regulatory Authority grant it a Certificate of Public Convenience and Necessity to provide resold and facilities-based local exchange and interexchange telecommunications services in the State of Tennessee as Competing Telecommunications Service Provider.

Respectfully submitted,
BIRCH TELECOM OF THE SOUTH, INC.

By: Colin M Alberts

Valerie M. Furman, Esq.
Colin M. Alberts, Esq.
Dickstein Shapiro Morin & Oshinsky LLP
2101 L Street, N.W.
Washington, D.C. 20037
Voice: (202) 955-6658
Fax: (202) 887-0689

Counsel for Birch Telecom of the South, Inc.

Dated: April 27, 2000

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EXHIBIT A

BIRCH'S ARTICLES OF INCORPORATION & CERTIFICATE OF INCORPORATION

State of Delaware

Office of the Secretary of State

I, EDWARD J. FREEL, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF INCORPORATION OF "BIRCH TELECOM OF THE SOUTH, INC.", FILED IN THIS OFFICE ON THE EIGHTH DAY OF FEBRUARY, A.D. 2000, AT 9 O'CLOCK A.M.

A FILED COPY OF THIS CERTIFICATE HAS BEEN FORWARDED TO THE NEW CASTLE COUNTY RECORDER OF DEEDS.

Edward J. Freel, Secretary of State

3173306 8100

001064560

AUTHENTICATION: 0250262

DATE: 02-10-00

STATE OF DELAWARE
SECRETARY OF STATE
DIVISION OF CORPORATIONS
FILED 09:00 AM 02/08/2000
001064560 - 3173306

CERTIFICATE OF INCORPORATION

OF

BIRCH TELECOM OF THE SOUTH, INC.

First: The name of the Corporation is Birch Telecom of the South, Inc.

Second: The address of the Corporation's initial registered office in the State of Delaware is 1013 Centre Road, in the City of Wilmington, County of New Castle, and the name of its initial registered agent at such address is Corporation Service Company.

Third: The Corporation is organized for profit, and its purpose is to engage in any lawful act or activity for which corporations may be organized under the Delaware General Corporation Law.

Fourth: The aggregate number of shares which the Corporation shall have authority to issue shall be 10,000 shares, all of which shall be common stock with a par value of one cent ($.01) each.

Fifth: The number of directors constituting the entire Board of Directors shall be three (3).

Sixth: The Board of Directors shall have power to make, and from time to time alter, amend, or repeal the Bylaws of the Corporation; provided, however, that (a) the stockholders shall have the paramount power to alter, amend and repeal the Bylaws or adopt new Bylaws, exercisable by a majority vote of the stockholders present in person or by proxy at any annual or special meeting of stockholders, and (b) if and to the extent the stockholders exercise such power, the Board of Directors shall not thereafter suspend, alter, amend or repeal the Bylaws, or portions thereof, adopted by the stockholders, unless, in adopting such Bylaws, or portions thereof, the stockholders otherwise provide.

Seventh: A director of the Corporation shall not be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (a) for any breach of the director's duty of loyalty to the Corporation or its stockholders, (b) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (c) under the provisions of Section 174 of the Delaware General Corporation Law and amendments thereto, or (d) for any transaction from which the director derived an improper personal benefit. If the Delaware General Corporation Law is amended to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the Corporation shall be eliminated or limited to the fullest extent permitted by the Delaware General Corporation Law, as so amended. No amendment, repeal or adoption of any provision of this Certificate of Incorporation inconsistent with this Article Seventh shall apply or have any effect on the liability of any director of the Corporation for or with respect to any acts or omissions of such director occurring prior to such amendment, repeal, or adoption of any inconsistent provision.

Eighth: The directors of the Corporation need not be elected by written ballot.

Ninth:

(a) Subject only to the exclusions set forth in paragraph (c) of this Article Ninth, the Corporation shall hold harmless and indemnify each director or officer of the Corporation (each, an "Indemnitee") against any and all expenses (including attorneys' fees), judgments, fines, excise taxes assessed with respect to any employee benefit plan, or penalties and amounts paid in settlement actually and reasonably incurred by Indemnitee in connection with any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (including an action by or in the right of the Corporation), to which Indemnitee is, was or at any time becomes a party, or is threatened to be made a party, by reason of the fact that Indemnitee is, was or at any time becomes a director or officer of the Corporation, or is, or was serving, or at any time serves at the request of the Corporation as a director or officer of another corporation, partnership, joint venture, trust or other enterprise.

(b) The expenses (including attorneys' fees) actually and reasonably incurred by Indemnitee in defending any proceeding and any judgments, fines or amounts to be paid in settlement shall be advanced by the Corporation at the request of the Indemnitee and upon delivery to the Corporation of an undertaking by such Indemnitee to repay all amounts so advanced if it shall ultimately be determined that Indemnitee was not entitled to be indemnified or was not to be fully indemnified.

(c) No indemnity pursuant to this Article Ninth shall be paid by the Corporation (i) for which payment is actually made to Indemnitee under a valid and collectible insurance policy, except in respect of any excess beyond the amount of payment under such insurance; (ii) for which Indemnitee is indemnified by the Corporation pursuant to applicable law or otherwise than pursuant to this Article Ninth; (iii) for an accounting of profits made from the purchase or sale by Indemnitee of securities of the Corporation within the meaning of Section 16(b) of the Securities Exchange Act of 1934 and amendments thereto or similar provisions of any state statutory law or common law; (iv) on account of Indemnitee's conduct which is finally adjudged by a court to have been knowingly fraudulent, deliberately dishonest or willful misconduct; or (v) if a final decision by a court having jurisdiction in the matter shall determine that such indemnity is not lawful.

(d) All obligations of the Corporation contained herein shall continue during the period Indemnitee is a director or officer of the Corporation (or is, or was serving at the request of the Corporation as a director or officer of another corporation, partnership, joint venture, trust or other enterprise) and shall continue thereafter so long as Indemnitee shall be subject to any possible claim or threatened, pending or completed action, suit or proceeding, whether civil, criminal or investigative, by reason of the fact that Indemnitee was a director or officer of the Corporation or serving in any other capacity referred to herein.

(e) Promptly after receipt by Indemnitee of notice of the commencement of any action, suit or proceeding, Indemnitee will, if a claim in respect thereof is to be made against the

Corporation under this Article Ninth, notify the Corporation of the commencement thereof; but the omission so to notify the Corporation will not relieve it from any liability which it may have to Indemnitee otherwise than under this Article Ninth. With respect to any such action, suit or proceeding as to which Indemnitee notifies the Corporation of the commencement thereof, the Corporation will be entitled to participate therein at its own expense.

(f) Except as otherwise provided below, to the extent that it may wish, the Corporation jointly with any other indemnifying party similarly notified will be entitled to assume the defense thereof. After notice from the Corporation to Indemnitee of its election so to assume the defense thereof, the Corporation will not be liable to Indemnitee under this Article Ninth for any legal or other expenses subsequently incurred by Indemnitee in connection with the defense thereof other than reasonable costs of investigation or as otherwise provided below. Indemnitee shall have the right to employ its counsel in such action, suit or proceeding, but the fees and expenses of such counsel, incurred after notice from the Corporation of its assumption of the defense thereof, shall be at the expense of Indemnitee unless (i) the employment of counsel by Indemnitee has been authorized by the Corporation, (ii) Indemnitee shall have reasonably concluded that there may be a conflict of interest between the Corporation and Indemnitee in the conduct of the defense of such, subject to the approval of the Corporation, which approval shall not be unreasonably withheld, or (iii) the Corporation shall not in fact have employed counsel to assume the defense of such action, in each of which cases the fees and expenses of counsel shall be at the expense of the Corporation. The Corporation shall not be entitled to assume the defense of any action, suit or proceeding brought by or on behalf of the Corporation or as to which Indemnitee shall have made the conclusion provided for in (ii) above.

(g) The Corporation shall not be liable to indemnify Indemnitee under this Article Ninth for any amounts paid in settlement of any action or claim effected without its written consent. The Corporation shall not settle any action or claim in any manner which would impose any penalty or limitation on Indemnitee without Indemnitee's written consent. Neither the Corporation nor Indemnitee will unreasonably withhold their consent to any proposed settlement.

(h) In the event Indemnitee is required to bring any action to enforce rights or to collect moneys due under this Article Ninth and is successful in such action, the Corporation shall reimburse Indemnitee for all of Indemnitee's reasonable fees and expenses in bringing and pursuing such action.

(i) The provisions of this Article Ninth shall inure to the benefit of and be enforceable by the Indemnitee's personal or legal representatives, executors, administrators, heirs, devises and legatees.

(j) The Corporation shall have power to purchase and maintain insurance, at its expense, on behalf of any person who is or was an officer, director, employee or agent of the Corporation or a subsidiary thereof, or is or was serving at the request of the Corporation as an officer, director, partner, member, employee, trustee or agent of another corporation, partnership, joint venture, trust or other enterprise, including any employee benefit plan, against any expense, liability or loss asserted against such person and incurred by such person in any such capacity, or arising out of such person's status as such, whether or not the Corporation would have the power to indemnify such person against such expense, liability or loss under the Bylaws, the provisions of this Article Ninth or the Delaware General Corporation Law.

(k) The indemnification provided by this Article Ninth shall not be deemed exclusive of any other rights to which a person seeking indemnification may be entitled under any statute, the Bylaws, other provisions of this Certificate of Incorporation, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in such person's official capacity and as to action in any other capacity while holding such office, and shall continue as to a person who has ceased to be an officer or director of the Corporation or a subsidiary thereof or an officer, director, partner, member, employee, trustee or agent of another corporation, partnership, joint venture, trust or other enterprise, including any employee benefit plan, and shall inure to the benefit of the heirs, executors and administrators of such person.

(l) This Article Ninth may be hereafter amended or repealed; provided, however, that no amendment or repeal shall reduce, terminate, or otherwise adversely affect the right of a person entitled to obtain indemnification hereunder with respect to acts or omissions of such person occurring prior to the effective date of such amendment or repeal.

Tenth: The incorporator is Gregory C. Lawhon, whose mailing address is 2020 Baltimore Avenue, Kansas City, Missouri 64108.

I, THE UNDERSIGNED, being the incorporator, for the purpose of forming a corporation under the laws of the State of Delaware do make, file and record this Certificate of Incorporation, do certify that the facts herein stated are true, and, accordingly, have hereto set my hand this 7th day of February, 2000.

Gregory C. Lawhon

Gregory C. Lawhon

EXHIBIT B

BIRCH'S CERTIFICATE OF AUTHORIZATION TO TRANSACT BUSINESS IN THE STATE OF TENNESSEE

Secretary of State
Corporations Section
James K. Polk Building, Suite 1800
Nashville, Tennessee 37243-0306

ISSUANCE DATE: 03/07/2000
REQUEST NUMBER: 00067134
TELEPHONE CONTACT: (615) 741-6488

CHARTER/QUALIFICATION DATE: 03/06/2000
STATUS: ACTIVE
CORPORATE EXPIRATION DATE: PERPETUAL
CONTROL NUMBER: 0385719
JURISDICTION: DELAWARE

TO:
THE SEARCH IS ON
PO BOX 120598

NASHVILLE, TN 37212

REQUESTED BY:
THE SEARCH IS ON
PO BOX 120598

NASHVILLE, TN 37212

CERTIFICATE OF AUTHORIZATION

I, RILEY C DARNELL, SECRETARY OF STATE OF THE STATE OF TENNESSEE DO HEREBY CERTIFY THAT

"BIRCH TELECOM OF THE SOUTH, INC.",

A CORPORATION FORMED IN THE JURISDICTION SET FORTH ABOVE, IS AUTHORIZED TO TRANSACT BUSINESS IN THIS STATE;
THAT ALL FEES, TAXES, AND PENALTIES OWED TO THIS STATE WHICH AFFECT THE AUTHORIZATION OF THE CORPORATION HAVE BEEN PAID;
THAT AN APPLICATION FOR CERTIFICATE OF WITHDRAWAL HAS NOT BEEN FILED.

FOR: REQUEST FOR CERTIFICATE

ON DATE: 03/07/00

	FEES	
RECEIVED:	$520.00	$0.00
TOTAL PAYMENT RECEIVED:		$520.00

RECEIPT NUMBER: 00002635058
ACCOUNT NUMBER: 00000499

FROM:
TSIO (BOX 120598)
P. O. BOX 120598

NASHVILLE, TN 37212-0000

Riley C Darnell

RILEY C. DARNELL
SECRETARY OF STATE

SS-4458

EXHIBIT C

BIOGRAPHIES OF THE BIRCH OFFICERS WHO WILL HAVE PRIMARY MANAGEMENT RESPONSIBILITY FOR BIRCH'S BUSINESS OPERATIONS

MANAGEMENT TEAM OF
BIRCH TELECOM OF THE SOUTH, INC.

David E. Scott, President

Mr. Scott has 17 years of managerial experience in the telecommunications industry. Prior to joining us, Mr. Scott was president and general manager of Kansas City FiberNet, a competitive local exchange carrier owned jointly by the country's two largest cable operators, TCI and Time Warner. Prior to his tenure at Kansas City FiberNet, Mr. Scott was vice president of strategic development for Sprint, responsible for developing investment plans in the competitive local exchange, wireless (PCS) and international marketplaces. Mr. Scott was vice president of strategic development for Sprint, responsible for developing investment plans in the competitive local exchange, wireless (PCS) and international marketplaces. Mr. Scott also served as director of strategic planning for Sprint from 1988 to 1991. Mr. Scott also serves as a director of BizSpace, Inc., an Internet publishing and E-commerce company he co-founded with Donald H. Goldman. BizSpace, Inc. produces web sites that serve as on-line trade publications. Their first website, clec.com, serves the competitive local exchange carrier industry. Mr. Scott holds a Bachelor of Science degree in electrical engineering, *summa cum laude*, from the University of Missouri and a Master of Business Administration degree from the University of Chicago.

Donald H. Goldman, Senior Vice President

Mr. Goldman has over 15 years of managerial experience in the telecommunications industry. Prior to joining us, Mr. Goldman served as vice president, corporate development at Sprint where he developed strategy and managed the acquisition of companies in the areas of systems integration, Internet telephony, and wireless (PCS) services among others. While at Sprint, Mr. Goldman led the team that founded Sprint PCS. Mr. Goldman also serves as chairman of the board of BizSpace, Inc. Mr. Goldman holds a Bachelor of Arts degree, with honors, from Johns Hopkins University and a Master of business Administration degree from the University of Chicago.

David M. Hollingsworth, Senior Vice President

Prior to joining us, from 1998 to February 200, Mr. Hollingsworth was the vice president of finance and corporate development for GST Telecommunications. From 1997 to 1998, Mr. Hollingsworth was a telecommunications analyst at George K. Baum and Company. From 1993 through 1996, Mr. Hollingsworth served as a director of finance and administration for Kansas City FiberNet. Before FiberNet, Mr. Hollingsworth was a mergers and acquisitions manager for Sprint Corporation. Mr. Hollingsworth holds a Bachelor of Arts in Business Administration, *cum laude*, from Washington State University.

Gregory C. Lawhon, Senior Vice President, Secretary and General Counsel

Prior to joining us, Mr. Lawhon practiced law for twelve years with the 90-lawyer Kansas City firm of Spencer Fane Britt & Browne. A partner in the firm since 1990, he was head of the firm's communications and media group and a member of its business group. Mr.

Lawhon's areas of practice were mergers and acquisitions, with an emphasis on communications industry acquisitions, cable television franchising, and commercial and regulatory issues with respect to the telecommunications industry. Mr. Lawhon holds a Bachelor of Arts degree in Economics, *magna cum laude*, from Vanderbilt University, and a law degree from Columbia University, where he was a Harlan Fiske Stone Scholar.

Bradley A. Moline, Senior Vice President, Chief Financial Officer and Treasurer

From 1994 to 1997, Mr. Moline was the treasurer and chief financial officer of Covenant Transport, Inc., a transportation company in Chattanooga, Tennessee that became publicly traded during his tenure. Prior to joining Covenant Transport, Mr. Moline worked for Ernst & Young LLP in Kansas City, Missouri and Grant Thornton in Lincoln, Nebraska, providing customer services in the auditing and consulting areas. Mr. Moline holds a Bachelor of Administration degree in Business Administration, with distinction, from the University of Nebraska and is a certified public accountant.

Jeffrey D. Shackelford, Senior Vice President

Mr. Shackelford has 13 years of experience in the telecommunications industry. Prior to joining us, Mr. Shackelford served as director of sales and marketing for Kansas City FiberNet. Prior to joining Kansas City FiberNet, Mr. Shackelford was the Branch Manager for Sprint's commercial sales office in Kansas City and was responsible for sales and service of small to large business customers. During his tenure at Sprint, which began in 1988, Mr. Shackelford also developed the long distance industry's first PC-based call management system, FONVIEW. Mr. Shackelford holds a Bachelor of Science degree in Computer Science from the University of Kansas.

David W. Vranicar, Senior Vice President

Prior to joining us, Mr. Vranicar was vice president, international business development, at Sprint. Before joining Sprint in 1992, Mr. Vranicar was vice president, Asia/Pacific operations, at MPSI Systems Private Ltd., based in Singapore. MPSI is a software and information services company that develops and markets decisions-support software and databases to major retail companies. Mr. Vranicar was the company's senior executive in the Asia/Pacific division, directing a staff of approximately 80 engaged in software development, computer graphics, and customer technical support. Mr. Vranicar holds a Bachelor of Business degree in Marketing, with honors, from the University of Texas at Austin, and a Master of Business Administration degree, with distinction, from the University of Michigan at Ann Arbor.

EXHIBIT D

INFORMATION REGARDING BIRCH'S FINANCIAL RESOURCES AND QUALIFICATIONS

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 1999

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

For the transition period from _______ to ________

Commission file number:
333-62797

BIRCH TELECOM, INC.

(Exact name of Registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**43-1766929** **(I.R.S. Employer Identification No.)**
2020 Baltimore Avenue **Kansas City, Missouri** **(Address of principal executive offices)**	**64108** **(Zip Code)**

Registrant's telephone number, including area code:
(816) 300-3000

Securities registered pursuant to Section 12(b) of the Act:
14% Senior Notes due 2008
(Title of Class)

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

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

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

BIRCH TELECOM, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands except share data)

	December 31, 1998	March 31, 1999
		(Unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 39,745	$ 21,213
Pledged securities	15,888	16,399
Accounts receivable, net	4,039	4,920
Inventory	916	3,209
Prepaid expenses and other	526	2,428
Total current assets	61,114	48,169
Property and equipment, net	26,153	32,632
Pledged securities - noncurrent	21,897	21,897
Goodwill, net	16,863	19,546
Other intangibles, net	7,689	7,537
Other assets	433	932
Total assets	$ 134,149	$ 130,713
Liabilities and Stockholders' Deficit		
Current liabilities:		
Current maturities of long-term debt and capital lease obligations	$ 335	$ 380
Accounts payable	8,503	9,299
Accrued expenses	2,556	8,277
Total current liabilities	11,394	17,956
14% Senior Notes	114,681	114,690
Capital lease obligations, net of current maturities	778	717
Other long-term debt, net of current maturities	332	330
Preferred stock, $.001 par value; 25,000,000 shares authorized:		
Series B Redeemable Preferred Stock, 8,572,039 shares issued and outstanding (stated at redemption and aggregate liquidation value)	14,063	14,556
Stockholders' deficit:		
Series C Preferred Stock, 8,492,749 shares issued and outstanding	8	8
Common stock, $.001 par value, 27,000,000 shares authorized, 5,000,296 shares issued and outstanding	5	5
Warrants	337	337
Additional paid-in capital	12,273	12,273
Accumulated deficit	(19,722)	(30,159)
Total stockholders' deficit	(7,099)	(17,536)
Total liabilities and stockholders' deficit	$ 134,149	$ 130,713

See accompanying notes to condensed consolidated financial statements.

BIRCH TELECOM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(In thousands except share data)

	Three months ended March 31, 1998	Three months ended March 31, 1999
Revenue:		
Communications services, net	$ 3,257	$ 9,308
Equipment sales, net	448	1,328
Total revenue	3,705	10,636
Cost of services:		
Cost of communications services	2,328	7,138
Cost of equipment sales	314	787
Total cost of services	2,642	7,925
Gross margin	1,063	2,711
Selling, general and administrative expense	1,372	8,296
Depreciation and amortization expense	258	1,543
Loss from operations	(567)	(7,128)
Interest expense	(56)	(3,715)
Interest income	-	907
Net loss	(623)	(9,936)
Preferred stock dividends	(216)	(493)
Amortization of preferred stock issuance costs	-	(8)
Loss applicable to common stock	$ (839)	$ (10,437)
Loss per common share — basic and diluted	$ (0.79)	$ (2.09)
Weighted average number of common shares outstanding	1,065	5,000

See accompanying notes to condensed consolidated financial statements.

BIRCH TELECOM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(In thousands)

	Three months ended March 31, 1998	Three months ended March 31, 1999
Net cash from operating activities	(1,217)	(5,730)
Investing activities		
Purchase of property and equipment	(329)	(6,957)
Business acquisitions, net of cash acquired	(4,375)	(4,368)
Amortization of discount on pledged securities	-	(511)
Net cash from investing activities	(4,704)	(11,836)
Financing activities		
Proceeds from issuance of preferred stock	9,500	-
Payment of financing costs	(364)	-
Payment of Series A Preferred Stock Dividends	(64)	-
Proceeds from convertible notes	3,500	-
Amortization of discount on senior notes	-	8
Repayment of short term notes	(380)	(200)
Repayment of long-term debt	(2)	(674)
Repayment of capital lease obligation	(16)	(100)
Net cash from financing activities	12,174	(966)
Net increase (decrease) in cash and cash equivalents	6,253	(18,532)
Cash and cash equivalents at beginning of period	210	39,745
Cash and cash equivalents at end of period	$ 6,463	$ 21,213
Supplementary schedule of non-cash investing and financing activities:		
Amounts recorded in connection with acquisitions:		
Fair value of net assets acquired, net of cash acquired	$ 4,840	$ 2,678
Fair value of intangible assets	17,592	3,488
Assumption of liabilities	2,524	926
Assumption of long-term debt and capital lease obligations	783	872
Issuance of Series A Preferred Stock	4,750	-
Issuance of Series C Preferred Stock	10,000	-
Property and equipment additions included in accounts payable	3,242	-

See accompanying notes to condensed consolidated financial statements.

BIRCH TELECOM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Three months ended March 31, 1999

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Birch Telecom, Inc. ("Birch" or the "Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 1999 are not necessarily indicative of the results that may be expected for the year ended December 31, 1999. For further information, refer to the consolidated financial statements and footnotes thereto included in the Birch Telecom, Inc. annual report on Form 10-K for the fiscal year ended December 31, 1998.

2. Reclassifications

Certain items in the 1998 condensed consolidated financial statements have been reclassified to be consistent with the classification in the 1999 condensed consolidated financial statements.

3. Acquisitions

In February 1998, Birch merged with Valu-Line Companies, Inc. (Valu-Line) in a transaction valued at $19.5 million, consisting of $4.75 million in cash, 2,968,750 shares of Series A Preferred Stock having an aggregate liquidation preference of $4.75 million and 6,250,000 shares of Series C Preferred Stock having an aggregate liquidation preference of $10.0 million. Since 1982, Valu-Line has been primarily providing switched long distance services, customer premises equipment (CPE) sales and services and, since March 1997, local service. The merger was accounted for under the purchase method of accounting. Accordingly, the operations of Valu-Line are included in the condensed consolidated statements of operations and cash flows from the date of acquisition.

In February 1999, the Company acquired American Local Telecommunications, LLC (ALT), a competitive local exchange carrier based in the Dallas, Texas metropolitan area. The acquisition, recorded as a purchase, included substantially all assets of ALT. The total purchase price was approximately $783,000 plus the potential for additional consideration estimated at $575,000 at March 31, 1999 based on lines converted to the Company's service from ALT's existing customer base.

In March 1999, the Company acquired the stock of Capital Communications Corporation (Capital), a telecommunications equipment provider based in the St. Louis, Missouri metropolitan area. The purchase price was $3.0 million, plus the potential for additional consideration based on lines converted to the Company's service from Capital's existing customer base.

4. Pledged Securities, Warrants, and Debt

During June 1998, the Company completed a \$115 million private offering of 14% Senior Notes due June 2008 (the Senior Notes) and 115,000 warrants to purchase 1,409,734 shares of common stock. Interest on the Senior Notes is payable semi-annually in arrears on June 15 and December 15 of each year. Warrants are exercisable at \$0.01 per share and expire June 2008. The Company received net proceeds from the Senior Notes of \$110.2 million and concurrently purchased pledged securities of \$44.2 million. The pledged securities are restricted for interest payments on the Senior Notes and, together with the interest accruing thereon, will be used to satisfy such interest payments through June 2001. The Company classifies its pledged securities, consisting of \$38.3 million and \$37.8 million of U.S. Treasury securities at March 31, 1999 and December 31, 1998, respectively, as held to maturity recorded at amortized cost and maturing between six and thirty months. A portion of the proceeds of this offering, \$337,000, was allocated to the warrants, and the resulting debt discount is being amortized over the life of the debt on the straight-line method, which does not differ materially from the effective interest method. Unamortized discount was \$310,000 and \$319,000 at March 31, 1999 and December 31, 1998, respectively. The amount allocated to the warrants represents the estimated fair value of the warrants at the date of issuance. The Senior Notes rank pari pasu in right of payment to all existing and future senior indebtedness of the Company and rank senior in the right of payment to all existing and future subordinated indebtedness of the Company.

The Company filed a registration statement with the Securities and Exchange Commission (SEC) for the registration of \$115 million aggregate principal amount of 14% Senior Notes due December 2008 (the Exchange Notes) to be offered in exchange for the Senior Notes (the Exchange Offer). The registration statement was declared effective by the SEC in February 1999, and the Exchange Offer was commenced at that time. The Exchange Offer was completed in March 1999, at which time all of the Senior Notes were exchanged for the Exchange Notes. The form and terms of the Exchange Notes are identical in all material respects to the form and terms of the Senior Notes except the Exchange Notes were registered under the Securities Act and holders of the Exchange Notes are not entitled to certain rights under a registration agreement relating to the Senior Notes.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

Three Months Ended March 31, 1999 Compared to Three Months Ended March 31, 1998

Revenue. Revenue was $10.6 million for the three months ended March 31, 1999 compared to $3.7 million for the three months ended March 31, 1998, principally as a result of a full quarter of Valu-Line's operations, the Dunn & Associates, Inc., d/b/a Boulevard Phone Company (Boulevard), Telesource Communications, Inc. (Telesource) and TFSnet, Inc. (TFSnet) acquisitions in 1998 and opening five new markets in 1998. The Capital and ALT acquisitions in 1999 provided approximately $600,000 of revenue in the 1999 quarter. Revenue increases in excess of revenue gained from acquisitons in 1998 were largely from new customer sales, particularly those focused on local service. For the three months ended March 31, 1999 and 1998, as a percentage of total revenue, communications and other services were 87.5% and 87.9%, respectively, and CPE sales were 12.5% and 12.1%, respectively.

Cost of services. Cost of services was $7.9 million for the three months ended March 31, 1999, compared to $2.6 million for the three months ended March 31, 1998, principally as a result of a full quarter of Valu-Line's operations, the Boulevard, Telesource and TFSnet acquisitions and opening five new markets in 1998. The Capital and ALT acquisitions added approximately $380,000 of cost of services in the 1999 quarter. Gross margin for the three months ended March 31, 1999 and 1998 was $2.7 million and $1.1 million, respectively, or 25.5% and 28.7% of revenue, respectively. The decline in gross margin is principally from a greater percentage of revenue being derived from resold local service during the first quarter of 1999 versus 1998.

Selling, general and administrative expense. Selling, general and administrative expense was $8.3 million for the three months ended March 31, 1999, compared to $1.4 million for the three months ended March 31, 1998. These expenses increased principally as a result of a full quarter of Valu-Line's operations, the Boulevard, Telesource and TFSnet acquisitions and opening five new markets in 1998, each of which effected wages, rent and advertising expenses. The Company had approximately 500 employees at March 31, 1999, compared to 137 employees at March 31, 1998. The Capital and ALT acquisitions added approximately $180,000 of selling, general and administrative expenses in the 1999 quarter. EBITDA was $(5.6) million for the three months ended March 31, 1999, compared to $(0.3) million for the three months ended March 31, 1998.

Depreciation and amortization. Depreciation and amortization was $1.5 million for the three months ended March 31, 1999, compared to $0.3 million for the three months ended March 31, 1998, principally attributable to the fixed and intangible assets acquired in the Valu-Line, Boulevard, Telesource and TFSnet acquisitions, as well as the deployment of network assets in the Company's markets.

Interest. Interest expense was $3.7 million for the three months ended March 31, 1999, compared to $0.1 million for the three months ended March 31, 1998, primarily attributable to the Senior Note interest charges. Interest income was $1.0 million for the three months ended March 31, 1999, primarily as a result of invested funds received from the Senior Notes.

Net loss. Net loss was $10.4 million for the three months ended March 31, 1999, compared to $0.8 million for the three months ended March 31, 1998.

Liquidity and Capital Resources

The expansion of the Company's business will require significant capital to fund capital expenditures, working capital needs, debt service and the cash flow deficits generated by operating losses. The Company's principal capital expenditure requirements include the purchase, installation, and expansion of switches and transmission equipment for the Company's local and data networks and the further development of operations support systems and automated back office systems. Management does not expect that the growth of the Company's long distance and CPE business will require significant capital expenditures.

To date, the Company has primarily funded its expenditures through the Senior Notes and private sales of equity securities. During the first quarter of 1997, the Company sold equity securities worth $1.8 million. In February and March 1998, the Company raised approximately $12.4 million in a private placement of its Series B Preferred Stock and Convertible Notes. On June 18, 1998, the Company sold the Senior Notes for net proceeds of $110.2 million.

The Company expects to make significant capital outlays for the foreseeable future in order to continue the development activities called for in its current business plan and to fund expected operating losses. The Company currently estimates that the cash required to fund capital expenditures for its expansion plans will be approximately $40.0 million in 1999. In order for the Company to implement its current business plan and finance its projected capital expenditures for 1999 and thereafter, the Company will be required to seek and obtain significant amounts of additional financing (debt and/or equity) within the next six months. The Company's expansion into Texas is dependent upon raising substantial additional financing in the near term. The accuracy of the Company's current projection of cash flow (and losses) from operations will depend upon numerous future factors and conditions, many of which are outside of the Company's control. There can be no assurance that such projections will be accurate. The Company's cost of developing new networks and services, funding other strategic initiatives and operating its business will depend on a variety of factors including, among other things, the number of subscribers and the service for which they subscribe, the nature and penetration of services that may be offered by the Company, regulatory changes, and actions taken by competitors in response to the Company's strategic initiatives. It is almost certain that actual costs and revenue will vary from expected amounts, very likely to a material degree, and that such variations are likely to affect the Company's future capital requirements. Current cash balances will not be sufficient to fund the Company's current business plan beyond the next six months. As a consequence, the Company is seeking additional debt and/or equity financing to fund the Company's liquidity. There can be no assurance that the Company will be able to raise additional capital on satisfactory terms or at all. In the event that the Company is unable to obtain such additional capital or to obtain it on acceptable terms or in sufficient amounts, the Company will be required to delay the development of its network or take other actions that could have a material adverse effect on the Company's business, operating results and financial condition.

The Company expects that it will generate operating losses and will not generate positive cash flow for the foreseeable future. In addition, the Company will require significant amounts of additional financing, which may not be available, before it will be able to generate positive cash flow. If the Company is unable to generate sufficient cash flow from operations to service its indebtedness, it may have to modify its growth plans, limit its capital expenditures, restructure or refinance its indebtedness or seek additional capital or liquidate its assets. There can be no assurance (i) that any of these strategies could be effected on satisfactory terms, if at all, in light of the Company's high leverage or (ii) that any such strategy would yield sufficient proceeds to provide funds for the company in the future.

Year 2000 Issue

The year 2000 issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any of the Company's computer programs that have date-sensitive software may recognize the date using "00" as the year 1900 rather than the year 2000. In addressing this problem, the Company anticipates spending $20 million on new systems from inception through the end of 1999. Specific expenditures for year 2000 costs are not being made related to the new systems. The Company has completed its assessment on the consequences of the year 2000 on information technology systems. As the Company has a relatively short history, virtually all systems are newly created or are being created. During information technology development, year 2000 issues have been consistently addressed. The new information technology systems will, in certain cases, replace systems of acquired companies in order to provide consistent and integrated systems. The acquired companies' systems are not all year 2000 compliant; however, these systems will be replaced by the third quarter of 1999. If all such systems are not replaced and year 2000 issues occur, significant disruption to the Company's operations could occur. The most significant system of the acquired companies relates to the provisioning and billing of resale local and long distance services which, if not replaced, could prevent the Company from billing or provisioning service to existing and future customers. Installation of an integrated billing and provisioning system is on schedule to date.

Other non-information technology systems which may be affected by the year 2000 issue include systems provided to the Company by third parties. The most significant third party systems are those which operate the incumbent local exchange carrier's interfaces and billing records, switching equipment and customer premises equipment. The Company has been assured by significant third parties that year 2000 compliance will be accomplished by the end of 1999. If such compliance is not achieved by these third parties, it would have a material adverse effect on the Company's business, operating results and financial condition and its ability to achieve sufficient cash flow.

Forward-Looking Statements

Certain statements contained in this quarterly report on Form 10-Q are forward-looking statements. These statements discuss, among other things, expected growth and expansion strategy. The forward-looking statements are subject to risks, uncertainties and assumptions, including, but not limited to, the impact of competitive products and pricing, product developments, changes in law and regulations, customer demand, litigation, availability of future financing, uncertainty of market acceptance of new products, and other risks. Actual results may materially differ from anticipated results described in these forward-looking statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company's exposure to market risk through derivative financial instruments and other financial instruments, such as investments in marketable securities and long-term debt, is not material.

PART II – OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

27.1 Financial Data Schedule (for SEC use only)

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

BIRCH TELECOM, INC.

DATE: MAY 12, 1999

BY: /S/ DAVID E. SCOTT
DAVID E. SCOTT
PRESIDENT AND CHIEF EXECUTIVE OFFICER

DATE: MAY 12, 1999

BY: /S/ BRADLEY A. MOLINE
BRADLEY A. MOLINE
CHIEF FINANCIAL OFFICER

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 1999

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

For the transition period from ______ to _______

Commission file number:
333-62797

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(Exact name of Registrant as specified in its charter)

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14% Senior Notes due 2008
(Title of Class)

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Prepaid expenses and other	526	2,979
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Pledged securities - noncurrent	21,897	15,075
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Other assets	433	1,076
Total assets	$ 134,149	$ 119,919
Liabilities and Stockholders' Deficit		
Current liabilities:		
Current maturities of long-term debt and capital lease obligations	$ 335	$ 800
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Accrued expenses	2,556	5,667
Total current liabilities	11,394	19,179
14% Senior Notes	114,681	114,698
Capital lease obligations, net of current maturities	778	1,129
Other long-term debt, net of current maturities	332	328
Preferred stock, $.001 par value; 25,000,000 shares authorized:		
Series B Redeemable Preferred Stock, 8,572,039 shares issued and outstanding (stated at redemption and aggregate liquidation value)	14,063	15,049
Stockholders' deficit:		
Series C Preferred Stock, 8,492,749 shares issued and outstanding	8	8
Common stock, $.001 par value, 27,000,000 shares authorized, 5,000,296 shares issued and outstanding	5	5
Warrants	337	337
Additional paid-in capital	12,273	12,485
Accumulated deficit	(19,722)	(43,299)
Total stockholders' deficit	(7,099)	(30,464)
Total liabilities and stockholders' deficit	$ 134,149	$ 119,919

See accompanying notes to condensed consolidated financial statements.

BIRCH TELECOM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(In thousands except share data)

	Three months ended June 30, 1998	Three months ended June 30, 1999	Six months ended June 30, 1998	Six months ended June 30, 1999
Revenue:				
Communications services, net	$ 5,560	$ 11,589	$ 8,817	$ 20,897
Equipment sales, net	500	2,386	948	3,714
Total revenue	6,060	13,975	9,765	24,611
Cost of services:				
Cost of communications services	4,102	9,034	6,430	16,172
Cost of equipment sales	330	1,367	644	2,154
Total cost of services	4,432	10,401	7,074	18,326
Gross margin	1,628	3,574	2,691	6,285
Selling, general and administrative expense	2,740	11,068	4,112	19,364
Depreciation and amortization expense	374	2,031	632	3,574
Loss from operations	(1,486)	(9,525)	(2,053)	(16,653)
Interest expense	(280)	(3,769)	(336)	(7,484)
Interest income	-	655	-	1,562
Net loss	(1,766)	(12,639)	(2,389)	(22,575)
Preferred stock dividends	(479)	(492)	(695)	(986)
Amortization of preferred stock issuance costs	(11)	(8)	(11)	(16)
Loss applicable to common stock	$ (2,256)	$ (13,139)	$ (3,095)	$ (23,577)
Loss per common share — basic and diluted	$ (0.55)	$ (2.60)	$ (1.20)	$ (4.68)
Weighted average number of common shares outstanding	4,069	5,044	2,582	5,035

See accompanying notes to condensed consolidated financial statements.

BIRCH TELECOM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(In thousands)

	Six months ended June 30, 1998	1999
Net cash used in operating activities	$ (695)	$ (18,356)
Investing activities		
Purchase of property and equipment	(3,495)	(20,496)
Business acquisitions, net of cash acquired	(5,133)	(4,756)
Purchase of pledged securities	(44,247)	-
Maturity of pledged securities	-	8,050
Amortization of discount on pledged securities	-	(913)
Net cash used in investing activities	(52,875)	(18,115)
Financing activities		
Proceeds from issuance of common stock and warrants	342	-
Proceeds from issuance of preferred stock	9,500	-
Payment of financing costs	(5,106)	-
Payment of Series A Preferred Stock Dividends	(168)	-
Proceeds from convertible notes	3,500	-
Proceeds from 14% Senior Notes	114,663	-
Redemption of Series A Preferred Stock	(4,750)	-
Repayment of short term notes	(250)	(200)
Repayment of long-term debt	(573)	(680)
Repayment of capital lease obligations	(40)	(327)
Net cash provided by (used in) financing activities	117,118	(1,207)
Net increase (decrease) in cash and cash equivalents	63,548	(37,678)
Cash and cash equivalents at beginning of period	210	39,745
Cash and cash equivalents at end of period	$ 63,758	$ 2,067
Supplementary schedule of non-cash investing and financing activities:		
Amounts recorded in connection with acquisitions:		
Fair value of net assets acquired, net of cash acquired	$ 4,762	$ 2,678
Fair value of intangible assets	18,469	4,087
Assumption of liabilities	2,321	926
Assumption of long-term debt and capital lease obligations	1,027	872
Issuance of Series A Preferred Stock	4,750	-
Issuance of Series C Preferred Stock	10,000	-
Issuance of common stock	-	211
Property and equipment additions included in accounts payable	7,213	2,646
Property and equipment additions acquired through capital lease	-	1,147

See accompanying notes to condensed consolidated financial statements.

BIRCH TELECOM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Six months ended June 30, 1999

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Birch Telecom, Inc. ("Birch" or "the Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months and six months ended June 30, 1999 are not necessarily indicative of the results that may be expected for the year ended December 31, 1999. For further information, refer to the consolidated financial statements and footnotes thereto included in the Birch Telecom, Inc. annual report on Form 10-K for the fiscal year ended December 31, 1998.

2. Reclassifications

Certain items in the 1998 condensed consolidated financial statements have been reclassified to be consistent with the classification in the 1999 condensed consolidated financial statements.

3. Acquisitions

In February 1998, Birch merged with Valu-Line Companies, Inc. (Valu-Line) in a transaction valued at $19.5 million, consisting of $4.75 million in cash, 2,968,750 shares of Series A Preferred Stock having an aggregate liquidation preference of $4.75 million and 6,250,000 shares of Series C Preferred Stock having an aggregate liquidation preference of $10.0 million. Since 1982, Valu-Line has been primarily providing switched long distance services, customer premises equipment (CPE) sales and services and, since March 1997, local service.

In May 1998, Birch acquired Boulevard Phone Company (Boulevard), a shared tenant service provider in the Kansas City metropolitan area, for $300,000 in cash and Telesource Communications, Inc. (Telesource), a CPE provider in the Kansas City metropolitan area, for $325,000 in cash.

In February 1999, the Company acquired American Local Telecommunications, LLC (ALT), a competitive local exchange carrier based in the Dallas, Texas metropolitan area. The acquisition included substantially all assets of ALT. The total purchase price was approximately $1.6 million.

In March 1999, the Company acquired the stock of Capital Communications Corporation (Capital), a telecommunications equipment provider based in the St. Louis, Missouri metropolitan area. The total purchase price was approximately $3.0 million plus the additional cash consideration based on local service lines converted to the Company's service from Capital's existing customer base, which totaled $100,000 through June 30, 1999.

The Valu-Line, Boulevard, Telesource, ALT and Capital acquisitions were recorded using the purchase method of accounting. Accordingly, the operations of each are included in the condensed consolidated statements of operations and cash flows from the date of acquisition.

4. Pledged Securities, Warrants, and Debt

During June 1998, the Company completed a $115 million private offering of 14% Senior Notes due June 2008 (the Senior Notes) and 115,000 warrants to purchase 1,409,734 shares of common stock. Interest on the Senior Notes is payable semi-annually in arrears on June 15 and December 15 of each year. Warrants are exercisable at $0.01 per share and expire June 2008. The Company received net proceeds from the Senior Notes of $110.2 million and concurrently purchased pledged securities of $44.2 million. The pledged securities are restricted for interest payments on the Senior Notes and, together with the interest accruing thereon, will be used to satisfy such interest payments through June 2001. The Company classifies its pledged securities, consisting of $30.6 million and $37.8 million of U.S. Treasury securities at June 30, 1999 and December 31, 1998, respectively, as held to maturity recorded at amortized cost and maturing between six and twenty-four months. A portion of the proceeds from the Senior Notes, $337,000, was allocated to the warrants, and the resulting debt discount is being amortized over the life of the debt on the straight-line method, which does not differ materially from the effective interest method. Unamortized discount was $302,000 and $319,000 at June 30, 1999 and December 31, 1998, respectively. The amount allocated to the warrants represents the estimated fair value of the warrants at the date of issuance. The Senior Notes rank pari pasu in right of payment to all existing and future senior indebtedness of the Company and rank senior in the right of payment to all existing and future subordinated indebtedness of the Company.

A Registration Statement on Form S-4, registering the Company's 14% Senior Notes and offering to exchange (the Exchange Offer) any and all of the outstanding 14% Senior Notes for Exchange Notes, was declared effective by the Securities and Exchange Commission (SEC) in March 1999. The Exchange Offer terminated after all of the outstanding 14% Senior Notes were exchanged. The terms and conditions of the Exchange Notes are identical to those of the 14% Senior Notes in all material respects.

5. Subsequent Events

During July and August 1999, the Company generated $44.0 million in net proceeds from the following transactions: sale of $10.0 million of Series D Preferred Stock to primarily existing stockholders; sale of $60.0 million of Series F Preferred Stock to an affiliate of Kohlberg Kravis Roberts & Co.; repurchase and retirement of 2,222,222 of the outstanding shares of Series C Preferred Stock for $10.0 million; conversion of each share of the Company's Series B Preferred Stock into, (1) one share of the Company's amended and restated Series B Preferred Stock, and (2) 0.22222 of a share of the Company's Series E Preferred Stock; and the subsequent redemption of all Series E Preferred Stock for $8.6 million.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The Company has used strategic acquisitions (the Acquisitions) to expand its business capabilities. The following acquisitions were completed during 1998 and the six months ending June 30, 1999:

Acquired Company	Date of Acquisition	Principal Business Activity
Valu-Line	February 1998	Provider of switched long distance, resold local services and CPE sales and services in Kansas
Boulevard	May 1998	Provider of shared tenant service in the Kansas City, MO metropolitan area
Telesource	May 1998	Provider of CPE sales and service in the Kansas City, MO metropolitan area
TFSnet	September 1998	Provider of Internet service in the Kansas City, MO metropolitan area
ALT	February 1999	Competitive local exchange carrier based in the Dallas, TX metropolitan area
Capital	March 1999	Provider of telecommunications equipment based in the St. Louis, MO metropolitan area

Results of Operations

Three Months Ended June 30, 1999 Compared to Three Months Ended June 30, 1998

Revenue. Revenue increased 130.6% to $14.0 million for the 1999 period compared to $6.1 million for the 1998 period. The increase in revenue is primarily a result of new customer sales from new and existing markets and the Acquisitions. For the 1999 and 1998 quarters, as a percentage of total revenue, communications services were 82.9% and 91.7%, respectively, and CPE sales were 17.1% and 8.3%, respectively. Lines in service increased 205.4% to 67,400 at June 30, 1999 compared to 22,070 at June 30, 1998.

Cost of services. Cost of services increased 134.7% to $10.4 million for the 1999 period compared to $4.4 million for the 1998 period. The increase in cost of services is primarily the result of associated revenue increases. Gross margin increased 119.5% to $3.6 million (25.6% of revenue) for the 1999 period compared to $1.6 million (26.9% of revenue) for the 1998 period. The decline in gross margin as a percentage of revenue is principally from a greater percentage of revenue being derived from resold local service during the 1999 period compared to the 1998 period.

Selling, general and administrative expense. Selling, general and administrative expense increased 303.9% to $11.1 million for the 1999 period compared to $2.7 million for the 1998 period. The increase in expense is primarily a result of supporting and attracting customers from new and existing markets, preparations for market launches in Texas and the Acquisitions, each of which affected wages, rent and advertising expenses. Additionally, the Company had approximately 670 employees at June 30, 1999, compared to 180 employees at June 30, 1998. EBITDA, a commonly used measure by securities analysts of earnings before deducting interest, taxes, depreciation and amortization, increased 573.9% to a loss of $7.5 million for the 1999 period compared to a loss of $1.1 million for the 1998 period.

Depreciation and amortization. Depreciation and amortization increased 443.0% to $2.0 million for the 1999 period compared to $374,000 for the 1998 period. The increase in depreciation and amortization is primarily attributable to the fixed and intangible assets related to the Acquisitions, as well as the deployment of network assets in the Company's markets.

Interest. Interest expense increased to $3.8 million for the 1999 period compared to $280,000 for the 1998 period. The increase in interest expense is primarily attributable to the interest charges on the $115 million Senior Notes due 2008. Interest income was $655,000 for the 1999 period resulting primarily from invested funds received from the $115 million Senior Notes due 2008.

Net loss. Net loss increased 615.7% to $12.6 million for the 1999 period compared to $1.8 million for the 1998 period.

Six Months Ended June 30, 1999 Compared to Six Months Ended June 30, 1998

Revenue. Revenue increased 152.0% to $24.6 million for the 1999 period compared to $9.8 million for the 1998 period. The increase in revenue is primarily a result of new customer sales from new and existing markets and the Acquisitions. For the 1999 and 1998 periods, as a percentage of total revenue, communications services were 84.9% and 90.3%, respectively, and CPE sales were 15.1% and 9.7%, respectively.

Cost of services. Cost of services increased 159.1% to $18.3 million for the 1999 period compared to $7.1 million for the 1998 period. The increase in cost of services is primarily a result of associated revenue increases. Gross margin increased 133.6% to $6.3 million (25.5% of revenue) for the 1999 period compared to $2.7 million (27.6% of revenue) for the 1998 period. The decline in gross margin as a percentage of total revenue is principally from a greater percentage of revenue being derived from resold local service during the 1999 period compared to the 1998 period.

Selling, general and administrative expense. Selling, general and administrative expense increased 370.9% to $19.4 million for the 1999 period compared to $4.1 million for the 1998 period. The increase in expense is primarily a result of supporting and attracting customers from new and existing markets, preparations for market launches in Texas and the Acquisitions, each of which affected wages, rent and advertising expenses. Additionally, the Company had approximately 670 employees at June 30, 1999 compared to 180 employees at June 30, 1998. EBITDA, a commonly used measure by securities analysts of earnings before deducting interest, taxes, depreciation and amortization, increased 820.4% to a loss of $13.1 million for the 1999 period compared to a loss of $1.4 million for the 1998 period.

Depreciation and amortization. Depreciation and amortization increased 465.5% to $3.6 million for the 1999 period compared to $632,000 for the 1998 period. The increase in depreciation and amortization is primarily attributable to the fixed and intangible assets related to the Acquisitions, as well as the deployment of network assets in the Company's markets.

Interest. Interest expense increased to $7.5 million for the 1999 period compared to $336,000 for the 1998 period. The increase in interest expense is primarily attributable to the interest charges on the $115 million Senior Notes due 2008. Interest income was $1.6 million for the 1999 period resulting primarily from invested funds received from the $115 million Senior Notes due 2008.

Net loss. Net loss increased 845.0% to $22.6 million for the 1999 period compared to $2.4 million for the 1998 period.

Liquidity and Capital Resources

The Company's assets decreased from $134.1 million at December 31, 1998 to $119.9 million at June 30, 1999, primarily due to the use of cash to fund operations offset by capital outlays for expansion of the Company's local and data networks and development of operations support systems and automated back office systems. At June 30, 1999, the Company's current assets of $31.0 million exceeded its current liabilities of $19.2 million, providing working capital of $11.8 million, representing a decrease of $37.9 million compared to December 31, 1998. Of working capital at June 30, 1999, $15.6 million represents securities pledged to satisfy interest payments on the $115 million Senior Notes due 2008, compared to $662,000 of accrued interest at June 30, 1999 related to such Notes. At December 31, 1998, the Company's current assets of $61.1 million exceeded current liabilities of $11.4 million, providing working capital of $49.7 million. This decrease is primarily attributable to the use of cash to fund operations and capital outlays for expansion of the Company's network, support systems and back office systems as previously stated.

Net cash used in operating activities was $18.4 million for the six months ended June 30, 1999 compared to $695,000 for the same period in 1998. Net cash used in operating activities was primarily used to fund the Company's net losses of $22.6 million in the 1999 period and $2.4 million in the 1998 period.

Net cash used in investing activities was $18.1 million for the six months ended June 30, 1999 compared to $52.9 million during the same period in 1998. In the 1999 period, net cash used in investing activities was primarily used for the purchase of property and equipment related to the expansion of the network, support systems and back office systems of $20.5 million, net proceeds from the sale of pledged securities of $8.1 million for the semi-annual interest payment on the $115 million Senior Notes due 2008 and acquisitions of $4.8 million. In the 1998 period, net cash used in investing activities was primarily used for purchases of pledged securities related to the $115 million Senior Notes due 2008 of $44.2 million, acquisitions of $5.1 million, and purchases of property and equipment related to the expansion of the network, support systems and back office systems of $3.5 million.

Net cash used in financing activities was $1.2 million for the six months ended June 30, 1999 compared to net cash provided by financing activities of $117.1 million for the same period in 1998. In the 1999 period, net cash used in financing activities was primarily used for the scheduled repayment of debt and capital lease obligations. In the 1998 period, net cash provided by financing activities was primarily a result of proceeds from the Company's private offering of the $115 million Senior Notes due 2008.

The expansion of the Company's business will continue to require significant capital to fund capital expenditures, working capital needs, debt service and the cash flow deficits generated by operating losses. The Company's principal capital expenditure requirements include the purchase, installation, and expansion of switches and transmission equipment for the Company's local and data networks and the further development of operations support systems and automated back office systems. Management does not expect that the growth of the Company's long distance and CPE business will require significant capital expenditures. The Company currently estimates that the cash required to fund capital expenditures for its expansion plans will be approximately $50.0 million in 1999.

To date, the Company has primarily funded its expenditures through proceeds from the $115 million Senior Notes due 2008 and private sales of equity securities. In February and March 1998, the Company raised approximately $12.4 million in a private placement of its Series B Preferred Stock and Convertible Notes. On June 18, 1998, the Company sold the $115 million Senior Notes due 2008 for net proceeds of $110.2 million. During July and August 1999, the Company completed the following equity transactions generating $44.0 million in net proceeds:

- Sale of $10.0 million of Series D Preferred Stock to existing stockholders
- Sale of $60.0 million of Series F Preferred Stock to an affiliate of Kohlberg Kravis Roberts & Co.
- Repurchase and retirement of 2,222,222 of the outstanding shares of Series C Preferred Stock for $10.0 million
- Conversion of each share of the Company's Series B Preferred Stock into (1) one share of the Company's amended and restated Series B Preferred Stock and (2) 0.22222 of a share of the Company's Series E Preferred Stock
- Redemption of all Series E Preferred Stock for $8.6 million.

Year 2000 Issue

The year 2000 issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any of the Company's computer programs that have date-sensitive software may recognize the date using "00" as the year 1900 rather than the year 2000. In addressing this problem, the Company anticipates spending $20 million on new systems from inception through the end of 1999. Specific expenditures for year 2000 costs are not being made related to the new systems. The Company has completed its assessment on the consequences of the year 2000 on information technology systems. As the Company has a relatively short history, virtually all systems are newly created or are being created. During information technology development, year 2000 issues have been consistently addressed. The new information technology systems will, in certain cases, replace systems of acquired companies in order to provide consistent and integrated systems. The acquired companies' systems are not all year 2000 compliant; however, these systems will be replaced by the end of 1999. If all such systems are not replaced and year 2000 issues occur, significant disruption to the Company's operations could occur. The most significant system of the acquired companies relates to the provisioning and billing of resale local and long distance services which, if not replaced, could prevent the Company from billing or provisioning service to existing and future customers. Installation of an integrated billing and provisioning system is on schedule to date.

Other non-information technology systems which may be affected by the year 2000 issue include systems provided to the Company by third parties. The most significant third party systems are those which operate the incumbent local exchange carrier's interfaces and billing records, switching equipment and customer premises equipment. The Company has been assured by significant third parties that year 2000 compliance will be accomplished by the end of 1999. If such compliance is not achieved by these third parties, it would have a material adverse effect on the Company's business, operating results and financial condition and its ability to achieve sufficient cash flow.

Forward-Looking Statements

Certain statements contained in this quarterly report on Form 10-Q are forward-looking statements. These statements discuss, among other things, expected growth and expansion strategy. The forward-looking statements are subject to risks, uncertainties and assumptions, including, but not limited to, the impact of competitive products and pricing, product developments, changes in law and regulations, customer demand, litigation, availability of future financing, uncertainty of market acceptance of new products, and other risks. Actual results may differ materially from anticipated results described in these forward-looking statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's exposure to market risk through derivative financial instruments and other financial instruments, such as investments in marketable securities and long-term debt, is not material.

PART II – OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

The following exhibits are included herein:

(27) Financial Data Schedule (for SEC use only)

The Company did not file any reports on Form 8-K during the three months ended June 30, 1999.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

BIRCH TELECOM, INC.

DATE: AUGUST 12, 1999

BY: /S/ DAVID E. SCOTT
DAVID E. SCOTT
PRESIDENT AND CHIEF EXECUTIVE OFFICER

DATE: AUGUST 12, 1999

BY: /S/ BRADLEY A. MOLINE
BRADLEY A. MOLINE
CHIEF FINANCIAL OFFICER

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 1999

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

For the transition period from ______ to _______

Commission file number:
333-62797

BIRCH TELECOM, INC.
(Exact name of Registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**43-1766929** **(I.R.S. Employer Identification No.)**
2020 Baltimore Avenue **Kansas City, Missouri** **(Address of principal executive offices)**	**64108** **(Zip Code)**

Registrant's telephone number, including area code:
(816) 300-3000

Securities registered pursuant to Section 12(b) of the Act:
14% Senior Notes due 2008
(Title of Class)

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

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

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

BIRCH TELECOM, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands except share data)

	December 31, 1998	September 30, 1999
		(Unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 39,745	$ 23,946
Pledged securities	15,888	15,998
Accounts receivable, net	4,039	8,037
Inventory	916	4,164
Prepaid expenses and other	526	2,681
Total current assets	61,114	54,826
Property and equipment, net	26,153	53,147
Pledged securities - noncurrent	21,897	15,075
Goodwill, net	16,863	19,320
Other intangibles, net	7,689	15,280
Other assets	433	365
Total assets	$ 134,149	$ 158,013
Liabilities and Stockholders' Deficit		
Current liabilities:		
Current maturities of long-term debt and capital lease obligations	$ 335	$ 1,200
Accounts payable	8,503	7,669
Accrued expenses	2,556	14,038
Total current liabilities	11,394	22,907
14% Senior Notes	114,681	114,706
Capital lease obligations, net of current maturities	778	1,268
Other long-term debt, net of current maturities	332	321
Series B Redeemable Preferred Stock, 8,572,039 shares issued and outstanding, (stated at redemption and aggregate liquidation value)	14,063	-
Series F Redeemable Preferred Stock, 13,333,334 shares issued and outstanding (stated at redemption and aggregate liquidation value)	-	61,300
Stockholders' deficit:		
Series B Preferred Stock, 8,572,039 shares issued and outstanding	-	8
Series C Preferred Stock, 8,492,749 and 6,270,527 shares issued and outstanding, respectively	8	6
Series D Preferred Stock, 2,222,222 shares issued and outstanding	-	2
Common stock, $.001 par value, 80,000,000 shares authorized, 5,016,889 and 5,333,676 shares issued and outstanding, respectively	5	5
Warrants	337	337
Additional paid-in capital	12,273	15,154
Accumulated deficit	(19,722)	(58,001)
Total stockholders' deficit	(7,099)	(42,489)
Total liabilities and stockholders' deficit	$ 134,149	$ 158,013

See accompanying notes to condensed consolidated financial statements.

BIRCH TELECOM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(In thousands except share data)

	Three months ended September 30, 1998	Three months ended September 30, 1999	Nine months ended September 30, 1998	Nine months ended September 30, 1999
Revenue:				
Communications services, net	$ 6,852	$ 14,564	$ 15,669	$ 35,461
Equipment sales, net	625	2,458	1,573	6,172
Total revenue	7,477	17,022	17,242	41,633
Cost of services:				
Cost of communications services	4,784	11,905	11,214	28,077
Cost of equipment sales	388	1,364	1,032	3,518
Total cost of services	5,172	13,269	12,246	31,595
Gross margin	2,305	3,753	4,996	10,038
Selling, general and administrative expense	4,704	14,649	8,816	34,013
Depreciation and amortization expense	597	2,814	1,229	6,388
Loss from operations	(2,996)	(13,710)	(5,049)	(30,363)
Interest expense	(4,181)	(3,705)	(4,517)	(11,189)
Interest income	1,709	725	1,709	2,287
Net loss	(5,468)	(16,690)	(7,857)	(39,265)
Preferred stock dividends	(509)	(491)	(1,204)	(1,477)
Amortization of preferred stock issuance costs	(10)	(61)	(21)	(77)
Loss applicable to common stock	$ (5,987)	$ (17,242)	$ (9,082)	$ (40,819)
Loss per common share — basic and diluted	$ (4.73)	$ (3.41)	$ (2.69)	$ (8.06)
Weighted average number of common shares outstanding	1,265	5,061	3,381	5,063

See accompanying notes to condensed consolidated financial statements.

BIRCH TELECOM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(In thousands)

	Nine months ended September 30, 1998	Nine months ended September 30, 1999
Net cash used in operating activities	$ (1,353)	$(31,073)
Investing activities		
Purchase of property and equipment	(10,118)	(28,925)
Business acquisitions, net of cash acquired	(7,740)	(4,553)
Purchase of pledged securities	(44,247)	-
Maturity of pledged securities	-	8,050
Amortization of discount on pledged securities	(511)	(1,339)
Net cash used in investing activities	(62,616)	(26,767)
Financing activities		
Proceeds from issuance of common stock and warrants	342	-
Proceeds from issuance of preferred stock	9,500	70,000
Payment of financing costs	(5,106)	(7,310)
Payment of Series A Preferred Stock Dividends	(168)	-
Proceeds from convertible notes	3,500	-
Proceeds from 14% Senior Notes	114,663	-
Redemption of preferred stock	(4,750)	(18,572)
Redemption of common stock	-	(450)
Repayment of short term notes	(250)	(200)
Repayment of long-term debt	(529)	(683)
Repayment of capital lease obligations	(65)	(744)
Net cash provided by financing activities	117,137	42,041
Net increase (decrease) in cash and cash equivalents	53,168	(15,799)
Cash and cash equivalents at beginning of period	210	39,745
Cash and cash equivalents at end of period	$ 53,378	$ 23,946
Supplementary schedule of non-cash investing and financing activities:		
Amounts recorded in connection with acquisitions:		
Fair value of net assets acquired, net of cash acquired	$ 5,064	$ 2,678
Fair value of intangible assets	20,883	3,884
Assumption of liabilities	2,430	926
Assumption of long-term debt and capital lease obligations	1,027	872
Issuance of Series A Preferred Stock	4,750	-
Issuance of Series C Preferred Stock	10,000	-
Issuance of common stock	-	211
Property and equipment additions included in accounts payable	4,703	2,978
Property and equipment additions acquired through capital lease	-	2,099

See accompanying notes to condensed consolidated financial statements.

BIRCH TELECOM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Nine months ended September 30, 1999

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Birch Telecom, Inc. ("Birch" or "the Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months and nine months ended September 30, 1999 are not necessarily indicative of the results that may be expected for the year ended December 31, 1999. For further information, refer to the consolidated financial statements and footnotes thereto included in the Birch Telecom, Inc. annual report on Form 10-K for the fiscal year ended December 31, 1998.

2. Reclassifications

Certain items in the 1998 condensed consolidated financial statements have been reclassified to be consistent with the classification in the 1999 condensed consolidated financial statements.

3. Acquisitions

In February 1998, Birch merged with Valu-Line Companies, Inc. (Valu-Line) in a transaction valued at $19.5 million, consisting of $4.75 million in cash, 2,968,750 shares of Series A Preferred Stock having an aggregate liquidation preference of $4.75 million and 6,250,000 shares of Series C Preferred Stock having an aggregate liquidation preference of $10.0 million. Since 1982, Valu-Line has been primarily providing switched long distance services, customer premises equipment (CPE) sales and services and, since March 1997, local service.

In May 1998, Birch acquired Boulevard Phone Company (Boulevard), a shared tenant service provider in the Kansas City metropolitan area, for $300,000 in cash and Telesource Communications, Inc. (Telesource), a CPE provider in the Kansas City metropolitan area, for $325,000 in cash.

In September 1998, Birch acquired TFSnet, Inc. (TFSnet), an Internet service provider based in the Kansas City metropolitan area, for $2.65 million.

In February 1999, the Company acquired American Local Telecommunications, LLC (ALT), a competitive local exchange carrier based in the Dallas, Texas metropolitan area. The acquisition included substantially all assets of ALT. The total purchase price was approximately $1.6 million.

In March 1999, the Company acquired the stock of Capital Communications Corporation (Capital), a telecommunications equipment provider based in the St. Louis, Missouri metropolitan area. The total purchase price was approximately $3.0 million plus additional cash consideration based on local service lines converted to the Company's service from Capital's existing customer base, which totaled $100,000 through September 30, 1999.

The Valu-Line, Boulevard, Telesource, TFSnet, ALT and Capital acquisitions were recorded using the purchase method of accounting. Accordingly, the operations of each are included in the condensed consolidated statements of operations and cash flows from the date of acquisition.

4. Pledged Securities, Warrants, and Debt

During June 1998, the Company completed a $115 million private offering of 14% Senior Notes due June 2008 (the Senior Notes) and 115,000 warrants to purchase 1,409,734 shares of common stock. Interest on the Senior Notes is payable semi-annually in arrears on June 15 and December 15 of each year. Warrants are exercisable at $0.01 per share and expire June 2008. The Company received net proceeds from the Senior Notes of $110.2 million and concurrently purchased pledged securities of $44.2 million. The pledged securities are restricted for interest payments on the Senior Notes and, together with the interest accruing thereon, will be used to satisfy such interest payments through June 2001. The Company classifies its pledged securities, consisting of $31.1 million and $37.8 million of U.S. Treasury securities at September 30, 1999 and December 31, 1998, respectively, as held to maturity recorded at amortized cost and maturing between six and twenty-one months. A portion of the proceeds from the Senior Notes, $337,000, was allocated to the warrants, and the resulting debt discount is being amortized over the life of the debt on the straight-line method, which does not differ materially from the effective interest method. Unamortized discount was $294,000 and $319,000 at September 30, 1999 and December 31, 1998, respectively. The amount allocated to the warrants represents the estimated fair value of the warrants at the date of issuance. The Senior Notes rank pari pasu in right of payment to all existing and future senior indebtedness of the Company and rank senior in the right of payment to all existing and future subordinated indebtedness of the Company.

A Registration Statement on Form S-4, registering the Company's 14% Senior Notes and offering to exchange (the Exchange Offer) any and all of the outstanding 14% Senior Notes for Exchange Notes, was declared effective by the Securities and Exchange Commission (SEC) in March 1999. The Exchange Offer terminated after all of the outstanding 14% Senior Notes were exchanged. The terms and conditions of the Exchange Notes are identical to those of the 14% Senior Notes in all material respects.

5. Capital Structure

During July and August 1999, the Company issued and sold Series F and Series D Preferred Stock generating net proceeds of $44.0 million.

The Company issued and sold 2,222,222 shares of Series D Preferred Stock at $4.50 per share. The Series D Preferred Stock accrues dividends at a rate of 15% per annum. As of September 30, 1999, cumulative dividends on the Series D Preferred Stock totaled $375,000.

The Company issued and sold 13,333,334 shares of its Series F Preferred Stock at a purchase price of $4.50 per share. Additionally, options were granted to purchase an additional 5,263,158 shares of Series F Preferred Stock at $4.75 per share and an additional 5,000,000 shares of Series F Preferred Stock at $5.00 per share on or before April 13, 2000. The Series F Preferred Stock accrues dividends at a rate of 15% per annum. As of September 30, 1999, cumulative dividends on the Series F Preferred Stock totaled $1.3 million.

In connection with the Series F Preferred Stock transaction, the Company (i) repurchased 2,222,222 shares of its Series C Preferred Stock for $10.0 million, (ii) undertook a plan of recapitalization whereby each outstanding share of the Company's Series B Preferred Stock was converted into one share of the Company's amended and restated Series B Preferred Stock and 0.2222 of a share of the Company's Series E Preferred Stock, and (iii) redeemed the Series E Preferred Stock issued for $8.6 million.

The rights and preferences of the Company's Series B Preferred Stock were amended and restated to remove the mandatory redemption rights and change the liquidation rights. As of September 30, 1999, cumulative dividends on the Series B Preferred Stock totaled $2.5 million.

In connection with these agreements, the Company amended and restated its certificate of incorporation to authorize 80,000,000 shares of common stock, and 55,000,000 shares of Preferred Stock. Of the authorized shares of Preferred Stock, 8,750,000 shares are designated as Series B Preferred Stock; 8,500,000 shares are designated as Series C Preferred Stock; 2,225,000 shares are designated as Series D Preferred Stock; 1,904,898 shares are designated as Series E Preferred Stock; and 30,000,000 shares are designated as Series F Preferred Stock.

Liquidation Rights

Birch's Series D, Series E and Series F Preferred Stock have a liquidation preference over the Series B and Series C Preferred Stock and common stock at the greater of (i) the purchase price plus accrued but unpaid dividends or (ii) the amount the holders would have received upon liquidation if such shares of Series D, Series E and Series F Preferred Stock had been converted to common stock immediately prior to liquidation. Birch's Series B Preferred Stock has a liquidation preference only over Series C Preferred Stock and common stock at an amount equal to the sum of the purchase price plus accrued but unpaid dividends. Series C Preferred Stock has preference only over common stock at an amount equal to the sum of the purchase price plus accrued but unpaid dividends.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The Company has used strategic acquisitions (the Acquisitions) to expand its business capabilities. The following acquisitions were completed during 1998 and the nine months ending September 30, 1999:

Acquired Company	Date of Acquisition	Principal Business Activity
Valu-Line	February 1998	Provider of switched long distance, resold local services and CPE sales and services in Kansas
Boulevard	May 1998	Provider of shared tenant service in the Kansas City, MO metropolitan area
Telesource	May 1998	Provider of CPE sales and service in the Kansas City, MO metropolitan area
TFSnet	September 1998	Provider of Internet service in the Kansas City, MO metropolitan area
ALT	February 1999	Competitive local exchange carrier based in the Dallas, TX metropolitan area
Capital	March 1999	Provider of telecommunications equipment based in the St. Louis, MO metropolitan area

Results of Operations

Three Months Ended September 30, 1999 Compared to Three Months Ended September 30, 1998

Revenue. Revenue increased 127.7% to $17.0 million for the 1999 period compared to $7.5 million for the 1998 period. The increase in revenue is primarily a result of new customer sales from new and existing markets and the Acquisitions. For the 1999 and 1998 quarters, as a percentage of total revenue, communications services were 85.6% and 91.6%, respectively, and CPE sales were 14.4% and 8.4%, respectively. Lines in service increased 188.6% to 89,108 at September 30, 1999 compared to 30,871 at September 30, 1998.

Cost of services. Cost of services increased 156.6% to $13.3 million for the 1999 period compared to $5.2 million for the 1998 period. The increase in cost of services is primarily the result of associated revenue increases. Gross margin increased 62.8% to $3.8 million (22.0% of revenue) for the 1999 period compared to $2.3 million (30.8% of revenue) for the 1998 period. The decline in gross margin as a percentage of revenue is principally from a greater percentage of revenue being derived from resold local service during the 1999 period compared to the 1998 period.

Selling, general and administrative expense. Selling, general and administrative expense increased 211.4% to $14.6 million for the 1999 period compared to $4.7 million for the 1998 period. The increase in expense is primarily a result of supporting and attracting customers from new and existing markets, preparations for market launches in Texas and the Acquisitions, each of which affected wages, rent and advertising expenses. Additionally, the Company had approximately 817 employees at September 30, 1999, compared to 283 employees at September 30, 1998. EBITDA, a commonly used measure by securities analysts of earnings before deducting interest, taxes, depreciation and amortization, increased 354.2% to a loss of $10.9 million for the 1999 period compared to a loss of $2.4 million for the 1998 period.

Depreciation and amortization. Depreciation and amortization increased 371.4% to $2.8 million for the 1999 period compared to $597,000 for the 1998 period. The increase in depreciation and amortization is primarily attributable to the fixed and intangible assets related to the Acquisitions, as well as the deployment of network assets in the Company's markets.

Interest. Interest expense decreased 11.4% to $3.7 million for the 1999 period compared to $4.2 million for the 1998 period. The decrease in interest expense is primarily attributable to an increase in capitalized interest expense on the purchase and installation of switches. Interest income decreased 57.6% to $725,000 for the 1999 period compared to $1.7 million for the 1998 period. The decrease in interest income is primarily a result of the maturity and sale of $8.1 million of pledged securities for the payment of interest on the $115 million Senior Notes due 2008 which was partially offset by the interest income on invested funds received as part of the Series D and Series F Preferred Stock transactions further described below.

Net loss. Net loss increased 205.2% to $16.7 million for the 1999 period compared to $5.5 million for the 1998 period.

Nine Months Ended September 30, 1999 Compared to Nine Months Ended September 30, 1998

Revenue. Revenue increased 141.5% to $41.6 million for the 1999 period compared to $17.2 million for the 1998 period. The increase in revenue is primarily a result of new customer sales from new and existing markets and the Acquisitions. For the 1999 and 1998 periods, as a percentage of total revenue, communications services were 85.2% and 90.9%, respectively, and CPE sales were 14.8% and 9.1%, respectively.

Cost of services. Cost of services increased 158.0% to $31.6 million for the 1999 period compared to $12.2 million for the 1998 period. The increase in cost of services is primarily a result of associated revenue increases. Gross margin increased 100.9% to $10.0 million (24.1% of revenue) for the 1999 period compared to $5.0 million (29.0% of revenue) for the 1998 period. The decline in gross margin as a percentage of total revenue is principally from a greater percentage of revenue being derived from resold local service during the 1999 period compared to the 1998 period.

Selling, general and administrative expense. Selling, general and administrative expense increased 285.8% to $34.0 million for the 1999 period compared to $8.8 million for the 1998 period. The increase in expense is primarily a result of supporting and attracting customers from new and existing markets, preparations for market launches in Texas and the Acquisitions, each of which affected wages, rent and advertising expenses. Additionally, the Company had approximately 817 employees at September 30, 1999 compared to 283 employees at September 30, 1998. EBITDA, a commonly used measure by securities analysts of earnings before deducting interest, taxes, depreciation and amortization, increased 527.6% to a loss of $24.0 million for the 1999 period compared to a loss of $3.8 million for the 1998 period.

Depreciation and amortization. Depreciation and amortization increased 419.8% to $6.4 million for the 1999 period compared to $1.2 million for the 1998 period. The increase in depreciation and amortization is primarily attributable to the fixed and intangible assets related to the Acquisitions, as well as the deployment of network assets in the Company's markets.

Interest. Interest expense increased 147.7% to $11.2 million for the 1999 period compared to $4.5 million for the 1998 period. The increase in interest expense is primarily attributable to the interest charges on the $115 million Senior Notes due 2008. Interest income increased 33.8% to $2.3 million for the 1999 period compared to $1.7 million for the 1998 period. The increase in interest income is primarily the result of invested funds received from the $115 million Senior Notes due 2008 and the Series D and Series F Preferred Stock transactions further described below.

Net loss. Net loss increased 399.7% to $39.3 million for the 1999 period compared to $7.9 million for the 1998 period.

Liquidity and Capital Resources

The Company's total assets increased from $134.1 million at December 31, 1998 to $158.0 million at September 30, 1999, primarily due to capital outlays for expansion of the Company's local and data networks and development of operations support systems and automated back office systems, partially offset by the use of cash to fund operations. At September 30, 1999, the Company's current assets of $54.8 million exceeded its current liabilities of $22.9 million, providing working capital of $31.9 million, representing a decrease of $17.8 million compared to December 31, 1998. At December 31, 1998, the Company's current assets of $61.1 million exceeded current liabilities of $11.4 million, providing working capital of $49.7 million. The decrease in working capital is primarily attributable to the use of cash to fund operations and capital outlays for expansion of the Company's network, support systems and back office systems as previously stated. Of working capital at September 30, 1999, $16.0 million represents securities pledged to satisfy interest payments on the $115 million Senior Notes due 2008, compared to $4.7 million of accrued interest at September 30, 1999 related to such Notes.

Net cash used in operating activities was $31.1 million for the nine months ended September 30, 1999 compared to $1.4 million for the same period in 1998. Net cash used in operating activities was primarily used to fund the Company's net losses of $39.3 million in the 1999 period and $7.9 million in the 1998 period.

Net cash used in investing activities was $26.8 million for the nine months ended September 30, 1999 compared to $62.6 million during the same period in 1998. In the 1999 period, net cash used in investing activities was primarily used for the purchase of property and equipment related to the expansion of the network, support systems and back office systems of $28.9 million and acquisitions of $4.6 million, partially offset by net proceeds from the sale of pledged securities of $8.1 million for the semi-annual interest payment on the $115 million Senior Notes due 2008. In the 1998 period, net cash used in investing activities was primarily used for purchases of pledged securities related to the $115 million Senior Notes due 2008 of $44.2 million, acquisitions of $7.7 million, and purchases of property and equipment related to the expansion of the network, support systems and back office systems of $10.1 million.

Net cash provided by financing activities was $42.1 million for the nine months ended September 30, 1999 compared to $117.1 million for the same period in 1998. In the 1999 period, net cash provided by financing activities was primarily a result of proceeds from the sale of Series D Preferred Stock, the sale of Series F Preferred Stock to an affiliate of Kohlberg Kravis Roberts & Co. and other associated preferred stock transactions described below. In the 1998 period, net cash provided by financing activities was primarily a result of proceeds from the Company's private offering of the $115 million Senior Notes due 2008.

The expansion of the Company's business will continue to require significant capital to fund capital expenditures, working capital needs, debt service and the cash flow deficits generated by operating losses. The Company's principal capital expenditure requirements include the purchase, installation, and expansion of switches and transmission equipment for the Company's local and data networks and the further development of operations support systems and automated back office systems. Management does not expect that the growth of the Company's long distance and CPE business will require significant capital expenditures. The Company currently estimates that the cash required to fund capital expenditures for its expansion plans will be approximately $45.0 million in 1999.

To date, the Company has primarily funded its expenditures through proceeds from the $115 million Senior Notes due 2008 and private sales of equity securities. In February and March 1998, the Company raised approximately $12.4 million in a private placement of its Series B Preferred Stock and Convertible Notes. On June 18, 1998, the Company sold the $115 million Senior Notes due 2008 for net proceeds of $110.2 million. During July and August 1999, the Company completed the following equity transactions generating $44.0 million in net proceeds:

- Sale of $10.0 million of Series D Preferred Stock to existing stockholders

- Sale of $60.0 million of Series F Preferred Stock to an affiliate of Kohlberg Kravis Roberts & Co.

- Repurchase and retirement of 2,222,222 of the outstanding shares of Series C Preferred Stock for $10.0 million

- Conversion of each share of the Company's Series B Preferred Stock into (1) one share of the Company's amended and restated Series B Preferred Stock and (2) 0.22222 of a share of the Company's Series E Preferred Stock

- Redemption of all Series E Preferred Stock for $8.6 million.

Year 2000 Issue

The year 2000 issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any of the Company's computer programs that have date-sensitive software may recognize the date using "00" as the year 1900 rather than the year 2000. In addressing this problem, the Company anticipates spending $20 million on new systems from inception through the end of 1999. Specific expenditures for year 2000 costs are not being made related to the new systems. The Company has completed its assessment on the consequences of the year 2000 on information technology systems. As the Company has a relatively short history, virtually all systems are newly created or are being created. During information technology development, year 2000 issues have been consistently addressed. The new information technology systems will, in certain cases, replace systems of acquired companies in order to provide consistent and integrated systems. The acquired companies' systems are not all year 2000 compliant; however, these systems will be replaced by the end of 1999. If all such systems are not replaced and year 2000 issues occur, significant disruption to the Company's operations could occur. The most significant system of the acquired companies relates to the provisioning and billing of resale local and long distance services which, if not replaced, could prevent the Company from billing or provisioning service to existing and future customers. Installation of an integrated billing and provisioning system is on schedule to date.

Other non-information technology systems which may be affected by the year 2000 issue include systems provided to the Company by third parties. The most significant third party systems are those which operate the incumbent local exchange carrier's interfaces and billing records, switching equipment and customer premises equipment. The Company has been assured by significant third parties that year 2000 compliance will be accomplished by the end of 1999. If such compliance is not achieved by these third parties, it would have a material adverse effect on the Company's business, operating results and financial condition and its ability to achieve sufficient cash flow.

Forward-Looking Statements

Certain statements contained in this quarterly report on Form 10-Q are forward-looking statements. These statements discuss, among other things, expected growth and expansion strategy. The forward-looking statements are subject to risks, uncertainties and assumptions, including, but not limited to, the impact of competitive products and pricing, product developments, changes in law and regulations, customer demand, litigation, availability of future financing, uncertainty of market acceptance of new products, and other risks. Actual results may differ materially from anticipated results described in these forward-looking statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's exposure to market risk through derivative financial instruments and other financial instruments, such as investments in marketable securities and long-term debt, is not material.

PART II – OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

Since July 1, 1999, Birch has issued and sold unregistered securities as follows:

(a) In July 1999, Birch sold 2,222,222 shares of its Series D Preferred Stock at $4.50 per share with net proceeds of approximately $10.0 million.

(b) In August 1999, in connection with the Series F Preferred Stock transaction, the Company (i) repurchased 2,222,222 shares of its Series C Preferred Stock for $10.0 million, (ii) undertook a plan of recapitalization whereby each outstanding share of the Company's Series B Preferred Stock was converted into one share of the Company's amended and restated Series B Preferred Stock and 0.2222 of a share of the Company's Series E Preferred Stock, and (iii) redeemed the Series E Preferred Stock issued for $8.6 million.

(c) In August 1999, Birch sold 13,333,334 shares of its Series F Preferred Stock at $4.50 per share with net proceeds of approximately $60.0 million. Additionally, options were granted to purchase an additional 5,263,158 shares of Series F Preferred Stock at $4.75 per share and an additional 5,000,000 shares of Series F Preferred Stock at $5.00 per share on or before April 13, 2000.

All sales of common stock made pursuant to the exercise of stock options granted under the 1998 Stock Option Plan to Birch's officers, directors, employees and consultants were made in reliance on Rule 701 under the Securities Act of 1933, as amended ("the Securities Act") or on Section 4(2) of the Securities Act. All other sales were made in reliance on Section 4(2) of the Securities Act and/or Regulation D promulgated under the Securities Act. These sales were made without general solicitation or advertising. Each purchaser was a sophisticated investor with access to all relevant information necessary to evaluate the investment and represented to Birch that the shares were being acquired for investment only and not with a view to or for sale in connection with any distribution thereof and appropriate legends were affixed to the securities.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS

(a) In June and July 1999, in connection with its proposed sale of Series D Preferred Stock, Birch obtained the written consent of its stockholders with respect to the amendment and restatement of Birch's Certificate of Incorporation.

(b) In June and July 1999, in connection with its proposed sale of Series F Preferred Stock, Birch obtained the written consent of its stockholders with respect to (i) the amendment and restatement of Birch's Certificate of Incorporation, (ii) the amendment and restatement of Birch's Purchasers Rights Agreement, (iii) the repurchase by Birch of certain outstanding shares of Series C Preferred Stock, (iv) the adoption of a plan of recapitalization relating to the Company's Series B and E Preferred Stock, and (v) and the reorganization of Birch's Board of Directors.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

The following exhibits are included herein:

3.1	Restated Certificate of Incorporation.
10.2	Amended and Restated Purchasers Rights Agreement, dated August 5, 1999.
10.18	Series D Preferred Stock Purchase Agreement, dated July 2, 1999.
10.19	Series F Preferred Stock Purchase Agreement, dated July 13, 1999.
10.21	Amendment to Employment Agreement by and between Birch Telecom, Inc. , and Gary L. Chesser.
10.22	Amendment to Employment Agreement by and between Birch Telecom, Inc. , and Gregory C. Lawhon.
10.23	Amendment to Employment Agreement by and between Birch Telecom, Inc. , and David E. Scott.
10.24	Amendment to Employment Agreement by and between Birch Telecom, Inc. , and David W. Vranicar.
27.1	Financial Data Schedule (for SEC use only)

(b) Reports on Form 8-K.

The Company did not file any reports on Form 8-K during the three months ended September 30, 1999.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

BIRCH TELECOM, INC.

DATE: NOVEMBER 15, 1999

BY: /S/ DAVID E. SCOTT
DAVID E. SCOTT
PRESIDENT AND CHIEF EXECUTIVE OFFICER

DATE: NOVEMBER 15, 1999

BY: /S/ BRADLEY A. MOLINE
BRADLEY A. MOLINE
CHIEF FINANCIAL OFFICER

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

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

For the fiscal year ended December 31, 1998

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

For the transition period from _______ to ________

Commission file number:
333-62797

BIRCH TELECOM, INC.

(Exact name of Registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**43-1766929** **(I.R.S. Employer Identification No.)**
2020 Baltimore Avenue **Kansas City, Missouri** **(Address of principal executive offices)**	**64108** **(Zip Code)**

Registrant's telephone number, including area code:
(816) 300-3000

Securities registered pursuant to Section 12(b) of the Act:
14% Senior Notes due 2008
(Title of Class)

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

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

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

PART I

THIS FORM 10-K CONTAINS CERTAIN FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. THE COMPANY'S ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF CERTAIN FACTORS, INCLUDING THOSE SET FORTH UNDER THE CAPTION "BUSINESS—RISK FACTORS" AND ELSEWHERE IN THIS FORM 10-K. UNLESS THE CONTEXT SUGGESTS OTHERWISE, REFERENCES IN THIS FORM 10-K TO THE "COMPANY" OR "BIRCH" MEAN BIRCH TELECOM, INC. AND ITS WHOLLY OWNED SUBSIDIARIES.

ITEM 1. BUSINESS

General

Birch is a competitive local exchange carrier (CLEC) serving small to mid-sized businesses and, to a lesser extent, residential customers, in selected markets in Missouri, Kansas, and Texas. The Company provides its customers with integrated telecommunications services, including local and long distance service, customer premises equipment (CPE), and Internet services, such as access, web hosting, web site design and Intranet development. Birch provides telecommunications services to its customers through a combination of owned and leased network facilities and resold services. For the year ended December 31, 1998, the Company's total revenue was $26.1 million.

Birch provides local, long distance, and CPE services in Missouri and Kansas, principally in territories served by Southwestern Bell Telephone Company (SWBT), including Kansas City, St. Louis and St. Joseph, Missouri and Wichita, Topeka, Manhattan, Lawrence, Emporia, Salina and Dodge City, Kansas. In 1999, the Company began providing local services in selected Texas markets. The Company also provides Internet services in selected markets in Kansas and Missouri. Birch currently operates a long distance circuit switch in Wichita, Kansas and a local/long distance circuit switch in Kansas City, Missouri. The Company expects to deploy additional local/long distance circuit switches in St. Louis, Missouri and Wichita, Kansas, in the second quarter of 1999. Additionally, in 1999, the Company expects to deploy asynchronous transfer mode (ATM) packet switches in various markets in which it offers telecommunications services.

Birch was incorporated under the laws of Delaware in December 1996. The Company's principal executive offices are located at 2020 Baltimore Avenue, Kansas City, Missouri 64108 and its telephone number is (816) 300-3000.

Recent Transactions

In February 1998, Birch merged with Valu-Line Companies, Inc. (Valu-Line) in a transaction valued at $19.5 million, consisting of $4.75 million in cash, 2,968,750 shares of Series A Preferred Stock of the Company having an aggregate liquidation preference of $4.75 million, and 6,593,750 shares of Series C Preferred Stock having an aggregate liquidation preference of $10.0 million. Valu-Line, founded in 1982, has been primarily providing switched long distance services, CPE sales and services and, since March 1997, local service in selected smaller markets throughout the state of Kansas.

On March 13, 1998, Birch completed a private placement of 6,264,063 shares of its Series B Preferred Stock having an aggregate liquidation preference of $9.5 million and $3.5 million in aggregate principal amount of convertible notes, raising aggregate net proceeds of approximately $12.4 million which were used to pay the cash portion of the consideration for the Valu-Line merger, to repay certain debt and for general corporate purposes. In June 1998, the convertible notes were converted into 2,307,965 shares of Series B Preferred Stock of the Company.

In May 1998, Birch acquired Dunn & Associates, Inc., d/b/a Boulevard Phone Company (Boulevard), a shared tenant service provider in the Kansas City metropolitan area, for $300,000 in cash.

In May 1998, Birch acquired Telesource Communications, Inc. (Telesource), a CPE provider in the Kansas City metropolitan area, for $325,000 in cash. In connection with the Telesource acquisition, the Company assumed $290,000 of Telesource's debt which has since been repaid.

During June 1998, the Company completed a $115 million private offering of 14% Senior Notes (the Senior Notes) due June 2008 and 115,000 warrants to purchase 1,409,734 shares of Common Stock of the Company. The warrants are exercisable at $0.01 per share and expire June 2008. The Company received net proceeds from the Senior Notes of $110.2 million and concurrently purchased pledged securities of $44.2 million. The pledged securities are restricted for interest payments on the Senior Notes and, together with the interest accruing thereon, will be used to satisfy such interest payments through June 2001. The Senior Notes were subsequently exchanged for substantially identical 14% notes due June 2008 that had been registered under the Securities Act of 1933 in an exchange offer that expired in March 1999.

In September 1998, the Company purchased certain assets and liabilities of TFSnet, Inc. (TFSnet), an Internet service provider in the Kansas City metropolitan area, for $2.65 million.

In February 1999, Birch acquired American Local Telecommunications, L.L.C. (ALT), a local service provider in the Dallas metropolitan area for $700,000 in cash and stock.

In March 1999, Birch acquired Capital Communications Corporation (Capital), a CPE provider in the St. Louis metropolitan area for $3.0 million in cash and additional cash compensation from conversion of Capital's customer base to Birch's local service.

Telecommunications Services

Birch's telecommunication services are designed to appeal to small and mid-sized businesses that not only rely on their telecommunications networks, but who also value integrated telecommunications services packages from a single provider.

Local and Long Distance

Birch provides local and long distance services to its customers in its markets. Local service is currently provided through resale of SWBT services, through a platform of SWBT's unbundled network elements and through Birch's switch and SWBT's unbundled local loops. Birch's services feature simple long-distance pricing structures and discounted local service packages (compared to SWBT). Birch's services are billed on a single invoice and customer inquiries are directed to a single customer service number. Long distance calling services include outbound, toll free (800/888), and calling card. Customers may subscribe to long distance services provided by other interexchange carriers (IXCs) upon request.

Customer Premises Equipment

Birch sells and services CPE, including key systems, PBXs, and voice-mail systems, and provides inside-wire services for commercial accounts, including wiring for data networking. Birch is an authorized equipment distributor for Northern Telecom, Inc. (NORTEL), Toshiba America Information Systems, Inc. and NEC America Inc. As a result of Birch's acquisition of Capital, it now also is an authorized equipment distributor for Executone Information Systems, Inc. and Tadiran Electronic Industries, Inc. in the St. Louis metropolitan area.

Internet Services

Birch provides Internet services, including both dial-up and dedicated Internet access services, web hosting, web-site design and Intranet development services. Birch targets customers that use the Internet as their primary wide-area data network, and therefore Birch expects their Internet requirements to grow both in terms of access capacity requirements and in the sophistication of required services.

In addition to these telecommunication services, in certain geographic areas, Birch provides a combination of equipment, local, long distance and Internet services to multiple tenants of office buildings and complexes in the greater Kansas City metropolitan area. Customers pay a monthly fee based solely on the number of telephone stations they require, the amount of long distance traffic they generate, and the Internet services for which they subscribe.

Sales and Marketing

Sales

As of December 31, 1998, Birch had a direct sales force of 55 representatives operating from nine offices throughout Missouri and Kansas. Of these representatives, 10 were primarily selling CPE and the remaining 45 were selling Birch's local and long-distance services. These sales representatives are supported by sales managers.

Birch focuses on converting customers in its targeted small to mid-size business segment, seeking to establish a solid, long-term relationship with its customers. The Company has developed a commission structure that enables it to attract experienced, productive sales people. The Company's commission structure incorporates both a revenue and a local-line quota, and is based on productivity parameters. Birch's sales managers are experienced in disciplined, activity-based sales management.

Birch does not actively market to residential customers, but has found that its other sales and promotional efforts attract residential customers, many of whom are owners or employees of businesses using Birch's telecommunication services.

Advertising and Promotion

Birch conducts an extensive marketing campaign in its local markets, making use of advertising and public relations to position itself in the small to mid-size business segment and contrasting its service attributes with that of SWBT. This marketing campaign includes sponsorship of major local events, affiliations with local organizations, and direct mailings. While the Company does not actively market to residential customers, management believes that its willingness to serve these customers — unlike many other CLECs — creates a greater interest in Birch's development among the news media and general public. In the past, Birch market launches have been accompanied by extensive local media coverage.

In keeping with Birch's philosophy of being accessible to its customers, Birch establishes local sales and customer service offices in many of the cities and towns in its markets. Birch is the only provider of local telephone service that maintains an office in many of these cities and towns. Birch's offices are open to walk-in traffic and often are located in high-profile areas.

Pricing

Birch does not intend to position itself as the cheapest provider of services, especially with respect to its long-distance services. Birch targets customers who value the convenience of its service offerings and personalized customer service. Customers who have the highest price sensitivity are likely to move frequently among providers, driving up churn rates. Birch has historically experienced a low churn rate.

Network Facilities

Ownership of Strategic Facilities

Birch currently operates a long distance circuit switch in Wichita, Kansas and a local/long distance circuit switch in Kansas City, Missouri. The Company expects to deploy additional circuit switches in St. Louis, Missouri and Wichita, Kansas in the second quarter 1999. Birch's local circuit switches are manufactured by Lucent Technologies, Inc. (Lucent) and are the Series 5ESS®-2000 digital models. Birch has a five-year purchase agreement with Lucent that allows it to purchase switching equipment at a discount from published list prices and that contains no minimum purchase requirements.

In markets where Birch operates a circuit switch, the Company is also collocating its electronic equipment at SWBT's main central office. This allows Birch to connect to transmission lines leased by Birch from SWBT (unbundled loops). Collocation and use of SWBT unbundled loops allows Birch to avoid the extensive capital costs of complete network construction and enables it to build its market share without undertaking a lengthy construction program.

At the customer's premise, Birch connects unbundled loops directly to customer-owned equipment. Birch also deploys electronic equipment (intelligent channel banks or access servers) that concentrate traffic and enable Birch to obtain higher capacity from the transmission line of the incumbent local exchange carrier (ILEC).

In addition to its circuit switches, Birch is deploying ATM packet switches in 1999. These packet switches will make use of the same type of monitoring, environmental control and power infrastructure that supports its circuit switches. Initially, the Company will use these packet switches to transmit data over its leased transmission lines, but also plans to use these packet switches to transmit voice traffic.

Leasing of Transmission Facilities

Birch leases transmission facilities connecting Birch's switches with its collocated equipment in SWBT's main central offices and unbundled loops primarily from SWBT. Birch believes that by leasing these local transmission facilities, rather than building them, it is able to access local transmission facilities at a competitive price. Given the existing capacity of local networks, the Company does not anticipate having to build local transmission facilities in the future. Similarly, Birch believes that the existing capacity of long-distance networks renders direct ownership of long distance transmission facilities unnecessary.

Leasing rather than building transmission lines supports Birch's strategy of rapid local market development insofar as the Company's sales activity is not constrained by network construction. Moreover, Birch's services can generally be made available throughout a metropolitan area utilizing leased transmission facilities rather than at a limited number of locations to which a provider has built transmission facilities.

Operations

Emporia Service Center

Central to Birch's ability to offer excellent service and support its growth is its service center in Emporia, Kansas. This service center processes orders, interfaces with SWBT's operational support systems, provides customer service, trouble resolution, billing and collection for the Company's customers. The Emporia service center provides rapid, human assistance, rather than the automated, cumbersome customer interface currently used by many telecommunications providers.

Field Technical Operations

Birch's field technicians service its owned facilities and customer-owned facilities. These technicians install, repair and maintain digital switches, transmission equipment, PBXs, key systems, data equipment and inside wiring, including wiring for data networking. Field technicians are often the most respected source of telecommunications advice for small and mid-sized business customers. Birch believes that having a skilled, in-demand group of technicians supports Birch's CPE customer base and strengthens customer loyalty.

Information Systems

Birch's proprietary information systems provide integrated customer service, ordering, provisioning, trouble tracking and billing. The Company intends to upgrade its existing systems to add capabilities providing for multi-state management of its local networks, automating the provisioning process and improving Birch's billing capabilities. These upgrades are being accomplished through the licensing of industry-leading operations support and billing systems. Birch personnel are responsible for integrating these modules with each other and with the Company's existing systems, and for ongoing management of the systems. The Company also maintains an electronic data interface with SWBT and intends to continuously improve this interface in order to achieve even more efficient provisioning intervals and customer service response.

Regulation

Overview

Telecommunications services provided by Birch are subject to regulation by federal, state and local government agencies. At the federal level, the Federal Communications Commission (FCC) has jurisdiction over interstate and international services. Interstate services are communications that originate in one state and terminate in another. Intrastate services are communications that originate and terminate in a single state. State regulatory commissions (State Commissions) exercise jurisdiction over intrastate services. Additionally, municipalities and other local government agencies may regulate limited aspects of Birch's business, such as use of government-owned rights-of-way, and may require permits such as zoning approvals and building permits.

In recent years, the regulation of the telecommunications industry has been in a state of flux as the United States Congress and various state legislatures have passed laws seeking to foster greater competition in telecommunications markets. The FCC and State Commissions have adopted many new rules to implement this legislation and encourage competition. These changes are incomplete. The following summary of regulatory developments and legislation does not purport to describe all present and proposed federal, state and local regulations and legislation affecting the telecommunications industry. Certain of these and other existing federal and state regulations are currently the subject of judicial proceedings, legislative hearings and administrative proposals which could change, in varying degrees, the manner in which this industry operates. Neither the outcome of these proceedings, nor their impact upon the telecommunications industry or Birch can be predicted at this time.

Removal of Entry Barriers

Federal law prohibits state and local governments from enforcing any law, rule or legal requirement that prohibits or has the effect of prohibiting any entity from providing interstate or intrastate telecommunications services. This should enable Birch to provide a full range of local telecommunications services in any state. This also reduces the barriers to entry by other potential competitors and therefore increases the level of competition Birch will likely face in all its markets.

Interconnection with ILEC Facilities

A CLEC cannot compete effectively with an ILEC in switched local telephone services unless it is able to connect its facilities with the ILEC and obtain access to certain essential services and resources under reasonable rates, terms and conditions. The Telecommunications Act of 1996 (the Telecommunications Act) imposes a number of access and interconnection requirements on all local exchange carriers (LECs), including CLECs, with additional requirements imposed on ILECs. These requirements will provide access to certain networks under reasonable rates, terms and conditions. Specifically, all LECs, including the Company, must provide the following:

- *Telephone Number Portability.* Telephone number portability enables a customer to keep the same telephone number when the customer switches LECs.

- *Dialing Parity.* All LECs must provide dialing parity, which means that a customer calling to or from a competing LEC network cannot be required to dial more digits than would be required for a comparable call originating and terminating on the other LEC's network.

- *Reciprocal Compensation.* The duty to provide reciprocal compensation means that a carrier must terminate calls that originate on another carrier's network in exchange for compensation.

- *Resale.* LECs generally may not prohibit or place unreasonable restrictions on the resale of their services by other carriers.

- *Access to Rights-of-Way.* All LECs must provide access to their poles, ducts, conduits and rights-of-way to competing carriers on a reasonable, nondiscriminatory basis.

In addition, ILECs must offer local exchange services to resellers at a wholesale rate that is less than the retail rate charged to end users. State commissions are charged with determining the size of this discount. ILECs also must offer access to various unbundled elements of their networks. This requirement allows new entrants to purchase elements of an ILEC's network, at cost-based rates, that may be necessary to provide service to a new entrant's customers. While ILECs are generally required to offer to CLECs interconnection, including reciprocal compensation for mutual termination of traffic, unbundled network elements and services that can be resold by CLECs, ILEC-CLEC interconnection agreements may have short terms, requiring the CLEC to renegotiate the agreements. ILECs may not provide timely provisioning or adequate service quality, thereby impairing a CLEC's reputation with customers who can easily switch back to the ILEC. In addition, the prices set in the agreements or through State Commissions arbitration proceedings may be subject to changes mandated by State Commissions as they develop permanent rules governing interconnection.

The FCC is charged with establishing national guidelines to implement certain portions of the Telecommunications Act. The FCC issued its Interconnection Order on August 8, 1996. In July of 1997, however, the United States Court of Appeals for the Eighth Circuit issued a decision vacating the FCC's pricing rules, as well as certain other portions of the FCC's interconnection rules, on the grounds that the FCC had improperly intruded into matters reserved for state jurisdiction. On January 25, 1999, the Supreme Court largely reversed the Eighth Circuit's order, holding that the FCC has general jurisdiction to implement the local competition provisions of the Telecommunications Act. The Supreme Court stated that the FCC has authority to set pricing guidelines for unbundled network elements, to prevent ILECs from separating existing combinations of network elements, and to establish "pick and choose" rules regarding interconnection agreements (which would permit a carrier seeking interconnection to "pick and choose" among the terms of various other interconnection agreements between the ILECs and other CLECs). This action reestablishes the validity of many of the FCC rules vacated by the Eighth Circuit. Although the Supreme Court affirmed the FCC's authority to develop pricing guidelines, the Supreme Court did not evaluate the specific pricing methodology adopted by the FCC and has remanded the case to the Eighth Circuit for further consideration. In addition, the Supreme Court concluded that it was proper for the FCC to conclude that unbundled network elements could include not only physical facilities such as transmission lines, but also services such as directory assistance, operator services, and vertical switching functions such as caller ID, call waiting, and call forwarding. However, it also vacated the FCC's rule that identifies the unbundled network elements that ILECs must provide to CLECs because the FCC had failed to consider which of those unbundled network elements were "necessary" for the CLEC or would "impair" the ability of the CLEC to provide the services it seeks to offer. The FCC is expected to reconsider the statutory criteria for requiring ILECs to make those network elements available to CLECs during 1999. Thus, while the Supreme Court resolved many issues, including the FCC's jurisdictional authority, other issues remain subject to further consideration by the courts and the FCC, and the Company cannot predict the ultimate disposition of those matters. The possible impact of this decision, including the portion dealing with unbundled network elements, on existing interconnection agreements between ILECs and CLECs or on agreements that may be negotiated in the future, cannot be determined at this time.

In June 1997, SWBT notified Birch and other CLECs in SWBT's service territory that it would not pay or collect reciprocal compensation under interconnection agreements for traffic terminated at an Internet service provider (ISP). On December 31, 1997, Birch filed a petition with the Missouri Public Service Commission to arbitrate the terms of an interconnection agreement between Birch and SWBT. In its pleading, Birch claimed, among other things, that ISP traffic is local in nature, and that the rate of reciprocal compensation payments for traffic to an ISP should be the same as the rate for other local calls. On April 23, 1998, the Missouri Public Service Commission ordered the parties, pending final resolution of these issues by the FCC, to compensate each other for ISP traffic at the same rate as is applicable to other local calls. On February 25, 1999, the FCC (i) adopted an order concluding that dial-up traffic to ISPs is jurisdictionally mixed and appears to be primarily interstate in nature, but that parties are bound by existing interconnection agreements, as interpreted by State Commissions, and thus are subject to reciprocal compensation obligations to the extent provided by such agreements or as determined by State Commissions, and (ii) issued a notice or proposed rulemaking to determine the appropriate compensation arrangements in the future for this type of traffic. If a decision adverse to Birch is issued on any appeal or review of the order of the Missouri Public Service Commission, or a future rule of the FCC eliminates or changes the compensation for ISP traffic, then the ability of Birch to serve existing and future ISP customers profitably would be limited, which could have a material adverse effect on Birch's business, operating results and financial condition.

Birch Interconnection Agreements

Birch has entered into interconnection agreements with SWBT covering Missouri, Kansas and Texas, each of which provides (i) the right to purchase SWBT's local telecommunications services at state-specific wholesale discount percentages (19.2% in Missouri, 21.6% in Kansas, and 21.6% in Texas, in general), and (ii) comprehensive terms covering collocation, interconnection, exchange of traffic between the Birch and SWBT networks, access to rights of way, number portability, and Birch's purchase of unbundled network elements from SWBT for transmission facilities to Birch's customers. On March 16, 1999, SWBT provided notice to Birch of its intention to terminate the Missouri and Texas interconnection agreements at the expiration of their terms (May 21, 1999 and January 22, 2000, respectively), and to negotiate the terms and conditions of successor interconnection agreements. Notwithstanding the notice of termination, each of the Missouri and Texas interconnection agreements provides that they will remain in effect until a replacement agreement has been negotiated by the parties, arbitrated (if necessary to resolve any disputed issues), and approved by the Missouri Public Service Commission or Texas Public Utilities Commission respectively.

SWBT Entry into Long-Distance Service

Birch's principal competitor in each of its markets is SWBT. Section 271 of the Telecommunications Act establishes procedures under which a Bell Operating Company (BOC), like SWBT, can provide services originating from (and in certain cases, terminating in) its telephone exchange service area ("in-region" interLATA service). SWBT is currently permitted to provide interLATA services to customers outside of its telephone exchange service areas ("out-of-region" interLATA service), and other "incidental" interLATA service. Before SWBT can provide non-incidental in-region interLATA service, it must offer interconnection on terms approved by the State Commission and receive approval from the FCC, with input from the U.S. Department of Justice and State Commissions. The interconnection offered by SWBT must comply with a "competitive checklist" that incorporates the interconnection requirements discussed above, as well as other requirements. SWBT sought authority pursuant to Section 271 to enter the in-region interLATA market in Oklahoma, and this application was denied by the FCC on June 26, 1997. SWBT has filed notices with the Missouri Public Service Commission, Kansas Corporation Commission and Texas Public Utilities Commission of its intention to file Section 271 applications with the FCC in the future, but has no other Section 271 applications pending before the FCC at this time. The Texas Public Utilities Commission and Kansas Corporation Commission concluded that SWBT had not yet met the requirements of the competitive checklist in their respective states. The Missouri Public Service Commission held hearings on SWBT's Section 271 filing in March 1999 and is expected to conclude in the near future whether it believes SWBT has met the requirements of the competition checklist in Missouri.

After receiving approval from the FCC as described above, SWBT will be able to provide in-region interLATA services, which will enable it to provide customers with a full range of local and long distance telecommunications services. The provision of interLATA services by SWBT is expected to reduce the market share of the major IXCs, which may be significant customers of Birch's services. Consequently, the entry of the BOCs into the long distance market may have adverse consequences on the ability of CLECs both to generate access revenue from the IXCs and to compete in offering a package of local and long distance services. No BOC has yet won FCC approval to enter the interLATA market, but industry analysts believe approval for the first such entry could occur as early as the fourth quarter of 1999.

Relaxation of Regulation

A long-term goal of the Telecommunications Act is to increase competition for telecommunications services, thereby reducing the need for regulation of these services. To this end, the Telecommunications Act requires the FCC to streamline its regulation of ILECs and permits the FCC to forbear from regulating particular classes of telecommunications services or providers. Because Birch is considered a non-dominant carrier and, therefore, is not heavily regulated by the FCC, the potential for regulatory forbearance likely will be more beneficial to the ILECs than Birch in the long run.

Federal Regulation Generally

Comprehensive amendments to the Communications Act were made by the Telecommunications Act, which was signed into law on February 8, 1996. The Telecommunications Act changed regulation at both the federal and state levels that affect virtually every segment of the telecommunications industry. The stated purpose of the Telecommunications Act is to promote competition in all areas of telecommunications. Through a series of proceedings, the FCC has established different levels of regulation for "dominant carriers" and "non-dominant carriers." Only ILECs are classified as dominant; all other providers of domestic interstate services are classified as non-dominant carriers. As a non-dominant carrier, Birch is subject to relatively limited regulation by the FCC. Birch may offer domestic interstate service without prior FCC approval. Birch must offer interstate services at just and reasonable rates in a manner that is not unreasonably discriminatory.

The FCC has adopted rules requiring ILECs to provide "collocation" to CLECs for the purpose of interconnecting their competing networks. Under the rules adopted by the FCC, ILECs are required to provide either physical collocation or virtual collocation at their switching offices.

As discussed earlier, all LECs, including CLECs, must make their services available for resale by other carriers, provide nondiscriminatory access to rights-of-way, offer reciprocal compensation for termination of traffic and provide dialing parity and telephone number portability. ILECs must offer "equal access" to competing IXCs, making it easier for new IXCs to attract customers. The Telecommunications Act requires all telecommunications carriers to contribute to the universal service mechanism established by the FCC and to ensure that their services are accessible to and usable by persons with disabilities. Moreover, the FCC is currently engaged in a number of rulemakings in which it is considering regulatory implications of various aspects of local exchange competition. Any or all of these proceedings may negatively affect CLECs, including Birch.

The FCC could grant ILECs substantial pricing flexibility with regard to interstate access services. The May 21, 1997 order reforming the FCC's price cap formula affords LECs greater flexibility in establishing rates and provides additional incentives to foster efficiency. To the extent these regulatory initiatives enable or require ILECs to offer selectively reduced rates for access services, the rates Birch may charge for access services will likely be constrained by competitive pressures. Birch's rates also will likely be constrained by the fact that competitors other than the ILECs are subject to the same streamlined regulatory regime as Birch and can price their services to meet competition.

States who have ruled on the issue treat traffic to ISPs terminated in the local exchange as local calls, for which end user customers normally pay fixed monthly charges or low per minute rates up to a cap. ILECs contend that traffic routed to ISPs is interstate in nature and the charge for such calls should be charged at a different rate. As discussed above, on February 25, 1999, the FCC concluded that parties are bound by existing interconnection agreements, as interpreted by State Commissions, and thus are subject to reciprocal compensation obligations to the extent provided by such agreements or as determined by State Commissions, but issued a notice or proposed rulemaking to determine the appropriate compensation arrangements in the future for this type of traffic. Therefore, in the future CLECs might no longer receive the benefit of substantial reciprocal compensation call-termination revenue for CLEC ISP customers.

Federal law also protects the privacy of certain information about telecommunications customers that a carrier such as Birch acquires by virtue of its provision of telecommunications services to such customers. Protected information, known as Customer Proprietary Network Information (CPNI), includes information related to the quantity, technological configuration, type, destination and the amount of use of a telecommunications service. A carrier may not use the CPNI acquired through one of its service offerings to market certain other service offerings without the approval of the affected customers. These restrictions may affect Birch's ability to market a variety of packaged services to existing customers.

State Regulation Generally

Most State Commissions require companies that wish to provide intrastate common carrier services to register or be certified to provide such services. These certifications generally require a showing that the carrier has adequate financial, managerial and technical resources to offer the proposed services in a manner consistent with the public interest. States also impose a variety of other requirements, including service quality, universal service and other obligations on CLECs.

Several states, including Missouri, Kansas and Texas, provide ILECs with flexibility for their rates, special contracts (selective discounting) and tariffs, particularly for services deemed subject to competition. This pricing flexibility increases the ability of SWBT and other ILECs to compete with Birch and constrains the rates Birch may charge for its services. In light of the additional competition that is expected to result from the Telecommunications Act, states may grant ILECs additional pricing flexibility. At the same time, some ILECs may request increases in local exchange rates to offset revenue losses due to competition.

Birch is currently certified by the Missouri Public Service Commission, the Kansas Corporation Commission, and the Texas Public Utilities Commission to provide both local and long distance service in Missouri, Kansas and Texas.

Local Regulation Generally

If Birch desires to install its own transmission facilities, Birch may be required, in certain cities, to obtain from municipal authorities zoning variances, street opening and construction permits, permission to use rights- of-way, and other approvals. Birch also may be required to obtain a franchise to place facilities in public rights of way. In some areas, Birch may be required to pay license or franchise fees for such approvals. There can be no assurances that fees will remain at current levels, or that Birch's competitors will face the same expenses, although the Telecommunications Act does require that any such fees charged by municipalities be reasonable and non-discriminatory as among telecommunications carriers.

Competition

The telecommunications industry is highly competitive. The Company believes that the principal competitive factors affecting its business are customer service, accurate billing, variety of services, and, to a lesser extent, pricing levels and clear pricing policies. The ability of the Company to compete effectively depends upon its continued ability to maintain high quality, market-driven services at prices generally equal to or below those charged by its competitors. To maintain its competitive posture, the Company believes that it must be in a position to reduce its prices in order to meet reductions in rates, if any, by others. Any such reductions could adversely affect the Company. Many of the Company's current and potential competitors have financial, personnel and other resources, including brand name recognition, substantially greater than those of the Company, as well as other competitive advantages over the Company.

Incumbent Local Exchange Carriers

In its existing markets, Birch competes principally with SWBT. As a recent entrant in the telecommunications services industry, Birch has not achieved and does not expect to achieve a significant market share for any of its services in its larger markets. In particular, SWBT and other local telephone companies have long-standing relationships with their customers, have financial, technical and marketing resources substantially greater than those of the Company, have the potential to subsidize competitive services with revenue from a variety of businesses and currently benefit from certain existing regulations that favor these ILECs over Birch in certain respects. While recent regulatory initiatives, which allow CLECs such as the Company to interconnect with ILEC facilities, provide increased business opportunities for Birch, such interconnection opportunities have been (and likely will continue to be) accompanied by increased pricing flexibility for and relaxation of regulatory oversight of the ILECs. Future regulatory decisions could afford ILECs with increased pricing flexibility or other regulatory relief and, such decisions could also have a material adverse effect on the Company.

CLECs/IXCs/Other Market Entrants

The Company also faces, and expects to continue to face, competition from other current and potential market entrants, including long distance carriers competing with Birch's long distance services and seeking to enter, reenter or expand entry into the local exchange market such as AT&T, MCI WorldCom, GTE and Sprint.

Competition also comes from other CLECs, resellers of local exchange services, competitive access providers (CAPs), cable television companies, electric utilities, microwave carriers, wireless telephone system operators and private networks built by large end users. In addition, a continuing trend toward consolidation and strategic alliances of telecommunications companies, as well as the development of new technologies, could give rise to significant new competitors to the Company, putting Birch at a competitive disadvantage. The Telecommunications Act includes provisions which impose certain regulatory requirements on all LECs, including the Company, while granting the FCC expanded authority to reduce the level of regulation applicable to any or all telecommunications carriers, including ILECs. The manner in which these provisions of the Telecommunications Act are implemented and enforced could have a material adverse effect on the Company's ability to compete successfully against ILECs and other telecommunications service providers

The changes in the Telecommunications Act radically altered the market opportunity for traditional CAPs and CLECs. Due to the fact that most existing CAP/CLECs initially entered the market providing dedicated access in the pre-1996 era, these companies had to build a fiber infrastructure before offering services. Since passage of the Telecommunications Act, many CAPs have added switches to become CLECs to take advantage of the opening of the local market. With the Telecommunications Act requiring unbundling of the LEC networks, CAP/CLECs will now be able to more rapidly enter the market by installing switches and leasing trunk and loop capacity until traffic volume justifies building facilities. Newer CLECs, like the Company and some competitors that Birch may encounter in some of its markets, will not have to replicate existing facilities and can be more opportunistic in designing and implementing networks.

In addition to the CLECs, IXCs and other competitors listed above, the Company may face competition from other market entrants such as electric utilities, cable television companies and wireless companies. Electric utilities have existing assets and low cost access to capital which could allow them to enter a market rapidly and accelerate network development. Cable television companies are also entering the telecommunications market. Some cable television companies are upgrading their networks with fiber optics and installing facilities to provide fully interactive transmission of broadband voice, video and data communications. Some cable companies are attempting to offer Internet access and local telephone service over hybrid fiber-coaxial cable systems. Finally, wireless companies have announced intentions to develop wireless technology to be deployed in the United States as a broadband substitute for traditional wireline local telephones.

Long Distance Services

The long distance telecommunications industry 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 by competitors. Prices in the long distance market have declined significantly in recent years and are expected to continue to decline. Birch's primary competitors are the major IXCs and resellers of long distance services. The Company believes that pricing levels are a principal competitive factor in providing long distance service; however Birch seeks to avoid direct price competition by packaging long distance service, local service, CPE and Internet access service together with a simple pricing plan.

CPE

The Company competes with numerous equipment vendors and installers, and telecommunications management companies with respect to CPE sales and related services. Birch generally offers its products at prices consistent with other providers and differentiates its service through its product packages.

Data/Internet Services Providers

The Internet services market is highly competitive, and the Company expects that competition will continue to intensify. Internet service, both Internet access and on-line content services, is provided by ISPs, satellite-based companies, long-distance carriers and cable television companies. Many of these companies provide businesses and individuals with direct access to the Internet and a variety of supporting services. In addition, many companies (such as America Online, Inc., MSN, Prodigy Services Company and WebTV Networks) offer "online" services consisting of access to closed, proprietary information networks with services similar to those available on the Internet, in addition to direct access to the Internet. Long distance companies, for example, are aggressively entering the Internet access markets. Long distance carriers have substantial transmission capabilities, traditionally carry data to large numbers of customers and have an established billing system infrastructure that permits them to add new services. Satellite companies are offering broadband access to the Internet from desktop PCs and cable companies are starting to provide Internet services using cable modems to customers in major markets. Many of these competitors have substantially greater financial, technological, marketing, personnel and other resources than those available to Birch.

Employees

At December 31, 1998, the Company employed approximately 345 persons. Additionally, the Company utilizes temporary employees in some of its processes. The Company is not party to any collective bargaining arrangements. The Company believes that its relationship with its employees is satisfactory.

Risk Factors

This Form 10-K includes "forward looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Although Birch believes that its plans, intentions and expectations reflected in such forward looking statements are reasonable, it can give no assurance that such plans, intentions or expectations will be achieved. Important factors that could cause actual results to differ materially from Birch's forward looking statements are set forth below and elsewhere in this Form 10-K. All forward looking statements attributable to Birch or persons acting on its behalf are expressly qualified in their entirety by the cautionary statements set forth below.

Substantial Future Operating Losses; Negative Cash Flow from Operations

The expansion of Birch's business and the deployment of its services and systems will require significant capital expenditures, a substantial portion of which will need to be incurred before the realization of significant revenue. Birch expects to generate negative earnings before interest, income taxes, depreciation and amortization (EBITDA) while it emphasizes deployment of its switches and further development of its telecommunications services business and until it establishes a sufficient revenue-generating customer base. There can be no assurance that an adequate revenue base will be established. For the year ended December 31, 1998, the Company had an operating loss of $10.9 million, net loss of $16.2 million and EBITDA loss of $8.6 million. See "Management's Discussion and Analysis of Financial Condition and Results of Operations." Birch expects to experience increasing operating losses and negative EBITDA as it expands its operations. There can be no assurance that Birch will achieve or sustain profitability or generate sufficient EBITDA to meet its working capital, capital expenditures and debt service requirements, which could have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow to service the Notes. See "— Substantial Leverage; Ability to Service Indebtedness;" "— Need for Additional Financing" and "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources."

Substantial Leverage; Ability to Service Indebtedness

The Company is highly leveraged. At December 31, 1998 Birch had total long term indebtedness of approximately $115.8 million (most of which consisted of the Senior Notes) and total stockholders' deficit (excluding $14.1 million in aggregate liquidation preference of Series B Preferred Stock) of approximately $7.1 million. For the years ended December 31, 1997 and 1998, earnings were insufficient to cover fixed charges by approximately $1.8 million and $16.2 million, respectively. The Company and its subsidiaries are permitted to incur substantial additional indebtedness in the future.

The ability of the Company to fund the capital expenditures and other costs contemplated by its business plan and to make scheduled payments with respect to the Senior Notes will depend upon, among other things, its ability to seek and obtain additional financing within the next year, to implement its business plan, to deploy its network and expand its operations, and to obtain and retain a significant number of customers in its target markets, and the future operating performance of Birch and its subsidiaries. Each of these factors is, to a large extent, subject to economic, financial, competitive, political, regulatory and other factors, many of which are beyond Birch's control. Birch expects that it will generate operating losses for the foreseeable future and that its business will not generate positive cash flow for the foreseeable future. In addition, the Company will require significant amounts of additional financing, which may not be available, before it will be able to generate positive cash flow. No assurance can be given that Birch will be successful in developing and maintaining a level of cash flow from operations sufficient to permit it to pay the principal of, and interest and any other payments, if any, on the Senior Notes. If Birch is unable to generate sufficient cash flow from operations to service its indebtedness, including the Senior Notes, it may have to modify its growth plans, limit its capital expenditures, restructure or refinance its indebtedness, seek additional capital or liquidate its assets. There can be no assurance (i) that any of these strategies could be effected on satisfactory terms, if at all, in light of Birch's high leverage or (ii) that any such strategy would yield sufficient proceeds to service the Senior Notes. Any failure by Birch to satisfy its obligations with respect to the Senior Notes at maturity or prior thereto would constitute a default under the agreements governing the Senior Notes (Indenture) and could cause a default under agreements governing other indebtedness of Birch. See "— Limited History of Operations as a Combined Organization," "— Need for Additional Financing" and "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources."

The degree to which Birch is leveraged could have important consequences to holders of the Senior Notes, including (i) making it more difficult for Birch to satisfy its obligations with respect to the Senior Notes; (ii) increasing Birch's vulnerability to general adverse economic and industry conditions; (iii) limiting Birch's ability to obtain additional financing to fund its expected capital expenditures for the next two years, future working capital (including anticipated future operating losses), or other general corporate requirements; (iv) requiring the dedication of a substantial portion of Birch's cash flow from operations (if any) to the payment of principal of, and interest on, its indebtedness, thereby reducing the availability of such cash flow to fund working capital, capital expenditures or other general corporate purposes; (v) limiting Birch's flexibility in planning for, or reacting to, changes in its business and the telecommunications industry; (vi) limiting Birch's ability to expand into new markets; and (vii) placing Birch at a competitive disadvantage relative to less leveraged competitors. In addition, Birch's operating and financial flexibility will be limited by covenants contained in agreements governing the indebtedness of Birch, including the Indenture. Among other things, the covenants in the Indenture limit, and covenants in agreements governing other indebtedness will likely limit, the ability of Birch and its subsidiaries to incur additional indebtedness, issue preferred stock, pay dividends or make distributions to its stockholders or to make certain other restricted payments, create certain liens upon assets, apply the proceeds from the disposition of certain assets or enter into certain transactions with affiliates. There can be no assurance that such covenants will not adversely affect Birch's ability to finance its future operations or capital needs or to engage in other business activities which may be in the interests of Birch.

The Company currently anticipates that, in order to pay the principal of the Senior Notes or to redeem or repurchase the Senior Notes upon a change of control, Birch may be required to adopt one or more alternatives, such as refinancing its indebtedness or selling its equity securities or the equity securities or assets of its subsidiaries. There can be no assurance that any of the foregoing actions could be effected on satisfactory terms, that any of the foregoing actions would enable the Company to pay the principal amount of the Senior Notes or that any of such actions would be permitted by the terms of the Indenture or any of the debt instruments of Birch or Birch's subsidiaries then in effect.

Need for Additional Financing

Birch expects to make significant capital outlays for the foreseeable future in order to continue the development activities called for in its current business plan and thereafter and to fund expected operating losses. In order for the Company to implement its current business plan and finance its projected capital expenditures, Birch will be required to seek and obtain significant amounts of additional financing (debt and/or equity) within the next year. The Company's ongoing expansion into Texas is dependent upon raising substantial additional financing in the near term. If Birch's plans or assumptions change, if its assumptions prove to be inaccurate, or if it experiences unanticipated costs or competitive pressures, Birch will be required to seek additional capital sooner than currently anticipated, possibly within the next six months. In particular, if Birch elects to pursue significant additional acquisition opportunities or to deploy more switches than currently planned, its cash needs may be increased substantially. There can be no assurance that Birch's current projection of cash flow (and losses) from operations (which will depend upon numerous future factors and conditions, many of which are outside of Birch's control) will be accurate. Because Birch's cost of developing new networks and services, funding other strategic initiatives and operating its business will depend on a variety of factors (including the number of subscribers and the service for which they subscribe, the nature and penetration of services that may be offered by Birch, regulatory changes, changes in technology and actions taken by competitors in response to Birch's strategic initiatives), it is almost certain that actual costs and revenue will vary from expected amounts, very likely to a material degree, and such variations are likely to affect Birch's future capital requirements. Birch intends to seek additional debt and/or equity financing necessary to fund Birch's liquidity needs. There can be no assurance that Birch will be able to raise additional capital on satisfactory terms or at all. If Birch decides to raise additional funds through the incurrence of debt, its interest obligations will increase and it may become subject to additional or more restrictive financial covenants. For example, Birch's ability to access the cash flow of its subsidiaries may be restricted by such future debt covenants. If Birch decides to raise additional funds through the issuance of equity, equity holders will be diluted. In the event that Birch is unable to obtain such additional capital or to obtain it on acceptable terms or in sufficient amounts, Birch will be required to delay the development of its network or take other actions that could have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources."

Limited History of Operations as a Combined Organization

Birch commenced operations on January 1, 1997 and merged with Valu-Line in February 1998. Prior to the merger, Birch had been a development stage company with no revenue. While Valu-Line has a 15-year operating history, it only has been under the guidance of Birch management for about one year. Additionally, in 1998, Birch acquired Boulevard, Telesource and TFSnet, and in 1999, Capital and ALT. Prospective investors, therefore, have limited financial or operating information about Birch as a combined organization. Birch's viability, profitability and growth depend upon its ability to successfully integrate its acquired companies. The implementation of Birch's business plan will be subject to numerous risks, many of which are outside of its control and any of which could require substantial changes to proposed plans or otherwise alter the time frames or budgets currently contemplated. Such risks include (i) risks related to the integration of Birch's acquired companies into a cohesive and efficient enterprise; (ii) the risks of unfavorable regulatory changes; (iii) the need to obtain required governmental and local regulatory approvals; (iv) the need to negotiate acceptable purchase, lease, joint venture and other agreements, including interconnection agreements with SWBT, other ILECs and long distance service providers; (v) identifying, financing and completing suitable acquisitions; (vi) risks associated with developing its operational support and back office systems; (vii) risks associated with entry into new markets; (viii) risks associated with recruiting and training new employees; and (ix) risks typically associated with any business venture, such as unanticipated cost increases. There can be no assurance that the implementation of Birch's current business plan will be successful, and the failure to integrate Birch's acquired companies successfully would have a material adverse effect on Birch's business, operating results and financial condition.

Risks Associated with Acquisitions

Birch's current business plan contemplates future acquisitions and may result in acquisitions of companies that are larger than Birch. Future acquisitions by Birch could result in the incurrence of debt or contingent liabilities, which could have a material adverse effect on Birch's business, financial condition and results of operations. Such transactions commonly involve certain risks, including, among others: the difficulty of assimilating the acquired operations and personnel; the potential disruption of Birch's ongoing business and diversion of resources and management time; the possible inability of management to maintain uniform standards, controls, procedures and policies; the risks of entering markets in which Birch has little or no direct prior experience; and the potential impairment of relationships with employees or customers as a result of changes in management. There can be no assurance that any future acquisition will be made, that Birch will be able to obtain additional financing needed to finance such acquisitions and, if any acquisitions are so made, that the acquired business will be successfully integrated into Birch's operations or that the acquired business will perform as expected. The failure to integrate any such future acquisition successfully would have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow.

Business Expansion Risks; Possible Inability to Manage Growth

Birch's business strategy contemplates expanding its operations rapidly into new markets. Birch's success will depend, among other things, upon Birch's ability to secure significant amounts of additional financing, assess potential markets, obtain required governmental authorizations and permits, provision new customers, implement interconnection and collocation with ILEC facilities, lease adequate trunking capacity from ILECs or other CLECs, purchase and install switches in additional markets, implement efficient operations support systems and other back office systems, and develop a sufficient customer base. The successful implementation of Birch's business plan will result in rapid expansion of its operations. Rapid expansion of Birch's operations may place a significant strain on Birch's management, financial and other resources. See "— Need for Additional Financing."

The Company's ability to manage future growth, should it occur, will depend upon its ability to develop efficient operations support systems and other back office systems, monitor operations, control costs, maintain regulatory compliance, maintain effective quality controls and significantly expand Birch's internal management, technical, information and accounting systems and to attract, assimilate, train and retain additional qualified personnel, including sales, marketing and technical personnel. See "— Dependence on New Employees." Failure of Birch to manage its future growth effectively could adversely affect the expansion of Birch's customer base and service offerings. There can be no assurance that the Company will successfully implement and maintain such operational and financial systems or successfully obtain, integrate and utilize the employees and management, operational and financial resources necessary to manage a developing and expanding business in an evolving, highly regulated and increasingly competitive industry. Any failure to expand these areas and to implement and improve such systems, procedures and controls in an efficient manner at a pace consistent with the growth of Birch's business could have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow.

If Birch were unable to hire sufficient qualified personnel or develop, acquire and integrate successfully its operational, customer service and other information systems, customers could experience delays in connection of service and/or lower levels of customer service. Failure by Birch to meet the demands of customers and to manage the expansion of its business and operations could have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow.

Regulation

Birch is subject to, and benefits from, varying degrees of federal, state, and local regulation of its business and the businesses of its competitors. On the federal level, Birch is not currently subject to rate regulation, nor is it currently required to obtain FCC authorization for the installation, acquisition, or operation of its network facilities. Birch's subsidiaries that provide intrastate services are generally subject to certification and tariff-filing requirements by state regulators. In addition, Birch must comply with various state and federal obligations, such as the duty to contribute to universal service subsidies, the impact of which cannot yet be fully assessed. Failure to comply with federal and state reporting and regulatory requirements may result in fines or other penalties, including loss of certification to provide services.

The Telecommunications Act, state laws, the rules of the FCC and State Commissions may provide ILECs with increased pricing flexibility for their services and other regulatory relief, which could have a material adverse effect on CLECs, including Birch. There can be no assurance that future regulatory provisions will not be less favorable to CLECs and more favorable to their competitors. If ILECs like SWBT are allowed by regulators to lower the rates for their services, to engage in substantial volume and term discount pricing practices for their customers, or to charge CLECs unreasonable fees for interconnection to the ILECs' networks, Birch's business, operating results and financial condition could be materially adversely affected. ILECs 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. For example, SWBT has refused to pay reciprocal compensation to Birch for calls to ISPs. See "Business — Regulation — Interconnection with ILEC Facilities." Increased local exchange competition resulting from various legislative initiatives, including the Telecommunications Act, may allow BOCs such as SWBT to provide long distance services under provisions of the Telecommunications Act more quickly than had earlier been anticipated. When SWBT is permitted to provide such services, it will be in a position to offer integrated local and long distance service, subject to certain regulatory constraints, and Birch will no longer enjoy the competitive advantage of being one of the only companies in its markets to offer integrated local and long distance service and billing. See "Business — Regulation — SWBT Entry into Long-Distance Service."

There are currently many regulatory actions under way and being contemplated by federal and state authorities regarding interconnection pricing and other issues that could result in significant changes to the business conditions in the telecommunications industry. State Commissions determine the size of the wholesale discount at which ILECs must offer local exchange services to resellers. Prices set forth in interconnection agreements or through proceedings before State Commissions may be subject to changes mandated by State Commissions as they develop permanent rules governing interconnection. No assurance can be given that changes in current or future regulations adopted by the FCC or state regulators, or other legislative, administrative, or judicial initiatives relating to the telecommunications industry, would not have a material adverse effect on Birch's business, operating results and financial condition. In particular, Birch's belief that the entire local exchange market will open to CLEC competition depends upon continued favorable pro-competitive regulatory changes, and the ability of Birch to compete in these new market segments may be adversely affected by the greater pricing flexibility and other regulatory relief granted to ILECs under the Telecommunications Act and under changes in state regulatory policy. See "Business — Regulation."

Competition

The telecommunications industry is highly competitive. Birch expects it will face substantial and increasing competition from a variety of service providers due to regulatory changes and a trend toward business combinations and alliances in the market. Birch faces competition from integrated service providers as well as entities that serve individual market segments targeted by Birch. In each of the cities served by Birch's networks, the services offered by Birch compete principally with the services offered by the ILEC serving that area. ILECs, like SWBT, have established networks, long-standing relationships with their customers, strong political and regulatory influence, the potential to subsidize competitive services from monopoly service revenue, and the benefit of state and federal regulations that, until recently, have favored ILECs. In the local exchange market, the ILECs continue to hold near-monopoly positions. Other ILECs are already offering in-region long distance services.

Birch also expects to face competition from other current and potential market entrants, including other CLECs, IXCs, cable television companies, electric utilities, microwave carriers, wireless telephone system operators, and private networks built by large end users. The Telecommunications Act facilitates such entry by requiring ILECs to allow new entrants 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 ILECs, or among CLECs in smaller markets, or transactions between telephone companies and cable companies, or between IXCs and CLECs, could give rise to significant new competitors. Many of Birch's current and potential competitors have financial, personnel, and other resources, including broad name recognition, substantially greater than those of Birch, as well as other competitive advantages over Birch.

The World Trade Organization (WTO) agreement on basic telecommunications services could increase the level of competition faced by Birch. Under this agreement, the United States and 68 other members of the WTO committed themselves to opening their respective telecommunications markets, including permitting foreign entry into basic telecommunications services markets and adopting regulatory measures to protect competitors against anticompetitive behavior by dominant telecommunications companies, effective in some cases as early as January 1998. The FCC has introduced streamlined processing of applications to facilitate entry into the U.S. market by entities of WTO-member origin. There can be no assurance that the pro-competitive effects of the WTO agreement will not have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow to service the Senior Notes.

Birch currently purchases all of its resold local services from SWBT and is therefore heavily dependent on the availability of the network of SWBT. To the extent Birch interconnects with and uses the networks of other ILECs, CLECs, and fiber optic transport providers to service its customers, Birch is and will be dependent upon the technology and capabilities of those carriers to meet certain telecommunications needs of Birch's customers and to maintain its service standards. Birch must interface with the ILEC's operations support systems in order to properly provision new customers. There can be no assurance that Birch will be able to obtain the interconnection it requires at rates and on terms and conditions that permit Birch to offer switched services that are both competitive and profitable. See "— Reliance on Leased Transport Facilities and ILEC Interconnection; Relationship with SWBT." In the event that Birch experiences difficulties in obtaining high quality, reliable and reasonably priced services from SWBT and other carriers, the attractiveness of Birch's services to its customers would be significantly impaired.

The long distance telecommunications market 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. The Company will face competition from large carriers such as AT&T, MCI WorldCom and Sprint. Other competitors are likely to include BOCs providing out-of-region (and, with the removal of regulatory barriers, in-region) long distance services, other ILECs, other CLECs, microwave and satellite carriers and private networks owned by large end users. See "— Regulation."

The FCC may authorize a BOC to provide interLATA (Local Access and Transport Area) services in a state when the BOC satisfies 14 specified interconnection requirements and receives approval from the FCC. In evaluating a BOC application for interLATA entry, the FCC must consult with the U.S. Department of Justice and the applicable State Commission. If and when SWBT obtains authority to provide interLATA services in a state, it will be able to offer customers local and long distance telephone services. This will permit SWBT to offer a full range of services to potential customers in that state and thus eliminate an existing competitive advantage of Birch. Given the resources and experience that SWBT currently possess in the local exchange market, the ability to provide both local and long distance services could make SWBT a very strong competitor. See "Business — Regulation — SWBT Entry into Long-Distance Service."

The Company competes with equipment vendors and installers, and telecommunications management companies with respect to certain portions of its business.

The Internet services market is also highly competitive and the Company expects that competition will continue to intensify. Birch's competitors in this market will include other Internet service providers, other telecommunications companies, on-line services providers and Internet software providers. Many of these competitors have substantially greater financial, technological, marketing, personnel and other resources than those available to Birch.

The Company believes that the principal competitive factors affecting its business operations are service quality, network reliability, reliable customer service, accurate billing and variety of services, to a lesser extent, pricing levels and clear pricing policies. The ability of Birch to compete effectively will depend upon its ability to maintain high quality, market-driven services at prices generally equal to or below those charged by its competitors. To maintain its competitive posture, the Company believes that it must be in a position to reduce its prices in order to meet reductions in rates, if any, offered by others. Any such reductions could adversely affect Birch's business, operating results and financial condition. See "Business — Competition."

Reliance on Leased Transport Facilities and ILEC Interconnection; Relationship with SWBT

Because Birch has elected to lease transport capacity, it is dependent upon the availability of fiber optic transmission facilities owned by ILECs (in particular SWBT), CLECs and other fiber optic transport providers whose fiber optic networks are being or will be leased by Birch. The risks inherent in this approach include, but are not limited to, negotiating and renewing favorable supply agreements, and the timeliness of the ILECs, CLECs or other fiber optic transport providers in processing Birch's orders for customers who seek to utilize Birch's service. Alternatively, if and when Birch seeks to install its own fiber, Birch must obtain permits, access to rights-of-way, and permission to utilize underground conduit and aerial pole space from entities such as ILECs and other utilities, railroads, long distance companies, state highway authorities, local governments and transit authorities, and may be required to obtain franchises from municipal governments. There can be no assurance that Birch will be able to obtain and maintain the franchises, permits and rights needed to implement its network buildout on acceptable terms.

The failure to enter into and maintain any such required arrangements for a particular network may affect Birch's ability to develop that network and may have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow.

In addition to transport providers, the Company is reliant on executing interconnection agreements with the ILECs, in particular SWBT, operating in its target markets. Birch's interconnection agreements with SWBT in Missouri, Kansas and Texas currently provide that Birch's connection and maintenance orders will be executed at parity with SWBT's customers and that SWBT will provide adequate trunking capacity to keep call blockage within industry standards. Accordingly, Birch and its customers are currently dependent on SWBT and will in the future be dependent on other ILECs to assure uninterrupted service. Blocked calls result in customer dissatisfaction and risk the loss of business. ILEC-CLEC interconnection agreements, such as the agreements between SWBT and certain operating subsidiaries of Birch, typically may have short terms, requiring Birch to renegotiate the agreements continually. ILECs may not provide timely provisioning or adequate service quality, thereby impairing Birch's reputation with customers who can easily switch back to the ILEC. In addition, the prices set in the agreements may be subject to significant rate increases at the discretion of the states. There can be no assurance that ILECs like SWBT will comply with their network provisioning requirements, or that Birch will be able to procure interconnections in other markets on terms comparable to the interconnection agreements Birch currently has in place. In addition, there can be no assurance that the rates charged to Birch under such interconnection agreements will allow Birch to offer low enough usage rates to attract a sufficient number of customers and to operate its business profitably. See "Business — Regulation — Birch Interconnection Agreements."

As described above, Birch is reliant on the continued cooperation of and the continued lack of competition from SWBT. Any extended interruption in SWBT's cooperation could disrupt Birch's operations and have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow. It is also possible that SWBT may expand and refocus its product offerings and networks to compete directly with Birch. Accordingly, there can be no assurance that SWBT will continue to lease transport capacity to Birch or that SWBT will continue to renew the interconnection agreements it has with Birch, which would have a material adverse effect on Birch's business, financial condition and results of operations.

Risks Relating to Long Distance Business

As part of its offering of a package of telecommunications services to its customers, Birch offers long distance services to its customers. The long distance business is extremely competitive and prices have declined substantially in recent years and are expected to continue to decline. In addition, the long distance industry has historically had a high average churn rate, as customers frequently change long distance providers in response to the offering of lower rates or promotional incentives by competitors. Birch will initially rely on other carriers to provide transmission and termination services for all of its long distance traffic. Birch will need resale agreements with long distance carriers to provide it with transmission services. Such agreements typically provide for the resale of long distance services on a per-minute basis and may contain minimum volume commitments. Negotiation of these agreements involves estimates of future supply and demand for transmission capacity as well as estimates of the calling patterns and traffic levels of Birch's future customers. In the event Birch fails to meet its minimum volume commitments, it may be obligated to pay underutilization charges and in the event it underestimates its need for transmission capacity, Birch may be required to obtain capacity through more expensive means. The incurrence of any underutilization charges, rate increases or termination charges could have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow.

Dependence on Billing, Customer Service and Information Systems

Sophisticated back office information and processing systems are vital to Birch's growth and its ability to monitor costs, bill customers, provision customer orders, provide customer service and achieve operating efficiencies. Birch's plans for the development and implementation of these operations support systems rely, for the most part, on choosing products and services offered by third party vendors and integrating such products and services in-house to produce efficient operational solutions. There can be no assurance that these systems will be successfully implemented on a timely basis or that they will perform as expected. Failure of these vendors to deliver proposed products and services in a timely and effective manner and at acceptable costs, failure by Birch to adequately identify all of its information and processing needs, failure of Birch's related processing or information systems, failure by Birch to integrate effectively such products or services, or the failure by Birch to upgrade systems as necessary could have a material adverse effect on Birch. In addition, Birch's right to use these systems is dependent upon license agreements with third party vendors. Certain of such agreements may be cancelable by the vendor and the cancellation or nonrenewal of these agreements may have an adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow.

Risk of New Service Acceptance by Customers

The success of Birch's service offerings will be dependent upon, among other things, the willingness of customers to accept Birch as a new provider of telecommunications services. There can be no assurance that Birch will be successful in overcoming the resistance of customers or that customers will be willing to contract for Birch's services. The lack of such acceptance could have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow.

Rapid Technological Change

The telecommunications industry is subject to rapid and significant changes in technology. Birch will be subject to competitive threats from new technology that becomes available before and after its networks are built. The effect of technological changes on the businesses of Birch, however, cannot be predicted. Birch believes its future success will depend, in part, on its ability to anticipate and adapt to such changes and to offer, on a timely basis, services that meet customer demands. Thus, there can be no assurance that technological developments will not have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow.

Risk of Loss or Reduction of Access Charge Revenues

A portion of Birch's revenue comes from access charges, which are paid to Birch by long distance carriers for originating and terminating calls to customers served by Birch. The amount of access charge revenue that Birch receives is calculated based on guidelines set by federal and state regulatory bodies, and such guidelines could change at any time. These circumstances could have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow. See "Business — Telecommunications Services" and "Business — Regulation — Federal Regulation Generally."

Difficulties in Implementing Enhanced Service Features

Birch has begun, and plans to continue, to deploy switches in the cities in which it will operate networks and plans initially to rely on ILEC or CLEC facilities for certain aspects of interconnection. Subject to obtaining interconnection with SWBT, Birch will be able to offer a variety of enhanced service features (such as voicemail, call waiting, caller ID and call forwarding). Although under the Telecommunications Act the ILECs will be required to unbundle network elements and permit Birch to purchase only the origination and termination services it needs, there can be no assurance that such unbundling will be effected in a timely manner and result in prices favorable to Birch. In addition, Birch's ability to implement successfully its enhanced service features will require the negotiation of resale agreements with ILECs and other CLECs and the negotiation of interconnection and collocation agreements with ILECs, which can take considerable time, effort and expense and are subject to federal, state and local regulation.

Birch's enhanced service features may not be profitable due to, among other factors, lack of customer demand, inability to secure access to ILEC facilities on acceptable terms, and competition and pricing pressure from the ILECs and other CLECs. There can be no assurance that Birch will be able to successfully implement its switched and enhanced service features strategy.

Control of Company by Current Stockholders

As of December 31, 1998, the executive officers and directors of the Company beneficially owned 14,103,752 shares of Common Stock, representing approximately 60.1% of the Common Stock on a fully-diluted basis. The Company's executive officers and directors as a group will be able to exercise significant influence over such matters as the election of the directors of the Company and other fundamental corporate transactions, such as mergers, assets sales and the sale of the Company. In addition, the Purchasers Rights Agreement (as defined) provides that each of the parties thereto will vote in favor of the election of certain designees to the Company's Board of Directors. See "Security Ownership of Certain Beneficial Owners and Management," "Certain Relationships and Related Party Transactions — Purchasers Rights Agreement".

In addition, the Company may adopt certain procedural and other requirements or amend its Certificate of Incorporation or By-Laws in a manner that could have the effect of delaying, deterring or preventing a change in control of the Company or make it more difficult for stockholders to effect certain corporate actions, including the ability to replace incumbent directors and to accomplish transactions opposed by the incumbent Board of Directors.

Dividend Policy

The Company has no plans to pay cash dividends on its Common Stock in the foreseeable future. The declaration and payment of any dividends in the future will be determined by the Board of Directors, in its discretion, and will depend on a number of factors, including the Company's earnings, capital requirements and overall financial condition. In addition, the Company's ability to declare and pay dividends will be substantially restricted under the terms of the Indenture.

Dependence on Key Personnel

Birch's business is managed by a small number of key executive officers, particularly David E. Scott, Birch's President and Chief Executive Officer, Jeffrey D. Shackelford, Birch's Senior Vice President of Sales, Gary L. Chesser, Birch's Senior Vice President of Engineering and Operations, David W. Vranicar, Birch's Senior Vice President of Business Development, Bradley A. Moline, Birch's Senior Vice President of Finance and Chief Financial Officer, Donald H. Goldman, Birch's Senior Vice President of Internet Services, Gregory C. Lawhon, Birch's Senior Vice President of Public Policy and General Counsel, and Stephen L. Sauder, Vice President of Birch, the loss of any of whom could have a material adverse effect on Birch's business, operating results and financial condition. Birch believes that its future success will depend in large part on its continued ability to attract and retain highly skilled and qualified executive personnel. See "Part III, Item 10, Directors and Executive Officers of the Registrant."

Dependence on New Employees

Birch's future success will depend in large part on its ability to obtain the services of motivated technical, information systems, marketing, and sales personnel. Birch is particularly dependent on its ability to identify, hire, train, retain, and manage highly skilled and experienced network engineers to execute the installation, development, and operation of Birch's networks, as well as sales and marketing personnel to create and expand Birch's customer base. The pace of growth of the CLEC industry may make it difficult to recruit qualified labor for key functions, particularly general managers, sales representatives, sales management, public policy experts, technicians, engineers, and operations management. Because many of Birch's markets are small, finding the right employees who are willing to relocate may be more difficult. There can be no assurance that Birch will be able to obtain or retain the services of additional personnel necessary for Birch's growth.

Risk of System Failure

Birch's operations are dependent upon its ability to protect its network infrastructure against damage from fire, earthquakes, floods, power loss, and similar events and to construct networks that are not vulnerable to the effects of such events. The occurrence of a natural disaster or other unanticipated problem at Birch's facilities or at the sites of its switches could cause interruptions in the services provided by Birch. The failure of a switch would result in interruption of service to the customers served by such switch until necessary repairs were effected or replacement equipment were installed. Additionally, failure of the other telecommunications providers to provide the data communications capacity required by Birch as a result of natural disaster, operational disruption or for any other reason could cause interruptions in the services provided by Birch. Any damage or failure that causes interruptions in Birch's operations could have a material adverse effect on Birch's business, financial condition and results of operations.

Year 2000 Issue

All companies that rely on computers face an issue as the year 2000 approaches. The "year 2000" problem is the result of the past practice in the computer industry of computer programs using two digits rather than four to define the applicable year. This practice will result in incorrect results when computers perform arithmetic operations, comparisons or data field sorting involving years later than 1999. Any of Birch's computer programs that have date-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or miscalculations causing disruptions of operations, including, among other things, a temporary inability to process transactions, send invoices, or engage in similar normal business activities. Based on ongoing assessments, the Company has determined that it will be required to modify or replace portions of its software so that its computer systems will function properly with respect to dates in the year 2000 and thereafter. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

There can be no assurance until the year 2000 that Birch's systems will be year 2000 compliant. In addition, Birch uses SWBT's facilities to service its customers, and such facilities currently utilize numerous date-sensitive computer applications. If SWBT's facilities are not year 2000 compliant, or if the systems of other ILECs, long-distance carriers and others upon which Birch relies are not year 2000 compliant, it would have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow.

ITEM 2. PROPERTIES

At December 31, 1998, the Company owned or leased the following facilities:

Location	Function	Approximate Square Feet	Lease/Own	Expiration Date of Lease
Kansas City, MO	Company Headquarters, Engineering & Operations	30,000	Lease	Month-to-Month
Kansas City, MO	Future Company Headquarters, Engineering & Operations	47,000	Lease	March 2007
Kansas City, MO	Sales Office	3,000	Lease	Month-to-Month
Kansas City, MO	Switch Site	8,300	Lease	March 2003
Emporia, KS	Customer Care Center & Customer Premises Equipment	58,500	Own	N/A
Emporia, KS	Advertising & Print Shop	3,000	Lease	Month-to-Month
Sunset Hills (St. Louis), MO	Sales Office	3,000	Lease	June 2002
Maryland Heights (St. Louis), MO	Switch Site	5,100	Lease	November 2008
Wichita, KS	Sales Office	2,000	Lease	May 2001
Wichita, KS	Switch Site	6,300	Lease	September 2008
Wichita, KS	Switch Site	1,100	Lease	August 2000
St. Joseph, MO	Sales Office	1,500	Lease	November 1999
Topeka, KS	Sales Office	2,100	Lease	April 2003
Salina, KS	Sales Office & Customer Premises Equipment Warehouse	5,000	Own	N/A
Manhattan, KS	Sales Office & Warehouse	5,000	Lease	Month-to-Month
Dodge City, KS	Sales Office	1,000	Lease	Month-to-Month
Tyler, TX	Sales Office	2,500	Lease	January 2002
Waco, TX	Sales Office	2,600	Lease	December 2001
Beaumont, TX	Sales Office	3,300	Lease	December 2001
Longview, TX	Sales Office	1,000	Lease	December 1999
Mission (Kansas City), KS	Internet Operations	1,000	Lease	December 1999
Overland Park (Kansas City), KS	Shared Tenant Services	3,200	Lease	September 2001
Lawrence, KS	Sales Office	775	Lease	May 1999
Irving, TX	Sales Office	1,000	Lease	Month-to-Month
Leawood (Kansas City), KS	Customer Premises Equipment	2,300	Lease	December 1999

ITEM 3. LEGAL PROCEEDINGS

Birch knows of no pending or threatened material litigation or proceedings involving the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

During the fourth quarter of 1998, the Company initiated the solicitation of stockholder approval for a proposal to (i) increase the authorized size of the Company's Board of Directors from five to seven, and (ii) to increase the number of shares of the Company's common stock authorized for issuance under the Company's 1998 Stock Option Plan to 6,195,845.

Part II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

a) Market Information

There is no established public trading market for the Company's Common Stock

b) Holders

As of March 29, 1999, there were 81 holders of record of the Company's Common Stock.

c) Dividends

The Company has not paid any cash dividends on its Common Stock since its inception and does not intend to pay any dividends on its Common Stock in the foreseeable future.

d) Recent Sales of Unregistered Securities

In February 1998, Birch merged with Valu-Line Companies, Inc. (Valu-Line) in a transaction valued at $19.5 million, consisting of $4.75 million in cash, 2,968,750 shares of Series A Preferred Stock of the Company having an aggregate liquidation preference of $4.75 million, and 6,593,750 shares of Series C Preferred Stock having an aggregate liquidation preference of $10.0 million. Valu-Line, founded in 1982, has been primarily providing switched long distance services, CPE sales and services and, since March 1997, local service in selected smaller markets throughout the state of Kansas. The securities in connection with the merger were issued pursuant to an exemption from registration provided by Section 4(2) of the Securities Act of 1933.

On March 13, 1998, Birch completed a private placement of 6,264,063 shares of its Series B Preferred Stock having an aggregate liquidation preference of $9.5 million and $3.5 million in aggregate principal amount of convertible notes, raising aggregate net proceeds of approximately $12.4 million which were used to pay the cash portion of the consideration for the Valu-Line merger, to repay certain debt and for general corporate purposes. In June 1998, the convertible notes were converted into 2,307,965 shares of Series B Preferred Stock of the Company. The securities in connection with this private placement were issued pursuant to an exemption under Rule 506 promulgated under Section 4(2) of the Securities Act of 1933.

During June 1998, the Company completed a $115 million private offering of 14% Senior Notes (the Senior Notes) due June 2008 and 115,000 warrants to purchase 1,409,734 shares of Common Stock of the Company. The warrants are exercisable at $0.01 per share and expire June 2008. The Company received net proceeds from the Senior Notes of $110.2 million and concurrently purchased pledged securities of $44.2 million. The pledged securities are restricted for interest payments on the Senior Notes and, together with the interest accruing thereon, will be used to satisfy such interest payments through June 2001. The Senior Notes were issued pursuant to Rull 144A promulgated under the Securities Act of 1933. The Senior Notes were subsequently exchanged for substantially identical 14% notes due June 2008 that had been registered under the Securities Act of 1933 in an exchange offer that expired in March 1999.

In February 1999, Birch acquired American Local Telecommunications, L.L.C. (ALT), a local service provider in the Dallas metropolitan area for $700,000 in cash and stock. The securities in connection with the merger were issued pursuant to an exemption from registration provided by Section 4(2) of the Securities Act of 1933.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA

The following table sets forth selected consolidated financial data and should be read in conjunction with and is qualified by reference to "Management's Discussion and Analysis of Financial Condition and Results of Operations," the Consolidated Financial Statements of the Company, the notes thereto and the other financial data contained elsewhere in this Form 10-K.

	Year Ended December 31,					
	The Predecessor[1]				The Company	
	1994	1995	1996	1997	1997	1998
	(Dollars in thousands)					
Statement of Operations Data:						
Revenue	$ 10,741	$ 12,226	$ 13,217	$ 16,801	$ -	$ 26,087
Cost of services	6,713	8,284	8,749	11,842	-	18,886
Gross margin	4,028	3,942	4,468	4,959	-	7,201
Selling, general and administrative	3,022	3,520	3,561	4,067	1,776	15,769
Depreciation and amortization	199	189	311	341	27	2,308
Income (loss) from operations	807	233	596	551	(1,083)	(10,876)
Interest, net	48	58	102	97	(14)	(5,332)
Income (loss) before income taxes	759	175	494	454	(1,789)	(16,208)
Provision for income taxes	319	81	205	186	-	-
Net income (loss)	$ 440	$ 94	$ 289	$ 268	(1,789)	(16,208)
Preferred stock dividends					-	1,696
Amortization of preferred stock issuance costs					-	29
Loss applicable to common stock					$ (1,789)	$ (17,933)
Weighted average shares outstanding – basic and diluted					1,235	3,809
Loss per common share – basic and diluted					$ (1.45)	$ (4.71)

[1]The Predecessor company is Valu-Line which merged with Birch during February 1998. Prior to February 1998, Birch had no revenues and was in the developmental stage.

	December 31,					
	The Predecessor				The Company	
	1994	1995	1996	1997	1997	1998
	(Dollars in thousands)					
Balance Sheet Data:						
Cash and cash equivalents	$ 333	$ 96	$ 158	$ 258	$ 210	$ 39,745
Pledged securities	-	-	-	-	-	37,785
Property and equipment	2,063	2,265	2,721	2,964	128	26,900
Total assets	3,748	3,971	3,868	4,802	534	134,149
Long-term debt and capital lease obligations	1,188	1,431	792	681	-	115,791
Redeemable preferred stock	-	-	-	-	-	14,063
Total stockholders' equity (deficit)	1,014	1,108	1,397	1,665	29	(7,099)
Other Financial Data:						
Cash flows from operating activities	$ 568	$ (267)	$ 834	$ 488	$ (1,464)	$ (10,643)
Cash flows from investing activities	(753)	(230)	(513)	(243)	(215)	(67,093)
Cash flows from financing activities	395	259	(257)	(145)	1,889	117,271
EBITDA[1]	1,006	422	907	892	(1,776)	(8,568)
Capital expenditures	753	230	513	243	128	21,550
Ratio of earnings to fixed charges[2]	14.1x	3.5x	5.2x	4.9x	-	-
Deficiency of earnings to fixed charges[2]	-	-	-	-	1,789	16,208
Operating Data:						
Access Lines	-	-	-	14,700	-	39,323
Local Customers	-	-	-	5,835	-	14,735
Average lines per business customer	-	-	-	*	-	4.73
Average lines per residential customer	-	-	-	*	-	1.25
Employees at end of period	51	58	61	84	14	345

[1]"EBITDA" is defined as earnings before interest, taxes, depreciation and amortization. Although EBITDA is not a measure of performance calculated in accordance with generally accepted accounting principles (GAAP), Birch's management believes that EBITDA is accepted as a generally recognized measure of performance in the telecommunications industry. Birch's management has noted that EBITDA is generally recognized as a measure of comparison of different CLECs in the telecommunications industry and, therefore, the Company believes that such information is useful and relevant to investors. Nevertheless, this measure should not be considered in isolation or as a substitute for operating income (as determined in accordance with GAAP) as an indicator of Birch's operating performance, or to cash flows from operating activities (as determined in accordance with GAAP) as a measure of liquidity. In addition, it should be noted that companies calculate EBITDA differently and, therefore, EBITDA as presented for the Company may not be comparable to EBITDA reported by other companies. See the consolidated financial statement of Valu-Line and Birch and related notes thereto (collectively, the Consolidated Financial Statements) included elsewhere in this Form 10-K for a review of the cash used in and provided by operating and investing activities. Furthermore, there are legal and functional requirements that limit management's discretionary use of funds depicted by EBITDA. See "Risk Factors – Substantial Future Operating Losses; Negative Cash Flow from Operations" and "Risk Factors – Substantial Leverage; Ability to Service Indebtedness."

[2]For purposes of calculating the ratio of earnings to fixed charges, earnings are defined as loss before income taxes plus fixed charges. Fixed charges consist of interest expense and a reasonable approximation of the interest factor included in rental payments on operating leases. Earnings were insufficient to cover fixed charges for the years ended December 31, 1997 and 1998.

*Information not available.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the consolidated financial statements, including the notes thereto, appearing elsewhere in this Annual Report on Form 10-K. Except for the historical information contained herein, the matters discussed in this Annual Report contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, that are based on management's beliefs and assumptions, current expectations, estimates, and projections. Statements that are not historical facts, including without limitation statements which are preceded by, followed by or include the words "believes," "anticipates," "plans," "expects," "may," "should" or similar expressions are forward-looking statements. Many of the factors that will determine the Company's future results are beyond the ability of the Company to control or predict. These statements are subject to risks and uncertainties and, therefore, actual results may differ materially. The Company disclaims any obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

Important factors that may affect future results include, but are not limited to: the impact of competitive products and pricing, product development, changes in law and regulations, customer demand, litigation, availability of future financing, uncertainty of market acceptance of new products, and other risks detailed from time to time in the Company's SEC reports, copies of which are available upon request from the Company's investor relations department.

Overview

Birch was organized on December 23, 1996 to become a leading provider of telecommunications services to small and mid-sized businesses in its target markets. Since such date and prior to the Valu-Line acquisition, Birch was a development stage company with no revenue and principal activities consisting of procuring governmental authorizations, raising capital, hiring management and other key personnel, designing and developing its telephone networks, acquiring equipment and facilities, negotiating resale and interconnection agreements and pursuing acquisition opportunities. Birch had no assets, liabilities or financial activity prior to January 1, 1997.

In February 1998, Birch merged with Valu-Line in a transaction valued at $19.5 million, consisting of $4.75 million in cash, 2,968,750 shares of Series A Preferred Stock having an aggregate liquidation preference of $4.75 million, and 6,593,750 shares of Series C Preferred Stock having an aggregate liquidation preference of $10.0 million. Valu-Line, founded in 1982, has been primarily providing switched long distance services, CPE sales and services and, since March 1997, local service.

On March 13, 1998, Birch completed a private placement of 6,264,063 shares of its Series B Preferred Stock having an aggregate liquidation preference of $9.5 million and $3.5 million in aggregate principal amount of its Convertible Notes, raising aggregate net proceeds of approximately $12.4 million which were used to pay the cash portion of the consideration in the Valu-Line merger, to repay certain debt and for general corporate purposes. The Convertible Notes have been converted to 2,307,965 shares of Series B Preferred Stock.

In May 1998, Birch acquired Boulevard, a shared tenant service provider in the Kansas City metropolitan area, for $300,000 in cash. In May 1998, Birch acquired Telesource, a CPE provider in the Kansas City metropolitan area, for $325,000 in cash. In connection with the Telesource acquisition, the Company assumed $290,000 of Telesource's debt which has since been repaid.

During June 1998, the Company completed a $115 million private offering of 14% Senior Notes due June 2008 and 115,000 warrants to purchase 1,409,734 shares of common stock. Interest on the Senior Notes is payable semi-annually in arrears on June 15 and December 15 of each year. Warrants are exercisable at $0.01 per share and expire June 2008. The Company received net proceeds from the Senior Notes of $110.2 million and concurrently purchased pledged securities of $44.2 million. The pledged securities are restricted for interest payments on the Senior Notes and, together with the interest accruing thereon, will be used to satisfy such interest payments through June 2001. The Company classifies its pledged securities, consisting of $37.8 million of U.S. Treasury securities at December 31, 1998, as held to maturity recorded at amortized cost and maturing between six and thirty months. A portion of the proceeds of this offering, $337,000, was allocated to the warrants, and the resulting debt discount is being amortized over the life of the debt on the straight-line method, which does not differ materially from the effective interest method. Unamortized discount was $319,000 at December 31, 1998. The amount allocated to the warrants represents the estimated fair value of the warrants at the date of issuance. The Senior Notes rank pari pasu in right of payment to all existing and future senior indebtedness of the Company and rank senior in the right of payment to all existing and future subordinated indebtedness of the Company.

In September 1998, the Company purchased certain assets and liabilities of TFSnet, an Internet service provider in the Kansas City metropolitan area, for $2.65 million. The Valu-Line, Telesource, Boulevard, and TFSnet acquisitions were recorded using the purchase method of accounting. Results from the acquired companies are included in the financial statements from the date of the respective acquisitions.

In February 1999, Birch acquired ALT, a local service provider in the Dallas metropolitan area for $700,000 in cash and stock. In March 1999, Birch acquired Capital, a CPE provider in the St. Louis metropolitan area for $3.0 million in cash and additional cash compensation from conversion of Capital's customer base to Birch's local service.

Birch is focused on the development of its existing markets in Missouri and Kansas and expansion into neighboring markets in SWBT's service area, including Texas. In May 1998, Birch expanded its markets to include Kansas City, St. Louis and St. Joseph, Missouri and Topeka and Wichita, Kansas. Birch currently operates a long distance circuit switch in Wichita, Kansas, a local/long distance circuit switch in Kansas City, Missouri, and is in the process of deploying local/long distance switches in St. Louis, Missouri and Wichita, Kansas. By operating its own switch in a particular market, Birch can "unbundle" the services traditionally offered by the ILEC in that market and retain a much higher percentage of the service charges paid by its customers.

Revenue

Birch generates most of its revenue from the sale of local and long distance telephone service, CPE and Internet service to small and mid-sized business customers. Birch offers local and long distance service packages in certain markets in Missouri, Kansas and Texas. Revenue from local services consists of charges for basic local service and custom calling features. Birch offers local telephone service at a discount to the competing ILEC and offers long distance service at a flat per minute rate for calls within the continental United States. CPE and related services are offered at negotiated rates generally consistent with other competitors. Birch also offers Internet access in selected markets primarily at a flat monthly rates.

Operating Expenses

Birch's primary operating expenses consist of cost of services and selling, general and administrative expenses.

Cost of Services. Birch's cost of services include the cost of purchasing the "bundle" of traditional ILEC services for resale to its local service subscribers. Birch purchases local telephone service for its customers on a "wholesale" basis pursuant to an interconnection agreement with the ILEC in Birch's targeted markets. Once a Birch switch is operational in a market, Birch can "unbundle" the local services offered by the ILEC in that market and retain a much higher percentage of the service charges paid by its customers as most charges relate only to leasing the transmission lines.

Additionally, ILECs typically charge both a start-up fee as well as a monthly recurring fee for use of their central offices for collocation of CLEC transmission equipment. By physically collocating its transmission equipment in or near existing ILEC switching offices, Birch has more direct control over its ILEC links for both unbundled loops and trunking facilities. Birch also invests in transmission and distribution electronics equipment associated with its switches.

The Company's primary long distance expenses are expenses associated with the Company's leased long distance network. For calls terminating outside of Birch's network, long distance carriers are used to provide services.

Birch's primary expense associated with providing Internet access to its customers is the cost of leasing transmission facilities. Birch's primary expense associated with CPE is the cost of purchasing equipment from manufacturers and labor for equipment installation.

Selling, General and Administrative Expenses. Birch's selling, general and administrative expenses include its selling and marketing costs and customer service, billing, corporate administration, personnel and network maintenance expense.

Birch employs a direct sales force in each of its target markets. To attract and retain a highly qualified sales force, Birch offers its sales personnel a compensation package that emphasizes commissions. Birch expects to incur significant selling and marketing costs as it expands its operations.

Birch has implemented and continues to refine tailored systems for operations support systems and other back office systems that provision and track customer orders from point of sale to the installation and testing of service. Along with the development costs of these systems, Birch also incurs ongoing expenses for customer service and billing systems. As Birch's strategy stresses the importance of personalized customer service, Birch expects that its customer service department will become a larger part of Birch's ongoing administrative expenses. Birch also expects billing costs to increase as its number of customers and the call volume increases. Birch incurs other costs and expenses, including the costs associated with the maintenance of its network, administrative overhead, office leases and bad debt. Birch expects that these costs will grow significantly as it expands its operations and that administrative overhead will be a large portion of these expenses during the expansion phase of Birch's business. However, Birch expects these expenses to become smaller as a percentage of Birch's revenue as Birch builds its customer base.

The Company has experienced operating losses since its inception as a result of efforts to build its customer base, develop and construct its network infrastructure, build its internal staffing, develop its systems and expand to new markets. The Company expects to continue to focus on increasing its customer base and geographic coverage. Accordingly, the Company expects that its cost of service, selling, general and administrative expenses, and capital expenditures will continue to increase significantly, all of which may have a negative impact on operating results. The projected increases in capital expenditures will continue to generate negative cash flows from construction activities during the next several years as the Company develops and constructs its switch network. The Company may also be forced to change its pricing policies to respond to a changing competitive environment, and there can be no assurance that the Company will be able to maintain its operating margin. There can be no assurance that growth in the Company's revenue or customer base will continue or that the Company will be able to achieve or sustain profitability or positive cash flows.

The Company has generated net operating losses since its inception and, accordingly, has incurred no income tax expense. The Company has reduced the net deferred tax assets generated by these losses by a valuation allowance which offsets the net deferred tax asset due to the uncertainty of realizing the benefit of the tax loss carryforwards. The Company will reduce the valuation allowance when, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will be realized.

Results of Operations

Year Ended December 31, 1998 Compared to Year Ended December 31, 1997

Revenue. Revenue was $26.1 million for the year ended December 31, 1998 compared to $-0- for the year ended December 31, 1997, principally as a result of the Valu-Line, Boulevard, Telesource and TFSnet acquisitions and opening five new markets in 1998. Revenue increases in excess of revenue gained from acquisiitons in 1998 were largely from new customer sales particularly focused on local. For 1998, as a percentage of total revenue, communications and other services were 81.4% (including revenue from Internet access services, which was 2% of total revenue for such period) and CPE sales were 18.6%.

Cost of services. Cost of services was $18.9 million for 1998 compared to $0 for 1997, principally as a result of the Valu-Line, Boulevard, Telesource and TFSnet acquisitions and opening five new markets in 1998. Gross margin for 1998 was $7.2 million, or 27.6% of revenue.

Selling, general and administrative expenses. Selling, general and administrative expenses were $15.8 million for 1998 compared to $1.8 million for 1997. These expenses increased principally as a result of the Valu-Line, Boulevard, Telesource and TFSnet acquisitions and opening five new markets in 1998. Additionally, the Company expanded its engineering and operations staff in preparation for switch deployment. EBITDA was $(8.6) million for 1998 compared to $(1.8) million for 1997.

Depreciation and amortization. Depreciation and amortization was $2.3 million for 1998 compared to $27,000 for 1997, most of which was attributable to the fixed and intangible assets acquired in the Valu-Line, Boulevard, Telesource and TFSnet acquisitions.

Interest. Interest expense was $8.2 million for 1998 primarily from the senior note interest charges. Interest income was $2.9 million in 1998 compared to $14,000 for 1997 primarily as a result of invested funds received from the Senior Notes.

Net loss. Net loss was $16.2 million for 1998 compared to $1.8 million for 1997, as discussed above.

Valu-Line (Predecessor Company)

Year Ended December 31, 1997 Compared to Year Ended December 31, 1996

Revenue. Revenue increased 27.1% to $16.8 million for the year ended December 31, 1997, from $13.2 million for the year ended December 31, 1996, primarily as a result of entering the local service market in March 1997 and long distance volumes increasing faster than the decline in long distance pricing. As a percent of total revenue, communications and other services were 82%, or $13.8 million, and CPE sales were 18%, or $3.0 million for the year ended December 31, 1997 compared to 80.9%, or $10.7 million, and 19.1%, or $2.5 million, for the year ended December 31, 1996.

Cost of services. Cost of services increased 35.4% to $11.8 million for the year ended December 31, 1997, from $8.7 million for the year ended December 31, 1996 primarily as a result of the increase in revenue. Gross margin increased 11.0% to $5.0 million, or 29.5% of revenue, for the year ended December 31, 1997 from $4.5 million, or 33.8% of revenue, for the year ended December 31, 1996 primarily as a result of low margins on resold local service, which was started in March 1997.

Selling, general and administrative expenses. Selling, general and administrative expenses increased 14.2% to $4.1 million for the year ended December 31, 1997, from $3.6 million for the year ended December 31, 1996, primarily as a result of sales commissions related to increased business volumes and increased customer service expenditures associated with the commencement of local service. EBITDA decreased 1.7% to $892,000 for the year ended December 31, 1997 from $907,000 for the year ended December 31, 1996 primarily as a result of the start-up costs associated with offering local service.

Depreciation and amortization. Depreciation and amortization increased 9.6% to $341,000 for the year ended December 31, 1997, compared to $311,000 for the year ended December 31, 1996.

Interest expense. Interest expense was $97,000 for the year ended December 31, 1997 compared to $102,000 for the year ended December 31, 1996.

Income taxes. Income taxes increased 9.3% to $186,000 for the year ended December 31, 1997, compared to $205,000 for the year ended December 31, 1996.

Net income. Net income was $268,000 for the year ended December 31, 1997, compared to $289,000 for the year ended December 31, 1996, as discussed above.

Liquidity and Capital Resources

The expansion of Birch's business will require significant capital to fund capital expenditures, working capital needs, debt service and the cash flow deficits generated by operating losses. Birch's principal capital expenditure requirements include the purchase and installation of switches and transmission equipment collocated in ILEC central offices and the further development of operations support systems and other automated back office systems. Management does not expect that the growth of Birch's long distance and CPE business will require significant capital expenditures.

To date, Birch has primarily funded its expenditures through the Senior Notes, private sale of equity securities, and the convertible notes. During the first quarter of 1997, the Company sold equity securities worth $1.8 million. In February and March 1998, Birch raised approximately $12.4 million in a private placement of its Series B Preferred Stock and Convertible Notes. On June 18, 1998, the Company sold Senior Notes for net proceeds of $110.2 million.

Birch expects to make significant capital outlays for the foreseeable future in order to continue the development activities called for in its current business plan and to fund expected operating losses. Birch currently estimates that the cash required to fund capital expenditures for its expansion plans will be approximately $35.0 million in 1999. In order for the Company to implement its current business plan and finance its projected capital expenditures for 1999 and thereafter, Birch will be required to seek and obtain significant amounts of additional financing (debt and/or equity) within the next year. The Company's expansion into Texas is dependent upon raising substantial additional financing in the near term. If Birch's plans or assumptions change, if its assumptions prove to be inaccurate, or if it experiences unanticipated costs or competitive pressures, Birch will be required to seek additional capital sooner than currently anticipated, possibly within the next six months. In particular, if Birch elects to pursue significant additional acquisition opportunities or to deploy more switches than currently planned, its cash needs may be increased substantially. There can be no assurance that Birch's current projection of cash flow (and losses) from operations (which will depend upon numerous future factors and conditions, many of which are outside of Birch's control) will be accurate. Because Birch's cost of developing new networks and services, funding other strategic initiatives and operating its business will depend on a variety of factors (including, among other things, the number of subscribers and the service for which they subscribe, the nature and penetration of services that may be offered by Birch, regulatory changes, and actions taken by competitors in response to Birch's strategic initiatives), it is almost certain that actual costs and revenue will vary from expected amounts, very likely to a material degree, and that such variations are likely to affect Birch's future capital requirements. Current cash balances will not be sufficient to fund Birch's current business plan beyond the next year. As a consequence, Birch intends to seek additional debt and/or equity financing to fund Birch's liquidity. There can be no assurance that Birch will be able to raise additional capital on satisfactory terms or at all. In the event that Birch is unable to obtain such additional capital or to obtain it on acceptable terms or in sufficient amounts, Birch will be required to delay the development of its network or take other actions that could have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow to service debt requirements.

The ability of Birch to fund the capital expenditures and other costs contemplated by its business plan and to make scheduled payments with respect to the Senior Notes, will depend upon, among other things, its ability to seek and obtain additional financing within the next year, to implement its business plan, to deploy its network and expand its operations and to obtain and retain a significant number of customers in its target markets, and the future operating performance of Birch and its subsidiaries. Each of these factors is, to a large extent, subject to economic, financial, competitive, political, regulatory and other factors, many of which are beyond Birch's control. Birch expects that it will generate operating losses for the foreseeable future and that its business will not generate positive cash flow for the foreseeable future. In addition, the Company will require significant amounts of additional financing, which may not be available, before it will be able to generate positive cash flow. No assurance can be given that Birch will be successful in developing and maintaining a level of cash flow from operations sufficient to permit it to pay the principal of, and interest and any other payments on, the Senior Notes. If Birch is unable to generate sufficient cash flow from operations to service its indebtedness, including the senior notes, it may have to modify its growth plans, limit its capital expenditures, restructure or refinance its indebtedness or seek additional capital or liquidate its assets. There can be no assurance (i) that any of these strategies could be effected on satisfactory terms, if at all, in light of Birch's high leverage or (ii) that any such strategy would yield sufficient proceeds to service the Senior Notes.

Year 2000 Issue

The year 2000 issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any of Birch's computer programs that have date-sensitive software may recognize the date using "00" as the year 1900 rather than the year 2000. The Company anticipates spending $20 million on new systems from inception through the end of 1999 from funds provided by the Senior Notes or from new sources of capital. Specific expenditures for year 2000 costs are not being made related to the new systems. The Company has completed its assessment on the consequences of the year 2000 on information technology systems. As the Company has a relatively short history, virtually all systems are newly created or are being created. During information technology development, year 2000 issues have been consistently addressed. The new information technology systems will, in certain cases, replace systems of acquired companies in order to provide consistent and integrated systems. The acquired companies' systems are not all year 2000 compliant, however, these systems will be replaced by the third quarter of 1999. If all such systems are not replaced and year 2000 issues occur, significant disruption to the Company's operations could occur. The most significant system of the acquired companies relates to the provisioning and billing of resale local and long distance services which, if not replaced, could prevent the Company from billing or provisioning service to existing and future customers. Installation of the integrated billing and provisioning system is on schedule to date.

Other non-information technology systems which may be affected by the year 2000 issue include systems provided to the Company by third parties. The most significant third party systems are those which operate SWBT's interfaces and billing records, switching equipment and customer premises equipment. The Company has been assured by significant third parties that year 2000 compliance will be accomplished by the end of 1999. If such compliance is not achieved by these third parties, it would have a material adverse effect on Birch's business, operating results and financial condition and its ability to achieve sufficient cash flow.

Impact of Inflation

The Company does not believe that inflation has had a significant impact on the Company's consolidated operations.

Seasonality

The Company's business is not considered to be seasonal.

Recently Issued Accounting Standards

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income" during 1998. SFAS No. 130 establishes standards for reporting and display of comprehensive income and its components (revenues, expenses, gains, and losses) in a full set of general purpose financial statements. SFAS No. 130 requires that an enterprise (a) classify items of other comprehensive income by their nature in a financial statement and (b) display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position. SFAS No. 130 had no material impact on the Company's consolidated financial statements.

The Company also adopted SFAS No. 131, "Disclosure About Segments of an Enterprise and Related Information" in 1998. SFAS No. 131 established standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosure about products and services, geographic areas, and major customers. The adoption of SFAS No. 131 required no additional disclosures in the Company's consolidated financial statements.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which supersedes SFAS No. 80, "Accounting for Futures Contracts," SFAS No. 105, "Disclosure of Information About Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentration of Credit Risk," and SFAS No. 119, "Disclosures about Derivative Financial Instruments and Fair Value of Financial Instruments," and also amends certain aspects of other SFAS's previously issued. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. SFAS No. 133 is effective for the Company's consolidated financial statements for the year ending December 31, 2000. The Company does not expect the impact of SFAS No. 133 to be material in relation to its consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's exposure to market risk – through derivative financial instruments and other financial instruments, such as investments in marketable securities and long-term debt – is not material.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

For information required by Item 8, refer to the "Consolidated Financial Statements" section of the Financial Statements and Financial Statement Schedules filed as part of this document.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Directors, Executive Officers and Other Key Employees

The following table sets forth certain information concerning the directors, executive officers and other key personnel of Birch, including their ages as of December 31, 1998:

Name	Age	Position
Henry H. Bradley	53	Chairman of the Board
David E. Scott	39	President, Chief Executive Officer and Director
Gregory C. Lawhon	39	Senior Vice President of Public Policy and General Counsel
Gary L. Chesser	52	Senior Vice President of Engineering and Operations
David W. Vranicar	40	Senior Vice President of Business Development
Bradley A. Moline	31	Senior Vice President of Finance and Chief Financial Officer
Jeffrey D. Shackelford	38	Senior Vice President of Sales
Donald H. Goldman	39	Senior Vice President of Internet Services
Stephen L. Sauder	52	Vice President and Director
Ian R. N. Bund	55	Director
David W. Bergmann	49	Director

Henry H. Bradley is Birch's Chairman of the Board of Directors (the Board). Mr. Bradley also is the Chairman of the Board of News-Press & Gazette Company (NPG), a co-founder of Birch. NPG is a family-owned company that owns and operates a daily newspaper, cable television systems, network affiliate broadcast television stations and FM and AM radio stations. Mr. Bradley has held a number of other positions with NPG since joining NPG in 1971, including terms as the Editor and Publisher of the St. Joseph News-Press.

David E. Scott, a co-founder and Director of Birch, is also its President and Chief Executive Officer. Mr. Scott has 16 years of managerial experience in the telecommunications industry. Prior to joining Birch, Mr. Scott was President and General Manager of Kansas City FiberNet, a CLEC owned jointly by the country's two largest cable operators, TCI and Time Warner. Prior to his tenure at Kansas City FiberNet, Mr. Scott was Vice President of Strategic Development for Sprint, responsible for developing investment plans in the competitive local exchange, wireless (PCS) and international marketplaces. Mr. Scott also served as Director of Strategic Planning for Sprint from 1988 to 1991. Mr. Scott also serves as a Director of DNS Publishing, an Internet publishing company he co-founded with Donald H. Goldman. DNS Publishing produces web sites that serve as on-line trade publications. Their first web site, C-LECinfo (www.clec.com), serves the competitive local exchange carrier industry.

Gregory C. Lawhon joined Birch in January 1997 as its Senior Vice President of Public Policy and General Counsel. Prior to joining Birch, Mr. Lawhon practiced law for twelve years with the 90-lawyer Kansas City firm of Spencer Fane Britt & Browne. A partner in the firm since 1990, he was head of the firm's Communications and Media Group and a member of its Business Group. Mr. Lawhon's areas of practice were mergers and acquisitions, with an emphasis on communications industry acquisitions, cable television franchising, and commercial and regulatory issues with respect to the telecommunications industry.

Gary L. Chesser joined Birch in March 1997 as its Senior Vice President of Engineering and Operations. Prior to joining Birch, Mr. Chesser was Vice President-Director of Engineering & Operations with Time Warner Connect, a startup business unit offering local and long distance telephony, cable television, and home security services. Prior to joining Time Warner, Mr. Chesser was employed by US West leading business process development and implementation for a startup data communications business unit called !NTERPRISE. Prior to joining US West, Mr. Chesser was employed by SWBT from 1965 to 1991 in a variety of engineering and operations and managerial positions.

David W. Vranicar joined Birch in March 1997 as its Senior Vice President of Business Development. Prior to joining Birch, Mr. Vranicar was Vice President, International Business Development, at Sprint. In that capacity, he directed Sprint's pursuit of numerous international strategic partnering opportunities, including ventures in China, Israel, Taiwan, Japan, Italy and Spain. During his tenure at Sprint, which began in 1992, Mr. Vranicar played a key role in many domestic business development activities, including a PCS joint venture with TCI, Cox Cable Communications, Inc. and Comcast Corp.

Bradley A. Moline joined Birch in July 1997 as its Senior Vice President of Finance and Chief Financial Officer. From 1994 to 1997, Mr. Moline was the Treasurer and Chief Financial Officer of Covenant Transport, Inc., a transportation company in Chattanooga, Tennessee that became publicly traded during his tenure. Prior to joining Covenant Transport, Mr. Moline worked for Ernst & Young LLP in Kansas City, Missouri and Grant Thornton in Lincoln, Nebraska, providing client services in the auditing and consulting areas.

Jeffrey D. Shackelford, a co-founder of Birch, is Senior Vice President of Sales. Mr. Shackelford has 13 years of experience in the telecommunications industry. Prior to joining Birch, Mr. Shackelford served as Director of Sales and Marketing for Kansas City FiberNet. Prior to joining Kansas City FiberNet, Mr. Shackelford was the Branch Manager for Sprint's Commercial Sales office in Kansas City and was responsible for sales and service of small to large business clients. During his tenure at Sprint, which began in 1988, Mr. Shackelford also developed the long distance industry's first PC-based call management system, FONVIEW.

Donald H. Goldman joined Birch in March 1998 as its Senior Vice President of Internet Services. Mr. Goldman has over 13 years of managerial experience in the telecommunications industry. Prior to joining Birch, Mr. Goldman served as Vice President, Corporate Development at Sprint where he developed the strategy and managed the acquisition of companies in the areas of systems integration, Internet telephony, and wireless (PCS) services among others. Mr. Goldman also serves as a Director of DNS Publishing, an Internet publishing company he co-founded with David E. Scott.

Stephen L. Sauder is a Vice President and Director of the Company. Mr. Sauder was elected as a Director of Birch in February 1998, as the designee of the holders of the Company's Series C Preferred Stock. Mr. Sauder was a co-founder of Valu-Line in 1982, and served as President and Chief Executive Officer of Valu-Line until February 1998, when Birch and Valu-Line were merged.

Ian R. N. Bund was elected as a director of Birch in February 1998, as the designee of White Pines Management L.L.C. (White Pines). Mr. Bund also has been President of White Pines since 1996. From 1990 to 1996, Mr. Bund served as president of White Pines Corporation, a management company and predecessor to White Pines. From 1993 to 1995, while continuing to operate his management company, Mr. Bund served as Senior Vice President — Corporate Finance of First Michigan Corporation, a leading Michigan investment banking and brokerage firm. Mr. Bund also currently serves on the boards of directors of several private companies.

David W. Bergmann was elected as a director of Birch in February 1998, as the designee of Advantage Capital Missouri Partners I, L.P. (Advantage). Since 1992, he has been involved in the analysis, negotiation of terms, and structuring of various portfolio company investments at Advantage Capital Partners, which he co-founded. Mr. Bergmann also serves on the boards of directors of several private companies as well as one commercial bank. In addition, he is the Chairman of the Board of Interface Security, L.L.C., an electronic security firm. He also serves as a consultant to Barnes Associates, an investment banking firm specializing in evaluations, mergers, acquisitions, and financing in the electronic security and communications fields.

ITEM 11. EXECUTIVE COMPENSATION

Compensation of Directors

Directors do not receive compensation for their service as directors, except that [**non-employee**] directors are reimbursed for out-of-pocket expenses incurred in connection with attendance at meetings of the Board and its committees.

Compensation of Executive Officers

Summary of Compensation

The following table sets forth the cash and non-cash compensation paid or incurred on behalf of Birch to its Chief Executive Officer and four other executive officers (the Named Executive Officers) for the years ended December 31, 1998 and 1997:

Summary Compensation Table

		Annual Compensation			Long-Term Compensation Awards	
Name and Principal Position	**Year**	**Salary($)**	**Bonuses**	**Other Annual Compensation($)**	**Securities Underlying Options (#)(a)**	**All Other Compensation ($)(e)**
David E. Scott	1998	175,000	—	—	1,052,362	7,000
President and Chief Executive Officer(b)	1997	164,904	—	—	—	—
Gregory C. Lawhon	1998	175,000	—	—	328,863	5,386
Senior Vice President of Public Policy and General Counsel(b)	1997	164,904	—	—	—	—
Gary L. Chesser	1998	140,000	35,000	--	301,458	—
Senior Vice President of Engineering and Operations(c)	1997	115,769	35,000	--	—	—
David W. Vranicar	1998	150,000	—	—	274,052	6,000
Senior Vice President of Business Development(c)	1997	118,269	—	—	—	—
Stephen L. Sauder	1998	226,471	—	—	—	—
Vice President(d)	1997	134,577	—	128,667	—	—

(a) Includes options to purchase shares of the Company's Common Stock, which were issued pursuant to the 1998 Stock Option Plan. Prior to the private placement of the Company's Series B Preferred Stock, Birch was a party to various stock option agreements with employees of the Company, all of which were governed by the Company's 1997 Stock Option Plan. In connection with the private placement of Series B Preferred Stock, the 1997 Stock Option Plan was replaced with the 1998 Stock Option Plan, and all stock option agreements governed by the 1997 Stock Option Plan were terminated. Options issued to the members of management listed above pursuant to the 1998 Stock Option Plan are exercisable immediately on grant at an exercise price of $.001 per share, and vest over a four-year period, at a rate of 6.25% per quarter. The stock options have been adjusted to reflect the Stock Dividend on June 23, 1998. Holders of exercised options have voting power with respect to all shares of Common Stock underlying the options. Upon termination of employment with the Company, Birch has the right to purchase all options which have not vested as of that date, subject to certain exceptions.

(b) Reflects compensation paid to Messrs. Scott and Lawhon commencing in January 1997.

(c) Reflects compensation paid to Messrs. Chesser and Vranicar commencing in March 1997.

(d) Mr. Sauder joined Birch after the Valu-Line acquisition and currently serves as Vice President of the Company. Compensation listed was paid by Valu-Line from January 1997 to February 1998.

(e) Reflects matching contributions made by the Company under its 401(k) plan.

Options Grants

Stock Option Grants and Exercises

The Company grants options to its executive officers under its 1998 Stock Option Plan (the Plan). As of March 29, 1999, options to purchase a total of 5,352,934 shares were outstanding under the Plan and options to purchase 842,911 shares remained available for grant thereunder.

The following table shows, for the fiscal year ended December 31, 1998, certain information regarding options granted to, exercised by, and held at year end by the Named Executive Officers:

	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(c)	
Name	Number of Securities Underlying Options Granted(#)(a)	% of Total Options Granted to Employees in Fiscal Year(b)	Exercise or Base Price ($/Sh)	Expiration Date	5%($)	10%($)
David E. Scott	931,696	18.4%	.001	2/10/2008	555	1,407
	120,666	2.4%	.001	3/13/2008	72	182
Gregory C. Lawhon	291,155	5.7%	.001	2/10/2008	174	440
	37,708	0.7%	.001	3/13/2008	22	57
Gary L. Chesser	266,893	5.3%	.001	2/10/2008	159	403
	34,565	0.7%	.001	3/13/2008	21	52
David W. Vranicar	242,628	4.8%	.001	2/10/2008	145	367
	31,424	0.6%	.001	3/13/2008	19	47
Stephen L. Sauder	—	—	—	—	—	—

(a) Includes options to purchase shares of Common Stock, which were issued pursuant to the 1998 Stock Option Plan. Prior to the private placement of Series B Preferred Stock, Birch was a party to various stock option agreements with employees of the Company, all of which were governed by the Company's 1997 Stock Option Plan. In connection with this private placement of Series B Preferred Stock, the 1997 Stock Option Plan was replaced with the 1998 Stock Option Plan, and all stock option agreements governed by the 1997 Stock Option Plan were terminated. Options issued pursuant to the 1998 Stock Option Plan are exercisable immediately on grant at an exercise price of $.001 per share, and vest over a four-year period, at a rate of 6.25% per quarter. The stock options have been adjusted to reflect the Stock Dividend on June 23, 1998. Holders of exercised options have voting power with respect to all shares of Common Stock underlying the options. Upon termination of employment with the Company, Birch has the right to purchase all options which have not vested as of that date, subject to certain exceptions.

(b) Based on an aggregate of options to purchase 5,352,934 shares of Birch's Common Stock granted to employees of Birch in fiscal 1998, including the Named Executive Officers.

(c) The potential realizable value assumes a per-share market price at the time of the grant to be approximately $.001 with an assumed rate of appreciation of 5% and 10%, respectively, compounded annually for 10 years.

Aggregated Options Exercises in Last Fiscal Year and Fiscal Year End Option Values(a)

Name	Shares Acquired on Exercise(#)(b)	Value Realized($)	Number of Securities Underlying Unexercised Options(#) Exercisable(E) Unexercisable(U)(c)	Value of Unexercised In-the-Money Options($) Exercisable(E) Unexercisable(U)(c)
David E. Scott	197,318	—	— (E)	—(E)
			855,044 (U)	—(U)
Gregory C. Lawhon	61,662	—	— (E)	—(E)
			267,201 (U)	—(U)
Gary L. Chesser	56,523	—	— (E)	—(E)
			244,935 (U)	—(U)
David W. Vranicar	51,385	—	— (E)	—(E)
			222,667 (U)	—(U)
Stephen L. Sauder	—	—	— (E)	—(E)
			— (U)	—(U)

(a) The options shown reflect options granted as of December 31, 1998.

(b) For purposes of this table alone, "exercise" means an employee's acquisition of shares of Common Stock which have already vested, "exercisable" means options to purchase shares of Common Stock which are subject to exercise and "unexercisable" means all other options to purchase shares of Common Stock.

(c) Includes options to purchase shares of Common Stock, which were issued pursuant to the 1998 Stock Option Plan. Prior to the private placement of Series B Preferred Stock, Birch was a party to various stock option agreements with employees of the Company, all of which were governed by the Company's 1997 Stock Option Plan. In connection with this private placement of Series B Preferred Stock, the 1997 Stock Option Plan was replaced with the 1998 Stock Option Plan, and all stock option agreements governed by the 1997 Stock Option Plan were terminated. Options issued pursuant to the 1998 Stock Option Plan are exercisable immediately on grant at an exercise price of $.001 per share, and vest over a four-year period, at a rate of 6.25% per quarter. The stock options have been adjusted to reflect the Stock Dividend on June 23, 1998. Holders of exercised options have voting power with respect to all shares of Common Stock underlying the options. Upon termination of employment with the Company, Birch has the right to purchase all options which have not vested as of that date, subject to certain exceptions.

Employment Agreements

David E. Scott. Mr. Scott is party to an employment agreement with Birch dated as of February 10, 1998. Under his employment agreement, Mr. Scott receives a base salary of $175,000 per annum. Mr. Scott is also eligible for a bonus based on achievement of performance criteria established by the Board. Mr. Scott's employment agreement is for an initial three-year term, and automatically renews for additional one-year terms unless either Mr. Scott or Birch provides written notice to each other at least 90 days prior to such renewal. Mr. Scott's employment agreement provides that upon termination of employment by Birch, other than for cause, disability or death, Birch shall pay Mr. Scott's salary for the remainder, if any, of the calendar month in which such termination is effective and for 24 consecutive calendar months thereafter. The agreement also provides for noncompetition, nonsolicitation and nondisclosure covenants.

Gregory C. Lawhon. Mr. Lawhon is party to an employment agreement with Birch dated as of February 10, 1998. Under his employment agreement, Mr. Lawhon receives a base salary of $175,000 per annum. Mr. Lawhon is also eligible for a bonus based on achievement of performance criteria established by the Board. Mr. Lawhon's employment agreement is for an initial one-year term, and automatically renews for additional one-year terms unless either Mr. Lawhon or Birch provides written notice to each other at least 90 days prior to such renewal. Mr. Lawhon's employment agreement provides that upon termination of employment by Birch, other than for cause, disability or death, Birch shall pay Mr. Lawhon's salary for the remainder, if any, of the calendar month in which such termination is effective and for 12 consecutive calendar months thereafter. The agreement also provides for noncompetition, nonsolicitation and nondisclosure covenants.

Gary L. Chesser. Mr. Chesser is party to an employment agreement with Birch dated as of February 10, 1998. Under his employment agreement, Mr. Chesser receives a base salary of $150,000 per annum. Mr. Chesser is also eligible for a bonus based on achievement of performance criteria established by the Board. Mr. Chesser's employment agreement is for an initial one-year term, and automatically renews for additional one-year terms unless either Mr. Chesser or Birch provides written notice to each other at least 90 days prior to such renewal. Mr. Chesser's employment agreement provides that upon termination of employment by Birch, other than for cause, disability or death, Birch shall pay Mr. Chesser's salary for the remainder, if any, of the calendar month in which such termination is effective and for 12 consecutive calendar months thereafter. The agreement also provides for noncompetition, nonsolicitation and nondisclosure covenants.

David W. Vranicar. Mr. Vranicar is party to an employment agreement with Birch dated as of February 10, 1998. Under his employment agreement, Mr. Vranicar receives a base salary of $150,000 per annum. Mr. Vranicar is also eligible for a bonus based on achievement of performance criteria established by the Board. Mr. Vranicar's employment agreement is for an initial one-year term, and automatically renews for additional one-year terms unless either Mr. Vranicar or Birch provides written notice to each other at least 90 days prior to such renewal. Mr. Vranicar's employment agreement provides that upon termination of employment by Birch, other than for cause, disability or death, Birch shall pay Mr. Vranicar's salary for the remainder, if any, of the calendar month in which such termination is effective and for 12 consecutive calendar months thereafter. The agreement also provides for noncompetition, nonsolicitation and nondisclosure covenants.

Stephen L. Sauder. Mr. Sauder is party to an employment agreement with Birch dated as of February 10, 1998. Under his employment agreement, Mr. Sauder receives a base salary of $213,000 per annum. Mr. Sauder is also eligible for a bonus based on achievement of performance criteria established by the Board. Mr. Sauder's employment agreement is for an initial one-year term, and automatically renews for additional one-year terms unless either Mr. Sauder or Birch provides written notice to each other at least 90 days prior to such renewal. Mr. Sauder's employment agreement provides that upon termination of employment by Birch, other than for cause, disability or death, Birch shall pay Mr. Sauder's salary for the remainder, if any, of the calendar month in which such termination is effective and for 12 consecutive calendar months thereafter. The agreement also provides for noncompetition, nonsolicitation and nondisclosure covenants.

Compensation Committee Interlocks and Insider Participation

The Compensation Committee of the Board of Directors consists of Ian R. N. Bund, Henry H. Bradley and David E. Scott.

Report of the Compensation Committee of the Board of Directors

REPORT OF THE COMPENSATION COMMITTEE OF THE BOARD OF DIRECTORS ON EXECUTIVE COMPENSATION

COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

The following is a report of the Compensation Committee of the Board (the Committee) describing the compensation policies applicable to the Company's executive officers (including the Named Executive Officers) during the fiscal year ended December 31, 1998.

General Policies

The Committee is responsible for assisting the Company's Chief Executive Officer (the CEO) in devising the general compensation policies and compensation plans of the Company, as well as the specific compensation levels for individual executive officers. The Committee also administers the Company's stock option, employee stock purchase and 401(k) plans and determines the terms and conditions of grants thereunder. The Committee consists of two non-employee Board members and the CEO. The CEO does not participate in Committee deliberations or decisions involving his own compensation.

The Company's compensation policies are designed to link the executive officers' compensation to the annual and long-term performance of the Company, to provide compensation that is competitive with that of executives in the industry, to reward performance and teamwork, and to attract and retain superior talent. The compensation mix reflects a balance of annual cash payments, consisting of annual base salary payments and incentive bonus payments, and long-term stock-based incentives in the form of stock options. The emphasis in incentive compensation is placed on strategic, stock-based options that align the financial interests of the Company's employees with those of its stockholders.

Base Salaries

The salary component of executive compensation is based on the executive's level of responsibility for meeting Company objectives and performance. Base salaries for executives are reviewed and adjusted at least annually based on information regarding competitive salaries, the results of industry compensation surveys, individual experience and performance.

Cash Bonuses

The Company's incentive program for executive officers provides direct financial incentives in the form of cash bonuses based on previous year performance.

Stock Options

The Company's 1998 Stock Option Plan provides for the issuance of stock options to officers and employees of the Company to purchase shares of the Company's common stock at an exercise price equal to the fair market value of such stock on the date of grant. The Company's stock options typically vest over a 48-month period.

The Company's compensation policies recognize the importance of stock ownership by senior executives, and stock options are an integral part of each executive's compensation. The Committee believes that the opportunity for stock appreciation through stock options that vest over time promotes the relationship between long-term interests of executive officers and stockholders. The size of specific grants takes into account the executive officer's salary and the number of options previously granted to the officer, as well as his or her contributions to the Company's success.

Compensation of the Chief Executive Officer

David E. Scott has served as President and CEO since the Company's inception. In February 1998 he entered into an employment agreement with the Company, the terms of which are described in more detail in "Employment Agreements."

During fiscal 1998, Mr. Scott received a base salary of $175,000 and options to purchase an aggregate of 1,052,362 shares of the Company's common stock. In reviewing the compensation paid to Mr. Scott for fiscal 1998, the Committee applied the factors discussed above in this Report under the headings "Base Salaries," "Cash Bonuses," and "Stock Options." In addition, the Committee considered a number of other factors, including competitive market compensation packages, Mr. Scott's past performance at the Company and the responsibilities he was undertaking in assuming the position of CEO. Based on its internal review and informal information reviewed by the Committee, the Committee believes that the base salary level for the CEO is commensurate with salaries paid to chief executive officers of comparable companies engaged in similar industries.

Overall, the Committee believes that Mr. Scott is being appropriately compensated in a manner that is consistent with the long-term interests of stockholders.

The members of the Committee submit the foregoing report.

COMPENSATION COMMITTEE:

Henry H. Bradley

Ian R. N. Bund

David E. Scott

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Birch's outstanding capital stock as of December 31, 1998 consisted of 5,000,296 shares of Common Stock, 8,572,039 shares of Series B Preferred Stock and 8,492,749 shares of Series C Preferred Stock.

The following table sets forth certain information regarding the beneficial ownership of the capital stock of Birch by: (i) each of the directors and the Named Executive Officers of Birch; (ii) all directors and Named Executive Officers as a group and (iii) each owner of more than 5% of the equity securities of Birch (5% Owners). Unless otherwise noted, the address for each director and Named Executive Officer of Birch is c/o Birch Telecom, Inc., 2020 Baltimore Avenue, Kansas City, Missouri 64108.

Name and Address of Beneficial Owner(a)	Number of Shares Beneficially Owned			Percentage of Class Owned			Percentage of Total Voting Power of Fully Diluted Common Stock
	Common(b)	Series B	Series C	Common(b)	Series B	Series C	
Directors and Executive Officers:							
Henry H. Bradley(c)	—	1,978,128	1,582,500	—%	23.1%	18.6%	15.2%
David E. Scott	1,190,768	—	189,900	18.6	—	2.2	5.9
Gregory C. Lawhon	380,137	49,453	—	5.9	*	—	1.8
Gary L. Chesser	348,459	32,969	—	5.4	*	—	1.6
David W. Vranicar	316,780	36,266	—	4.9	*	—	1.5
Bradley A. Moline(d)	297,932	70,625	—	4.6	*	—	1.6
Jeffrey D. Shackelford	794,160	—	126,600	12.4	—	1.5	3.9

Name and Address of Beneficial Owner(a)	Number of Shares Beneficially Owned			Percentage of Class Owned			Percentage of Total Voting Power of Fully Diluted Common Stock
	Common(b)	Series B	Series C	Common(b)	Series B	Series C	
Directors and Executive Officers:							
Stephen L. Sauder(e)	—	85,719	6,311,797	—	1.0	74.3	27.3
Donald H. Goldman	263,750	—	—	4.1	—	—	1.1
Ian R. N. Bund(f)	—	47,808	—	—	*	—	*
David W. Bergmann(g)	—	—	—	—	—	—	—
All directors and executive officers as a group (11 persons)	3,591,987	2,300,968	8,210,797	56.0	26.8	96.7	60.1
5% Owners:							
News-Press & Gazette Company(h)	—	1,648,438	1,582,500	—	19.2	18.6	13.8
Advantage Capital Missouri Partners I, L.P.(g)(i)	—	1,318,750	—	—	15.4	—	5.6
Pacific Capital, L.P.(f)(j)	—	1,219,925	—	—	14.2	—	5.2

* Less than one percent

(a) Beneficial ownership is determined in accordance with the Commission's rules and includes voting and investment power with respect to the shares.

(b) Includes options to purchase shares of the Common Stock, which were issued pursuant to the 1998 Stock Option Plan. Certain options are exercisable immediately on grant at an exercise price of $.001 per share, and vest over a four-year period, at a rate of 6.25% per quarter. Holders of exercised options have voting power with respect to all shares of Common Stock underlying the options. Upon termination of employment with the Company, Birch has the right to purchase all options which have not vested as of that date, subject to certain exceptions.

(c) Includes 1,648,438 shares of Series B Preferred Stock and 1,582,500 shares of Series C Preferred Stock held by NPG. Mr. Bradley and his brother hold voting power of NPG. Also includes 329,687 shares of Series B Preferred Stock held by various trusts and relatives of the Bradley family.

(d) Includes 5,275 shares of Series B Preferred Stock held by Mr. Moline's father.

(e) Includes 65,937 shares of Series B Preferred Stock held by Mr. Sauder's father.

(f) Mr. Bund is the president of White Pines which provides management services to White Pines L.P. I and the Pacific Capital, L.P. partnership. Mr. Bund serves on the Board of Birch.

(g) Mr. Bergmann is a general partner of Advantage Capital Missouri Partners I, L.P. and serves on the Board of Birch.

(h) The principal business address of NPG is 825 Edmond Street, St. Joseph, MO 64501.

(i) The principal business address of Advantage is 7733 Forsyth Boulevard, Suite 1850, St. Louis, MO 63105.

(j) The principal business address of Pacific Capital, L.P. is 2401 Plymouth Road, Suite B, Ann Arbor, MI 48105.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Purchase of Series A Preferred Stock By Stephen L. Sauder

In connection with the merger of Birch and Valu-Line, the Company paid to Stephen L. Sauder, the principal stockholder of Valu-Line, 2,968,750 shares of its Series A Preferred Stock, 5,982,746 shares of its Series C Preferred Stock and $4,500,000.00 in cash. During the year ended December 31, 1998, the Company paid dividends of $168,000 to Mr. Sauder, the holder of all of the Company's Series A Preferred Stock. Pursuant to the Purchasers Rights Agreement dated February 10, 1998 (the Purchasers Rights Agreement), Mr. Sauder was elected as a Director of the Company. In June 1998, Birch repurchased all of the outstanding shares of Birch's Series A Preferred Stock held by Mr. Sauder.

Series B Preferred Stock Offering

On March 13, 1998, Birch completed a private placement of 6,264,074 shares of its Series B Preferred Stock (the Series B Preferred Stock Offering) having an aggregate liquidation preference of $9.5 million and $3.5 million in aggregate principal amount of its Convertible Notes which on June 18, 1998 were converted to 2,307,965 shares of Series B Preferred Stock, raising aggregate net proceeds of approximately $12.4 million. The transaction was consummated pursuant to the Purchasers Rights Agreement and the Securities Purchase Agreement, agreements which designate certain rights and obligations of the Series B Preferred Stock. See "— Purchasers Rights Agreement" and "— Securities Purchase Agreement." Pursuant to the Securities Purchase Agreement, NPG, a stockholder which owns in excess of 5% of the Company's voting securities, purchased $2,500,000 of Series B Preferred Stock, and certain parties affiliated with NPG, including Henry H. Bradley, Chairman of the Board of the Company, purchased $500,000 of Series B Preferred Stock. In addition, pursuant to the Securities Purchase Agreement, Bradley A. Moline and Gregory C. Lawhon, executive officers of Birch, purchased $105,000 and $75,000 of Series B Preferred Stock, respectively. In connection with this Series B Preferred Stock Offering, NPG surrendered 1,500,000 shares of Common Stock and 1,500,000 warrants exercisable into shares of Common Stock in exchange for 1,582,500 shares of Series C Preferred Stock; David E. Scott, Birch's President, Chief Executive Officer and Director, surrendered 180,000 shares of Common Stock and 180,000 warrants exercisable into shares of Common Stock in exchange for 189,900 shares of Series C Preferred Stock; and Jeffrey D. Shackleford, Birch's Senior Vice President of Sales and Marketing, surrendered 120,000 shares of Common Stock and 120,000 warrants exercisable into shares of Common Stock in exchange for 126,600 shares of Series C Preferred Stock. The Company then cancelled the exchanged shares and warrants exercisable into shares of common stock.

In connection with this Series B Preferred Stock transaction, Gregory C. Lawhon, Birch's Senior Vice President of Public Policy and General Counsel, purchased 49,453 shares, Gary L. Chesser, Birch's Senior Vice President of Engineering and Operations, purchased 32,969 shares, David W. Vranicar, Senior Vice President of Business Development, purchased 36,266 shares and Bradley A. Moline, Birch's Senior Vice President of Finance and Chief Financial Officer, purchased 70,625 shares.

Purchasers Rights Agreement

Current stockholders of Birch are parties to the Purchasers Rights Agreement, pursuant to which they agreed to vote their respective shares in such a manner as to elect certain persons to serve as Directors. The holders of Series B Preferred Stock have agreed to vote their shares to elect one designee of NPG; one designee of Advantage and one designee of White Pines. In addition, the holders of Series C Preferred Stock agreed to vote their shares to elect Stephen L. Sauder, and the holders of Common Stock agreed to vote their shares for the election of David E. Scott. As a result, so long as the Purchasers Rights Agreement is in effect, these investors will effectively control the election of the Company's Board of Directors.

Registration Rights

The parties to the Purchasers Rights Agreement, subject to certain conditions, have certain registration rights with respect to shares of Common Stock, including shares of Common Stock issuable upon conversion or redemption of shares of Series B Preferred Stock or upon conversion of shares of Series C Preferred Stock. Such purchasers may, subject to certain conditions, require Birch to register their shares of Common Stock pursuant to the Securities Act in connection with an underwritten public offering of the Common Stock to the general public. Each purchaser of stock pursuant to the Purchasers Rights Agreement is subject to lock-up restrictions in the event of a public offering of Birch's securities.

Restrictions on Transfer

Birch's outstanding Common Stock (including shares issued pursuant to Options), Series B Preferred Stock and Series C Preferred Stock are subject to certain restrictions on transfer. Holders of Common Stock, Series B Preferred Stock and Series C Preferred Stock that are parties to the Purchasers Rights Agreement, subject to certain exceptions, may not transfer their shares without first giving Birch the opportunity to purchase such shares (a Right of First Refusal). In addition, holders of Common Stock and Series C Preferred Stock that are parties to the Purchasers Rights Agreement, subject to certain exceptions, may not transfer their shares without first giving the holders of Series B Preferred Stock the opportunity to participate in such transfer (a Co-Sale Right). Holders of Common Stock, Series B Preferred Stock and Series C Preferred Stock that are parties to the Purchasers Rights Agreement are required to sell their shares in the event of an agreement by 66-2/3% of the outstanding shares of Common Stock (assuming conversion or exercise of all convertible securities, options or warrants) to sell or transfer their shares, or to sell all or substantially all of the assets of Birch to a third party.

Pre-Emptive Rights

Holders of Birch's Series B Preferred Stock and Series C Preferred Stock have the right to purchase a pro rata portion of any Common Stock or Preferred Stock that Birch proposes to sell and issue, subject to certain exceptions.

Size of the Board of Directors

The Purchasers Rights Agreement provides that so long as 10% or more of the outstanding shares of Series B Preferred Stock are held by the parties to the Purchasers Rights Agreement, the approval by the vote or written consent of the holders of at least a majority of the then-outstanding shares of Series B Preferred Stock shall be necessary to change the size of the Board of Directors.

Securities Purchase Agreement

In connection with the Series B Preferred Stock Offering, the current stockholders entered into the Securities Purchase Agreement. Pursuant to this agreement, Birch sold shares of its Common Stock to certain of its employees pursuant to the Stock Purchase Plan and sold shares of its Series B Preferred Stock and Convertible Notes to certain investors. In addition, pursuant to the Securities Purchase Agreement, Birch implemented a plan of recapitalization whereby it exchanged all shares of its Common Stock and warrants for shares of its Common Stock issued and outstanding prior to the Securities Purchase Agreement for shares of its Series C Preferred Stock. Birch then cancelled the exchanged shares of common stock and warrants exercisable into shares of common stock.

Sales of Common Stock to Executive Officers of the Company

In connection with the Series B Preferred Stock Offering, 474,750 shares of the Company's Common Stock were sold to certain employees of the Company for an aggregate purchase price of $450.00. The shares were sold pursuant to the Company's Stock Purchase Plan. In connection with this transaction, David E. Scott, Birch's President, Chief Executive Officer and Director, purchased 138,405 shares of Common Stock, Jeffrey D. Shackelford, Birch's Senior Vice President of Sales, purchased 92,587 shares of Common Stock, Gregory C. Lawhon, Birch's Senior Vice President of Public Policy and General Counsel, purchased 51,273 shares of Common Stock, Gary L. Chesser, Birch's Senior Vice President of Engineering and Operations, purchased 47,000 shares of Common Stock, David W. Vranicar, Senior Vice President of Business Development, purchased 42,728 shares of Common Stock and Bradley A. Moline, Birch's Senior Vice President of Finance and Chief Financial Officer, purchased 34,182 shares of Common Stock.

NPG Loan

On December 16, 1997, the Company borrowed $250,000 from NPG in order to satisfy its working capital needs. NPG is a stockholder which owns in excess of 5% of the Company's voting securities. The loan was repaid with the proceeds of the Company's private placement of its Series B Preferred Stock and Convertible Notes.

Valu-Line Loans

As of December 31, 1997, Valu-Line, which merged into Birch on February 10, 1998, had notes payable of $111,870 from Stephen L. Sauder. Mr. Sauder was the President and principal stockholder of Valu-Line at the time the loan was made and is currently a Vice President and a Director of the Company. In addition, as of December 31, 1997, Valu-Line had notes payable of $105,457 from Mr. Sauder's father. The loans were due on demand. As of December 31, 1998, the amounts outstanding under these loans were fully repaid.

Dealings with Valu-Broadcasting, Inc.

In 1996, 1997, and 1998, Valu-Line provided services principally related to rent and operating costs to Valu-Broadcasting, Inc., an affiliate of Valu-Line and owned by a Birch stockholder at the time of the transactions, in the amounts of $74,000, $81,000 and $30,000 respectively. Valu-Line also received services principally related to advertising from Valu-Broadcasting, Inc. in the amounts of $31,000, $41,000 and $40,000 in 1996, 1997 and 1998, espectively.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Documents filed as part of this report

(1) Financial Statements

See "Item 8. Financial Statements and Supplementary Data" for Financial Statements included with this Annual Report on Form 10-K.

(2) Financial Statement Schedules

All schedules have been omitted because they are not required, not applicable, or the information is otherwise set forth in the financial statements or notes thereto.

(3) Exhibits

(a) Exhibits

Exhibit No.	Description of Exhibit
2.1	Agreement and Plan of Merger among Birch Telecom, Inc., Valu-Line Companies, Inc., Stephen L. Sauder, Paula K. Sauder, Richard L. Tidwell, Sarah J. Tidwell, Stormy Supiran and Carla S. Supiran. (incorporated by reference to Exhibit 2.1 to Birch Telecom, Inc.'s Registration Statement on Form S-4, as amended (SEC File No. 333-62797), originally filed September 3, 1998 (the "Form S-4")).
3.1	Amended and Restated Certificate of Incorporation of Birch Telecom, Inc. (incorporated by reference to Exhibit 3.1 to the Form S-4).
*3.2	Certificate of Amendment of Amended and Restated Certificate of Incorporation.
3.3	Restated Bylaws of Birch Telecom, Inc. (incorporated by reference to Exhibit 3.2 to the Form S-4).
4.1	Indenture, dated as of June 23, 1998, between Birch Telecom, Inc. and Norwest Bank Minnesota, National Association, as trustee, relating to $115,000,000 aggregate principal amount of 14% Senior Notes due 2008 (incorporated by reference to Exhibit 4.1 to the Form S-4).
4.2	Specimen Certificate of 14% Senior Notes due 2008 (the "Exchange Notes") (included in Exhibit 4.1, which is incorporated by reference to Exhibit 4.1 to the Form S-4).
4.4	Collateral Pledge and Security Agreement, dated as of June 23, 1998 from Birch Telecom, Inc., Pledgor, to Norwest Bank Minnesota, National Association, Trustee (incorporated by reference to Exhibit 4.5 to the Form S-4).
10.1	Birch Telecom, Inc. Securities Purchase Agreement (incorporated by reference to Exhibit 10.1 to the Form S-4).
10.2	Birch Telecom, Inc. Purchasers Rights Agreement (incorporated by reference to Exhibit 10.2 to the Form S-4).
10.3	Employment Agreement dated as of February 10, 1998 between Birch Telecom, Inc. and David E. Scott (incorporated by reference to Exhibit 10.3 to the Form S-4).
10.4	Employment Agreement dated as of February 10, 1998 between Birch Telecom, Inc. and Gregory C. Lawhon (incorporated by reference to Exhibit 10.4 to the Form S-4).
10.5	Employment Agreement dated as of February 10, 1998 between Birch Telecom, Inc. and Gary L. Chesser (incorporated by reference to Exhibit 10.5 to the Form S-4).
10.6	Employment Agreement dated as of February 10, 1998 between Birch Telecom, Inc. and David W. Vranicar (incorporated by reference to Exhibit 10.6 to the Form S-4).
10.7	Employment Agreement dated as of February 10, 1998 between Birch Telecom, Inc. and Stephen L.

	Sauder (incorporated by reference to Exhibit 10.7 to the Form S-4).
10.8	General Agreement between Birch Telecom, Inc. and Lucent Technologies Inc. (incorporated by reference to Exhibit 10.12 to the Form S-4).
10.9	Interconnection Agreement under Sections 251 and 252 of the Telecommunications Act of 1996 by and between Southwestern Bell Telephone Company and Birch Telecom of Missouri, Inc. (the "Missouri Interconnection Agreement") (incorporated by reference to Exhibit 10.13 to the Form S-4).
10.10	Amendment No. 1 dated May 27, 1998 to Missouri Interconnection Agreement. (incorporated by reference to Exhibit 10.10 to the Form 10-k)
+10.11	Software License Agreement between Birch Telecom, Inc. and Saville Systems Inc. (incorporated by reference to Exhibit 10.14 to the Form S-4).
10.12	Interconnection Agreement under Sections 251 and 252 of the Telecommunications Act of 1996 by and between Southwestern Bell Telephone Company and Birch Telecom of Kansas, Inc. (incorporated by reference to Exhibit 10.12 to the Form 10-K)
10.13	Interconnection Agreement under Sections 251 and 252 of the Telecommunications Act of 1996 by and between Southwestern Bell Telephone Company and Birch Telecom of Texas Ltd., LLP. (incorporated by reference to the Exhibit 10.13 to the Form 10-K)
*10.14	1998 Stock Option Plan
*10.15	Form of Incentive Stock Option Agreement under 1998 Stock Option Plan
*10.16	Form of Nonstatutory Stock Option Agreement under 1998 Stock Option Plan
*10.17	Lease Agreement between Francor, L.L.C. and Birch Telecom, Inc. dated July 20, 1998
12.1	Statement of Computation of Ratio of Earnings to Fixed Charges (incorporated by reference to Exhibit 12.1 to the Form S-4).
21.1	Subsidiaries of Birch Telecom, Inc. (incorporated by reference to Exhibit 21.1 to the Form S-4).
24.1	Power of Attorney (included on the signature page to this Form 10-K).
27.1	Financial Data Schedule

* Filed herewith.

+ Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Such portions have been filed separately with the Commission.

(b) Reports on Form 8-K

No report on Form 8-K was filed during the fourth quarter of fiscal 1998.

SIGNATURES

Pursuant to the requirements of the Section 13 or 15(d) of the Securities and Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Kansas City, State of Missouri, on May 6, 1999.

BIRCH TELECOM, INC.

By: /s/ David E. Scott
David E. Scott
President and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints David E. Scott and Bradley A. Moline, and each of them, his attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place, and stead, in any and all capacities, to sign any and all amendments to this Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission granting unto such attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming that all such attorneys-in-fact and agents, or any of them or their or his substitute or substituted, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities and Exchange Act of 1934, this Report has been signed by the following persons in the capacities and as of the dates indicated.

Signature	Title	Date
David E. Scott	President and Chief Executive Officer (Principal Executive Officer)	May 6, 1999
Bradley A. Moline	Chief Financial Officer (Principal Financial and Accounting Officer)	May 6, 1999
Henry H. Bradley	Director	May 6, 1999
Stephen L. Sauder	Director	May 6, 1999
Ian R. N. Bund	Director	May 6, 1999
David W. Bergmann	Director	May 6, 1999

Exhibit 12.1

COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

	December 31,					
	The Predecessor (1)				The Company	
	1994	1995	1996	1997	1997	1998
			(Dollars in thousands)			
Earnings						
Total earnings (loss)	$ 440	$ 94	$ 289	$ 268	$ (1,789)	$ (16,208)
Income tax	319	81	205	186	-	-
Capitalized interest	-	-	-	-	-	-
Subtotal	759	175	494	454	(1,789)	(16,208)
Fixed charges						
Interest charges	48	58	102	97	-	-
Interest factor of operating rents	10	13	16	19	-	-
Total fixed charges	58	71	118	116	-	-
Earnings, as adjusted	$ 817	$ 246	$ 612	$ 570	$ (1,789)	$ (16,208)
Ratio of earnings to fixed charges	14.09x	3.46x	5.19x	4.91x	-	-
Deficiency of earnings to fix charges	--	--	--	--	$ (1,789)	$(16,208)

Note: For purposes of calculating the ratio of earnings to fixed charges, earnings are defined as loss before income taxes plus fixed charges. Fixed charges consist of interest expense and a reasonable approximation of the interest factor included in rental payments on operating leases.

(1) The Predecessor company is Valu-Line Companies which were merged with Birch during February 1998. Prior to February 1998, Birch had no revenues and was in the developmental stage.

Exhibit 27.1

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONSOLIDATED FINANCIAL STATEMENTS OF BIRCH TELECOM, INC. AS OF, AND FOR THE YEAR ENDING DECEMBER 31, 1998 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH CONSOLIDATED FINANCIAL STATEMENTS INCLUDED IN THE ANNUAL REPORT ON FORM 10-K OF BIRCH TELECOM, INC.

MULTIPLIER 1000
CURRENCY U.S. DOLLARS

PERIOD-TYPE	YEAR
FISCAL-YEAR END	DECEMBER 31, 1998
PERIOD-START	JANUARY 1, 1998
PERIOD-END	DECEMBER 31, 1998
EXCHANGE-RATE	1
CASH	39,745
SECURITIES	15,888
RECEIVABLES	4,267
ALLOWANCES	228
INVENTORY	916
CURRENT-ASSETS	61,114
PP&E	26,900
DEPRECIATION	747
TOTAL-ASSETS	134,149
CURRENT-LIABILITIES	11,394
BONDS	114,681
PREFERRED-MANDATORY	14,063
PREFERRED	8
COMMON	5
OTHER-SE	(7,112)
TOTAL LIABILITY-AND-EQUITY	134,149
SALES	26,087
TOTAL-REVENUES	26,087
CGS	18,886
TOTAL COSTS	18,886
OTHER-EXPENSES	18,077
LOSS-PROVISION	0
INTEREST-EXPENSE	8,254
INCOME-PRETAX	(16,208)
INCOME-TAX	0
INCOME-CONTINUING	(16,208)
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET-INCOME	(16,208)
EPS-BASIC	(4.71)
EPS-DILUTED	(4.71)

INDEX TO FINANCIAL STATEMENTS

BIRCH TELECOM, INC.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Birch Telecom, Inc.

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

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

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

Ernst & Young LLP

Kansas City, Missouri
February 19, 1999

BIRCH TELECOM, INC.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 1997 AND 1998
(In thousands except share data)

	1997	1998
Assets		
Current assets:		
Cash and cash equivalents	$ 210	$ 39,745
Pledged securities	—	15,888
Accounts receivable, net	—	4,039
Inventory	—	916
Prepaid expenses and other	7	526
Total current assets	217	61,114
Property and equipment, net	101	26,153
Pledged securities - noncurrent	—	21,897
Goodwill, net	—	16,863
Other intangibles, net	—	7,689
Other assets	216	433
Total assets	$ 534	$ 134,149
Liabilities and Stockholders' Equity		
Current liabilities:		
Current maturities of long-term debt and capital lease obligations	$ —	$ 335
Notes payable to related parties	250	—
Accounts payable	255	8,503
Accrued expenses	—	2,556
Total current liabilities	505	11,394
14% Senior Notes	—	114,681
Capital lease obligations, net of current maturities	—	778
Other long-term debt, net of current maturities	—	332
Preferred stock, $.001 par value; 25,000,000 shares authorized:		
Series B Redeemable Preferred Stock, 8,572,039 shares issued and outstanding (stated at redemption and aggregate liquidation value)	—	14,063
Stockholders' equity:		
Series C Preferred Stock, 8,492,749 shares issued and outstanding	—	8
Common stock, $.01 par value, 20,000,000 shares authorized, 1,800,000 shares issued and outstanding at December 31, 1997	18	—
Common stock, $.001 par value, 27,000,000 shares authorized, 5,000,296 shares issued and outstanding at December 31, 1998	—	5
Warrants	18	337
Additional paid-in capital	1,782	12,273
Accumulated deficit	(1,789)	(19,722)
Total stockholders' equity (deficit)	29	(7,099)
Total liabilities and stockholders' equity (deficit)	$ 534	$ 134,149

See accompanying notes.

BIRCH TELECOM, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 1997 AND 1998
(In thousands except share data)

	1997	1998
Revenue:		
Communications services, net	$ —	$ 21,783
Equipment sales, net	—	4,304
Total revenue	—	26,087
Cost of services:		
Cost of communications services	—	16,339
Cost of equipment sales	—	2,547
Total cost of services	—	18,886
Gross margin	—	7,201
Selling, general and administrative expense	1,776	15,769
Depreciation and amortization expense	27	2,308
Loss from operations	(1,803)	(10,876)
Interest expense	—	(8,254)
Interest income	14	2,922
Net loss	(1,789)	(16,208)
Preferred stock dividends	—	(1,696)
Amortization of preferred stock issuance costs	—	(29)
Loss applicable to common stock	$ (1,789)	$ (17,933)
Loss per common share — basic and diluted	$ (1.45)	$ (4.71)
Weighted average number of common shares outstanding	1,235	3,809

See accompanying notes.

BIRCH TELECOM, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
YEARS ENDED DECEMBER 31, 1997 AND 1998
(In thousands)

	Series A Preferred Stock		Series C Preferred Stock		Common Stock			Common Stock					
	Number of Shares	$.001 Par	Number of Shares	$.001 Par	Number of Shares	$.01 Par	Warrants	Number of Shares	$.001 Par	Warrants	Additional Paid-In Capital	Accumulated Deficit	Total
Balance at December 23, 1996 (date of inception) and December 31, 1996	—	$ —	—	$ —	—	$ —	$ —	—	$ —	$ —	$ —	$ —	$ —
Issuance of common stock and warrants	—	—	—	—	1,800	18	18	—	—	—	1,782	—	1,818
Net loss	—	—	—	—	—	—	—	—	—	—	—	(1,789)	(1,789)
Balance at December 31, 1997	—	—	—	—	1,800	18	18	—	—	—	1,782	(1,789)	29
Recapitalization	—	—	1,800	2	(1,800)	(18)	(18)	—	—	—	34	—	—
Issuance of common stock	—	—	—	—	—	—	—	450	—	—	—	—	—
Merger with Valu-Line	2,969	3	6,250	6	—	—	—	—	—	—	14,741	—	14,750
Issuance of Warrants in connection with 14% Senior Notes	—	—	—	—	—	—	—	—	—	337	—	—	337
Redemption of Series A Preferred Stock	(2,969)	(3)	—	—	—	—	—	—	—	—	(4,747)	—	(4,750)
Stock dividend	—	—	443	—	—	—	—	262	1	—	(1)	—	—
Option exercise	—	—	—	—	—	—	—	4,305	4	—	—	—	4
Early exercised options terminated	—	—	—	—	—	—	—	(17)	—	—	—	—	—
Restatement of Series B Preferred Stock dividends	—	—	—	—	—	—	—	—	—	—	64	—	464
Amortization of Preferred Stock issuance costs	—	—	—	—	—	—	—	—	—	—	—	(29)	(29)
Series A Preferred Stock dividends	—	—	—	—	—	—	—	—	—	—	—	(168)	(168)
Series B Preferred Stock dividends	—	—	—	—	—	—	—	—	—	—	—	(1,528)	(1,528)
Net loss	—	—	—	—	—	—	—	—	—	—	—	(16,208)	(16,208)
Balance at December 31, 1998	—	$ —	8,493	$ 8	—	$ —	$ —	5,000	$ 5	$ 337	$ 12,273	$ (19,722)	$ (7,099)

BIRCH TELECOM, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 1997 AND 1998
(In thousands)

	1997	1998
Operating activities		
Net loss	$ (1,789)	$ (16,208)
Adjustments to reconcile net loss to net cash from operating activities:		
Depreciation	27	720
Amortization	—	1,588
Provision for losses on accounts receivable	—	140
Other	50	16
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	—	(1,905)
Inventory	—	(300)
Prepaid expenses	(7)	(370)
Other assets	—	(198)
Accounts payable	255	3,888
Accrued expenses	—	1,986
Net cash from operating activities	(1,464)	(10,643)
Investing activities		
Purchase of property and equipment	(128)	(21,550)
Costs of interconnection agreements	(87)	—
Business acquisitions, net of cash acquired	—	(7,757)
Amortization of discount on pledged securities	—	(1,231)
Maturity of pledged securities	—	7,692
Purchase of pledged securities	—	(44,247)
Net cash from investing activities	(215)	(67,093)
Financing activities		
Proceeds from issuance of common stock and warrants	1,768	342
Proceeds from issuance of preferred stock	—	9,500
Deferred financing costs	(129)	(4,922)
Payment of Series A Preferred Stock dividends	—	(168)
Proceeds from convertible notes	—	3,500
Proceeds from 14% Senior Notes	—	114,663
Redemption of Series A Preferred Stock	—	(4,750)
Repayment of capital lease obligations	—	(172)
Proceeds from long-term debt	—	123
Repayment of long-term debt	—	(321)
Borrowing (repayment) of notes payable to stockholder	250	(524)
Net cash from financing activities	1,889	117,271
Net increase in cash and cash equivalents	210	39,535
Cash and cash equivalents at beginning of year	—	210
Cash and cash equivalents at end of year	$ 210	$ 39,745
Supplementary schedule of non-cash investing and financing activities:		
Amounts recorded in connection with acquisitions:		
Fair value of net assets acquired, net of cash acquired	$ —	$ 5,735
Fair value of intangible assets	—	20,839
Assumption of long-term debt and capital lease obligations	—	(3,999)
Issuance of Series A Preferred Stock	—	(10,000)
Issuance of Series C Preferred Stock	—	(4,750)
Common stock issued in exchange for other assets	50	—
Property and equipment acquired through capital lease	—	728
Property and equipment additions included in accounts payable	—	2,157
Supplemental disclosure of cash flow information:		
Cash payment for interest, net of interest capitalized of $436 in 1998	—	7,725

See accompanying notes.

BIRCH TELECOM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The Company

Birch Telecom, Inc. was incorporated December 23, 1996, as a Delaware corporation for the purpose of providing local, long distance, Internet access, and other communications services to business and residential customers initially in Kansas and Missouri. The consolidated financial statements of Birch Telecom, Inc. include the accounts of Birch Telecom, Inc. and the accounts of its subsidiaries, all of which are wholly owned (collectively, the Company). The Company's business is highly competitive and is subject to various federal, state and local regulations.

The Company was in the development stage for the period from December 23, 1996 (date of inception) to February 10, 1998. Accordingly, the Company had no operating revenue and incurred operating losses and operating cash flow deficits during that period.

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents

For purposes of reporting cash flows, the Company includes as cash and cash equivalents highly liquid investments with original maturities of three months or less.

Revenue Recognition

Revenue for communications services are recognized when customers use the associated services. Equipment revenue is recognized when systems or services are substantially complete. Revenue on billings to customers in advance of providing services is deferred and recognized when earned.

Cost of Services

Cost of services includes local and long-distance services purchased from Southwestern Bell Telephone, interexchange carriers and certain providers of fiber optic telephone networks. Cost of services also includes costs associated with the sale and installation of telephone systems.

Inventory

Inventory is carried at the lower of average cost or market determined on a first-in, first-out basis and consists primarily of parts and equipment used in the maintenance and installation of telephone systems.

Advertising Costs

Advertising costs are expensed as incurred and totaled $895,000 for the year ended December 31, 1998.

Property and Equipment

Property and equipment is stated at cost and depreciated using the straight-line method over the following estimated useful lives of the assets:

	Years
Communications network	3-10
Buildings, furniture, fixtures and equipment	3-40

Goodwill

Goodwill represents the excess of the purchase price paid over the fair value of the net assets acquired in the Company's acquisitions. Goodwill is being amortized over 25 years using the straight-line method and is periodically reviewed for impairment based upon an assessment of future operations to ensure that it is appropriately valued. Accumulated amortization on goodwill totaled $599,000 at December 31, 1998.

Other Intangibles

Other intangibles consist primarily of customer lists and noncompete agreements related to the Company's acquisitions and deferred financing costs. Customer lists and noncompete agreements are amortized over periods ranging from 1 to 5 years using the straight-line method. The deferred financing costs are amortized over 5 to 10 years, the term of the associated financing, using the straight-line method. Accumulated amortization on other intangibles totaled $1,050,000 at December 31, 1998.

Income Taxes

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Net deferred tax assets are reduced by a valuation allowance when appropriate (see Note 11). Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Stock Options

The Company has adopted the disclosure provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, which establishes a fair value based method for the financial reporting of its stock-based employee compensation plans. However, as allowed by SFAS No. 123, the Company has elected to continue to measure compensation using the intrinsic value based method as prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. Under this method, compensation is measured as the difference between the market value of the stock on the grant date, less the amount required to be paid for the stock. The difference, if any, is charged to expense over the vesting period of the options. The estimated market value used for the stock options granted was determined on a periodic basis by the Company's Board of Directors.

Fair Values of Financial Instruments

The carrying amount of cash and cash equivalents approximates fair value due to the short maturity of the instruments. The fair value of the Company's pledged securities was $38 million at December 31, 1998. The fair value of the Company's senior notes is estimated to be $106 million at December 31, 1998 based on the quoted market rates for the debt. The fair value of other long-term debt approximates the recorded value.

Use of Estimates in Financial Statements

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

Loss Per Share

The net loss per share amount reflected on the consolidated statement of operations is based on the weighted-average number of common shares outstanding. Stock options and convertible preferred stock are antidilutive, and therefore excluded from the computation of earnings per share. In the future, these stock equivalents may become dilutive.

Reclassifications

Certain items in the 1997 consolidated financial statements have been reclassified to be consistent with the classification in the 1998 consolidated financial statements.

3. Acquisitions

In February 1998, Birch merged with Valu-Line in a transaction valued at $19.5 million, consisting of $4.75 million in cash, 2,968,750 shares of Series A Preferred Stock having an aggregate liquidation preference of $4.75 million and 6,250,000 shares of Series C Preferred Stock having an aggregate liquidation preference of $10.0 million. Since 1982, Valu-Line has been primarily providing switched long distance services, customer premises equipment (CPE) sales and services and, since March 1997, local service. In connection with the merger, intangible assets were recorded related to customer lists and goodwill totaling $2,000,000 and $15,541,878, respectively.

In May 1998, Birch acquired Boulevard Phone Company, a shared tenant service provider in the Kansas City metropolitan area, for $300,000 in cash. Goodwill totaling $274,000 was recorded related to the acquisition.

In May 1998, Birch acquired Telesource Communications, Inc. (Telesource), a CPE provider in the Kansas City metropolitan area, for $325,000 in cash. In connection with the Telesource acquisition, the Company assumed $290,000 of Telesource's liabilities. Goodwill and customer lists associated with the acquisition were recorded totaling $325,000 and $328,000, respectively.

In September 1998, Birch acquired TFSnet, Inc., an Internet service provider based in the Kansas City metropolitan area, for $2.65 million in cash. Goodwill and customer lists associated with the acquisition were recorded totaling $1.1 million and $1.2 million, respectively.

All acquisitions were recorded using the purchase method of accounting. Results from the acquired companies are included in the consolidated financial statements from the date of the respective acquisitions.

The following is unaudited pro forma information reflecting the affect of the acquisitions on the Company's results as though they had been completed effective January 1, 1997 and 1998 (*in thousands except per share amounts*):

	December 31, 1997	December 31, 1998
Revenue	$ 18,847	$ 29,193
Net loss	19,325	28,921
Loss per common share	15.65	8.05

4. Accounts Receivable

The composition of accounts receivable, net is as follows (*in thousands*):

	December 31, 1997	December 31, 1998
Billed	$ —	$ 3,144
Unbilled	—	1,129
	—	4,273
Less allowance for doubtful accounts	—	234
	$ —	$ 4,039

5. Property and Equipment

The following is a summary of the Company's property and equipment as of December 31, 1997 and 1998 (*in thousands*):

	1997	1998
Communications network	$ —	$ 5,966
Buildings, furniture, fixtures and equipment	128	6,529
Construction in progress	—	14,405
	128	26,900
Less accumulated depreciation and amortization	27	747
Property and equipment, net	$ 101	$ 26,153

6. Pledged Securities, Warrants, and Debt

During June 1998, the Company completed a $115 million private offering of 14% Senior Notes (the Senior Notes) due June 2008 and 115,000 warrants to purchase 1,409,734 shares of common stock. Interest on the Senior Notes is payable semi-annually in arrears on June 15 and December 15 of each year. Warrants are exercisable at $0.01 per share and expire June 2008. The Company received net proceeds from the Senior Notes of $110.2 million and concurrently purchased pledged securities of $44.2 million. The pledged securities are restricted for interest payments on the Senior Notes and, together with the interest accruing thereon, will be used to satisfy such interest payments through June 2001. The Company classifies its pledged securities, consisting of $37.8 million of U.S. Treasury securities at December 31, 1998, as held to maturity recorded at amortized cost and maturing between six and thirty months. A portion of the proceeds of this offering, $337,000, was allocated to the warrants, and the resulting debt discount is being amortized over the life of the debt on the straight-line method, which does not differ materially from the effective interest method. Unamortized discount was $319,000 at December 31, 1998. The amount allocated to the warrants represents the estimated fair value of the warrants at the date of issuance. The Senior Notes rank pari pasu in right of payment to all existing and future senior indebtedness of the Company and rank senior in the right of payment to all existing and future subordinated indebtedness of the Company.

The Company filed a registration statement with the Securities and Exchange Commission (SEC) for the registration of $115 million aggregate principal amont of 14% Senior Notes due December 2008 (the Exchange Notes) to be offered in exchange for the Senior Notes (the Exchange Offer). The registration statement was declared effective by the SEC in February 1999, and the Exchange Offer was commenced at that time. The Exchange Offer will expire in March 1999, at which time all of the Senior Notes will be exchanged for the Exchange Notes. The form and terms of the Exchange Notes are identical in all material respects to the form and terms of the Senior Notes except the Exchange Notes will have been registered under the Securities Act and holders of the Exchange Notes will not be entitled to certain rights under a registration agreement relating to the Senior Notes.

The indenture related to the Senior Notes contains certain covenants which, among other things, restrict the ability of the Company to incur additional indebtedness, pay dividends or make distributions of the Company's or its subsidiaries' stock, enter into sale and leaseback transactions, create liens, enter into transactions with affiliates or related persons, consolidate, merge or sell all of its assets. The Company was in compliance with these covenants at December 31, 1998.

The Company's debt consisted of the following at December 31, 1997 and 1998 (*in thousands*):

	December 31, 1997	December 31, 1998
14 % Senior Notes	$ —	$ 114,681
Other long-term debt, interest accruing between 8.9% and 9.8%, maturing through 2013, secured by buildings	—	345
Less current maturities	—	13
	$ —	$ 332

Assets securing the other long-term debt total $814,000, net of accumulated depreciation of $19,000.

Principal payments required on the outstanding debt during each of the next five years are as follows (*in thousands*):

1999	$ 13
2000	14
2001	16
2002	17
2003	19

7. Capital Lease Obligations

The Company leases telecommunications equipment and computer equipment under capital leases with imputed interest between 8.0% and 10.2%. Assets under capital lease total $1,459,000, net of accumulated amortization of $210,000 at December 31, 1998. The future minimum lease payments under the capital leases and the present value of the net minimum lease payments as of December 31, 1998 are as follows (*in thousands*):

1999	$ 447
2000	447
2001	257
2002	58
2003	58
Total minimum lease payments	1,267
Less amount representing interest	167
Present value of net minimum lease payments	1,100
Less current maturities	322
	$ 778

Amortization expense for assets under capital lease was $157,000 for the year ended December 31, 1998.

8. Capital Structure

During 1997, 1,750,000 shares of common stock and 1,800,000 warrants were sold to management and equity investors for $1.00 and $0.01 per share, respectively. The warrants entitled the holders to purchase an additional 1.8 million shares in the aggregate of common stock at $1.00 per share. In addition to cash investments, members of management contributed the business plan to the Company in exchange for 50,000 shares of common stock valued at $1.00 per share. During 1998, all common stock was exchanged for Series C Preferred Stock and the warrants were surrendered.

First Quarter 1998 Recapitalization

During February and March 1998, the Company issued $9.5 million of Series B Preferred Stock, issued $3.5 million of Convertible Notes, converted common stock to Series C Preferred Stock, canceled the 1997 Stock Option Plan, and created the 1998 Stock Option Plan in transactions related to new investors.

The Series B Preferred Stock and Convertible Notes generated net proceeds of $12.4 million. In June 1998, the Convertible Notes were converted into Series B Preferred Stock. The Series B Preferred Stock accrues cumulative compounding dividends at 15% per annum and is mandatorily redeemable in equal annual installments in 2003, 2004 and 2005 provided, however, that so long as any of the Company's Senior Notes due 2008 are outstanding, none of the Series B Preferred Stock may be redeemed until the earlier of June 15, 2008 or the 91st day after redemption in full of the Senior Notes. During the year ended December 31, 1998 cumulative dividends on the Series B Preferred Stock totalled 1,063,000. The Series B Preferred Stock is convertible into 8,572,039 (after considering stock dividend described below) shares of common stock at the option of the holders. The shares have liquidation preference over the Series C Preferred Stock and common stock at the greater of (i) par value plus accrued but unpaid dividends or (ii) par value plus the fair market value of common stock into which the shares could be converted. Each share can be converted into a share of common stock at the option of the holder.

In February 1998, the old common stockholders exchanged all of the previously issued and outstanding $1.00 par value common stock for an equal number of shares of Series C Preferred Stock and relinquished all rights to the warrants previously held. The Series C Preferred Stock outstanding after the conversion and merger transactions total 8,492,750 shares (after considering stock dividend described below). All shares were issued at $1.52 per share and have a $0.001 par value. The convertible, voting shares have a 10% non-cumulative dividend. The shares have liquidation preference over the common stock at the greater of (i) par value plus accrued but unpaid dividends or (ii) par value plus the fair market value of common stock into which the shares could be converted. Each share can be converted into a share of common stock at the option of the holder. Voting rights are exercised together with Series B and Series C Preferred Stocks but not common stock. The Series C Preferred Stock is subordinate to the Series B Preferred Stock.

The 1997 Stock Option Plan was canceled and vested options were forfeited and the 1998 Stock Option Plan was created (See Note 12). Certain employees were allowed to purchase 474,750 (after considering stock dividend described below) shares of new common stock at par value ($0.001 per share) in exchange for the forfeiture of the vested options.

The new common stock has voting rights equal to the Series B and C Preferred Stock. Common stock dividends, if any, will be declared at the discretion of the board of directors.

The Series A Preferred Stock issued in comnection with the Valu-Line Merger (See Note 3) was fully redeemed in June 1998. Dividends paid totaled $168,000 in 1998.

Stock Dividend

On June 23, 1998, the Company paid a dividend in kind, in the amount of 0.055 shares per share, to the holders of the Company's Series B Preferred Stock, Series C Preferred Stock, and common stock as of June 15, 1998.

9. Related-Party Transactions

During December 1997, the Company borrowed $250,000 from the Company's principal stockholder under a note payable. The note payable was fully repaid in February 1998.

The Company acquired notes payable to Valu-Line shareholders totaling $274,000 in the Valu-Line merger. These notes were fully repaid during 1998.

During 1998, a broadcasting company owned by one of the Birch's shareholders rented office space from Birch for $30,000. Birch purchased advertising from the broadcasting company totaling $40,000 in 1998.

10. Commitments and Contingencies

Future minimum rental commitments at December 31, 1998 for all noncancelable operating leases, consisting mainly of leases for office space and equipment, are as follows *(in thousands)*:

1999	$	1,180
2000		1,050
2001		1,060
2002		945
2003		836
Thereafter		2,891
Total	$	7,962

Total rent expense for the years ended December 31, 1997 and 1998 was $81,000 and $485,000, respectively.

In February 1998, the Company entered into a five-year general agreement with Lucent Technologies, Inc. (Lucent) establishing terms and conditions for the purchase of Lucent products, services and licensed materials. This agreement includes a five-year exclusivity commitment for the purchase of products and services related to new switches. The agreement contains no minimum purchase requirements.

11. Income Taxes

Net deferred taxes consist of the following as of December 31, 1997 and 1998 (*in thousands*):

	1997	1998
Deferred tax assets:		
Net operating loss carryforwards	$ —	$ 5,528
Accruals and reserves not currently deductible	—	91
Other	681	668
	681	6,287
Valuation allowance	(681)	(5,799)
	—	488
Deferred tax liabilities:		
Property and equipment	—	488
	$ —	$ —

In the years ended December 31, 1997 and 1998, the net income tax benefits of approximately $681,000 and $6.0 million, respectively, have been offset by increases in the valuation allowance. At December 31, 1998, the Company had operating loss carryforwards for federal income tax purposes of approximately $13.8 million, expiring in 2013.

The primary difference that caused the effective tax rate to vary from the statutory federal income tax rate of 35% was the valuation allowance.

12. Stock Option Plan

At December 31, 1997, the Company had granted options to purchase common stock under the 1997 Stock Option Plan. The options granted had a term of 10 years and vested over a four-year period. This plan was terminated and superseded in 1998 by the 1998 Stock Option Plan. No options were or ever will be exercised and no shares were or will ever be issued under the terminated and superseded 1997 Stock Option Plan.

Stock option activity under the 1997 Stock Option Plan was as follows:

	Shares	Weighted-Average Per Share Exercise Price
Granted	2,783,000	$ 1.00
Exercised	—	—
Forfeited	—	—
Outstanding at December 31, 1997	2,783,000	1.00
Terminated	(2,783,000)	(1.00)
Outstanding at December 31, 1998	—	$ —

Stock option activity under the 1998 Stock Option Plan was as follows:

	Shares	Weighted-Average Per Share Exercise Price
Granted	5,065,984	$ 0.26
Exercised	4,542,139	0.01
Forfeited	44,918	1.55
Outstanding at December 31, 1998	478,927	$ 2.48
Exercisable at December 31, 1998	—	

The 1998 Stock Option Plan authorized the grant of options for up to 6,195,844 shares of the Company's common stock. The options have a term of 10 years and vest over a four-year period. All options exercised during 1998 were for options granted with an early exercise provision. The shares from exercised options continue to be subject to the four-year vesting period.

Options granted in 1998 had exercise prices approximating the market value. Exercise prices for options outstanding at December 31, 1998 ranged from $0.001 to $2.50. The weighted average remaining contractual life of those options is 3.1 years. At December 31, 1998, the Company has reserved 1,129,860 shares of common stock for issuance under the 1998 Stock Option Plan.

The Company estimated the fair value of each option grant using the minimum value method permitted by SFAS No. 123 for entities not publicly traded. The Company utilized the following assumptions in the calculation: risk-free interest rate of 5.25%, expected life of four years and no dividends being paid over the life of the options. Had compensation cost for the stock based compensation plan been determined as prescribed by SFAS No. 123, the net loss and loss per common share would have been as follows for the years ended December 31, 1997 and 1998 (*in thousands except per share data*):

	1997	1998
Net loss — as reported	$ (1,789)	$ (16,208)
Net loss — pro forma	(1,921)	(16,212)
Loss per share — Basic and Diluted — Pro Forma	(1.56)	(4.26)

13. Employee Benefit Plan

The Company sponsors a 401(k) profit-sharing plan covering substantially all employees under which employees can contribute up to 15% of their annual salary subject to annual maximum limitations. Employees can participate after meeting the plan's eligibility requirements. The Company may also make discretionary contributions. Company contributions to the plan were $148,000 for the year ended December 31, 1998.

14. Employment Agreements

The Company has entered into employment agreements with certain executive employees, which provide for payments to be made in connection with certain termination of employment or change of control. The benefits include cash compensation, immediate vesting of outstanding stock options and coverage under the Company's group health plan.

15. Significant Suppliers

The Company purchased telephone services from Southwestern Bell Telephone amounting to 29% of revenue in the year ended December 31, 1998. The Company purchased switches and other network equipment and software from Lucent Technologies amounting to $7.5 million in the year ended December 31, 1998.

16. Subsequent Events

In February 1998, the Company acquired American Local Telecommunications (ALT), a competitive local exchange carrier based in the Dallas, Texas metropolitan area. The acquisition, which was recorded as a purchase, included substantially all assets of ALT. The total purchase price was approximately $700,000.

In February 1998, the Company signed a letter of intent to acquire the stock of Capital Communications Corporation, a telecommunications equipment provider based in the St. Louis, Missouri metropolitan area. The purchase price is anticipated to be $3.0 million, plus the potential for additional consideration based on lines converted to the Company's service from Capital Communications Corporation's existing customer base.

17. Quarterly Data — Unaudited

The following table includes summarized quarterly financial data for the years ended December 31, (*in thousands*):

	Quarters			
	First	Second	Third	Fourth
1998:				
Revenue	$ 3,705	$ 6,060	$ 7,478	$ 8,844
Gross margin	1,063	1,628	2,305	2,205
Operating loss	(567)	(1,486)	(2,996)	(5,827)
Net loss	(623)	(1,766)	(5,468)	(8,351)
Loss per common share	(0.79)	(0.55)	(1.19)	(1.76)
1997:				
Revenue	$ —	$ —	$ —	$ —
Gross margin	—	—	—	—
Operating loss	(111)	(573)	(549)	(570)
Net loss	(112)	(570)	(543)	(564)
Loss per common share	(0.22)	(0.52)	(0.35)	(0.31)

REPORT OF INDEPENDENT AUDITORS

The Board of Directors
Valu-Line Companies, Inc.

We have audited the accompanying consolidated balance sheet of the Valu-Line Companies, Inc. (the Company) as of December 31, 1997, and the related consolidated statements of income and retained earnings, and cash flows for two years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Valu-Line Companies, Inc. at December 31, 1997 and the consolidated results of its operations and its cash flows for each of the two years in the period ended December 31, 1997 in conformity with generally accepted accounting principles.

Ernst & Young LLP

Kansas City, Missouri
May 15, 1998

VALU-LINE COMPANIES, INC.
CONSOLIDATED BALANCE SHEET
December 31, 1997
(In thousands except share data)

Assets	
Current assets:	
Cash and cash equivalents	$258
Accounts receivable, net of allowance of $70,	1,790
Other receivables — related parties	97
Inventories	530
Prepaid expenses	37
Income taxes receivable	30
Other assets	60
Deferred income taxes	71
Total current assets	2,873
Property and equipment, net	1,612
Other assets	317
Total assets	$4,802
Liabilities and stockholders' equity	
Current liabilities:	
Current maturities of long-term debt and capital lease obligation	$110
Notes payable — related parties	240
Accounts payable	1,262
Accrued expenses	225
Customer deposits	39
Accrued salaries and commissions	266
Deferred revenue	287
Total current liabilities	2,429
Long-term debt, net of current maturities	345
Capital lease obligation, net of current maturities	336
Deferred income taxes	27
Stockholders' equity	
Common stock, no par value, 100,000 shares authorized; 10,360 issued and outstanding	181
Retained earnings	1,484
Total stockholders' equity	1,665
Total liabilities and stockholders' equity	$4,802

See accompanying notes.

VALU-LINE COMPANIES, INC.
CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

	Years Ended December 31, 1996	Years Ended December 31, 1997
	(In thousands except shares and per share data)	
Revenue:		
Communications services, net	$ 10,686	$ 13,785
Equipment sales, net	2,531	3,016
Total revenue	13,217	16,801
Cost of services:		
Cost of communications services	7,308	9,859
Cost of equipment sales	1,441	1,983
Total cost of services	8,749	11,842
Gross margin	4,468	4,959
Selling, general and administrative	3,561	4,067
Depreciation and amortization	311	341
Income from operations	596	551
Interest expense	102	97
Income before income taxes	494	454
Income tax expense	205	186
Net income	289	268
Retained earnings, beginning of year	927	1,216
Retained earnings, end of year	$ 1,216	$ 1,484
Earnings per share — basic and diluted	$ 27.90	$ 25.87
Common shares outstanding — basic and diluted	10,360	10,360

See accompanying notes.

VALU-LINE COMPANIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31, 1996	Years Ended December 31, 1997
	(In thousands)	
Operating activities		
Net income	$ 289	$ 268
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	311	341
Deferred income taxes	7	(14)
Income tax expense	43	73
Changes in operating assets and liabilities:		
Accounts receivable	185	(660)
Other receivables — related parties	(18)	(52)
Inventory	(122)	(94)
Income taxes receivable/payable	290	(56)
Accounts payable	(303)	520
Accrued expenses and other current liabilities	188	304
Other	(36)	(142)
Net cash from operating activities	834	488
Investing activities		
Purchase of property and equipment	(513)	(243)
Net cash from investing activities	(513)	(243)
Financing activities		
Proceeds from issuance of long-term debt	92	—
Proceeds from issuance of note payable	—	—
Proceeds from issuance of notes payable — related parties	33	—
Payment of notes payable	(300)	(11)
Payment of notes payable — related parties	—	(44)
Payment of long-term debt	—	—
Payment of capital lease obligation	(82)	(90)
Net cash from financing activities	(257)	(145)
Net increase (decrease) in cash and cash equivalents	64	100
Cash and cash equivalents, beginning of year	94	158
Cash and cash equivalents, end of year	$ 158	$ 258

See accompanying notes.

VALU-LINE COMPANIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended December 31, 1997 and 1996

1. The Company

These consolidated financial statements include the accounts of Valu-Line Companies, Inc., a Kansas Corporation, and its wholly-owned subsidiaries (collectively, the "Company"), Valu-Line of Kansas, Inc. and IS Advertising. The Company was acquired by Birch Telecom, Inc. in February 1998 (see *Note 11*). The accounts of Valu Broadcasting, Inc. and Steve Sauder Real Estate, respectively, a wholly-owned subsidiary of and a division of Valu-Line Companies, Inc., both of which were spun off in December 1997, have been excluded for all periods from these consolidated financial statements in order to reflect financial position and operating results on a basis consistent with the businesses acquired by Birch Telecom, Inc. All intercompany balances and transactions have been eliminated in consolidation.

The Company provides local, long distance, Internet, customer premises equipment and other communications services to business and residential customers in the state of Kansas.

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents

For purposes of reporting cash flows, the Company includes as cash and cash equivalents, cash and marketable securities with original maturities of three months or less.

Revenue Recognition

Revenue from communications services is recognized when the services are provided. Revenue on billings to customers in advance of providing services is deferred and recognized when earned.

Concentration of Credit Risk

The Company is exposed to concentrations of credit risk principally from customer accounts receivable. At December 31, 1997, the Company's customers are located in the state of Kansas. The Company performs ongoing credit evaluations of its customers as a means to reduce credit risk.

Fair Values of Financial Instruments

As of December 31, 1997, the fair values of the Company's financial instruments, including cash equivalents and notes payable — related parties, approximate their carrying value.

Inventories

Inventories, which consist of customer premises communications equipment held for sale and supplies, are valued at lower of average cost or market.

Property and Equipment

Property and equipment, including assets held under capital leases, are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the related assets or lease term.

Use of Estimates in Financial Statements

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

3. Property and Equipment

The components of property and equipment at December 31, 1997 are as follows:

	Estimated Useful Lives	1997
		(In thousands)
Telecommunications and other equipment	5 years	$1,103
Office equipment, furniture and other............	3 - 7 years	1,178
Buildings and improvements	40 years	683
		2,964
Accumulated depreciation and amortization...		(1,352)
		$1,612

Telecommunication equipment under capital lease was $607,000 at December 31, 1997. Accumulated amortization totaled $194,000 as of December 31, 1997. Amortization of assets under capital lease is included in depreciation and amortization expense. Interest expense associated with the obligations under these leases amounted to $47,000 in 1997.

4. Capital Lease Obligation

The Company leases telecommunications equipment under a capital lease. The future minimum lease payments under the capitalized lease and the present value of the net minimum lease payments as of December 31, 1997 are as follows (*in thousands*):

1998	$137
1999	137
2000	137
2001	57
2002	57
2003	57
Total minimum lease payments	582
Less amount representing interest........................	(147)
Present value of net minimum lease payments with interest at 10.0%........................	435
Less current maturities........................	(99)
	$336

5. Long Term Debt and Notes Payable

The Company entered into a note payable with a financial institution in the amount of $300,000 in 1992 to finance the remodeling of a building. The note is payable in monthly installments through 2007. Interest is payable at prime plus 1 1/2% (10.0% at December 31, 1997). The note is secured by the building and the deposit accounts of the Company with the financial institution. The outstanding principal balance on the note was $262,000 at December 31, 1997.

In 1996, the Company issued a note payable of $100,000 to finance the purchase of an office building. The note is payable in monthly installments through 2011. Interest is payable at a variable rate (8.90% at December, 31, 1997). The note is secured by the building. The outstanding principal balance on the note was $94,000 at December 31, 1997.

Maturities on the aforementioned notes payable are as follows (*in thousands*):

1998	$11
1999	13
2000	14
2001	15
2002	17
Thereafter	286
Total	$356

The Company also has notes payable to officers of the Company and members of their families. The notes are unsecured and payable on demand. Interest is payable at the treasury rate (5.85% at December 31, 1997). The outstanding principal balance on these notes was $240,000 at December 31, 1997. Principal and interest payments were $43,000 and $128,000 for 1996 and 1997, respectively.

Total interest paid for the years 1996 and 1997 was $102,000 and $97,000, respectively.

6. Employee Benefit Plan

The Company sponsors a 401(k) profit-sharing plan covering substantially all employees under which employees can contribute up to 15% of their annual salary subject to annual Internal Revenue Code maximum limitations. Employees can participate after meeting the plan's eligibility requirements. The Company may make a discretionary contribution. Company contributions to the plan were $72,000 and $81,000 for 1996 and 1997, respectively.

7. Income Taxes

The income tax expense (benefit) consisted of the following:

	Years Ended December 31,	
	1996	1997
	(In thousands)	
Current:		
Federal	$174	$175
State	24	25
Total Current	198	200
Deferred:		
Federal	6	(12)
State	1	(2)
Total deferred	7	(14)
Income tax expense	$205	$186

The differences between the amount computed by applying the statutory federal income tax rate to income before income taxes and the provision for income taxes are as follows:

	Years Ended December 31,	
	1996	1997
	(In thousands)	
Tax computed at statutory rate	$173	$159
State taxes, net of federal effect	24	22
Other, net	8	5
Income tax expense	$205	$186

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for federal and state income tax purposes. Significant components of the Company's deferred tax assets and liabilities at December 31, 1997 are as follows (*in thousands*):

Deferred tax assets (current):	
Accrued liabilities	$32
Allowance for doubtful accounts	28
Inventory capitalization	11
	71
Deferred tax liability (noncurrent):	
Depreciation	27
Net deferred tax assets	$44

Net cash paid (refunded) for income taxes for the years ended December 31, 1996 and 1997 was $(48,000) and $225,000, respectively.

8. Additional Financial Information

Related Parties

In 1996 and 1997 Valu-Line provided services principally related to rent and operating costs to Valu-Broadcasting, Inc., an affiliate of Valu-Line at the time of the transactions, in the amounts of $74,000 and $81,000 respectively. Valu-Line also received services principally related to advertising from Valu-Broadcasting, Inc. in the amounts of $31,000 and $41,000 in 1996 and 1997, respectively. In February 1998, Valu-Line merged with and into the Company pursuant to the Merger.

Major Supplier Information

Cost of communications services provided by Southwestern Bell approximated 39% and 40% of the total cost of communication services for the years ended December 31, 1996 and 1997, respectively. Equipment purchases from Toshiba approximated 76% and 59% of cost of equipment sales for the years ended December 31, 1996 and 1997, respectively.

9. Commitments and Contingencies

Minimum rental commitments at year-end 1997 for all noncancelable operating leases, consisting mainly of leases for office space and vehicles, are as follows (*in thousands*):

1998	$30
1999	19
2000	9
Thereafter	$58

Total rent expense for the years ended 1996 and 1997 was $48,000 and $56,000, respectively.

10. Subsequent Event

In February 1998, the Company was acquired by Birch Telecom, Inc. for $19,500,000. Shareholders of the Company received $4,750,000 of cash and $14,750,000 of preferred stock in Birch Telecom, Inc.

11. Year 2000 Compliance — Unaudited

Year 2000 issues arise from computer programs written using two digits rather than four to define the applicable year. Any of the Company's computer programs that have time-sensitive software may recognize a date using 00 as the year 1900 rather than the year 2000. This could result in a system failure or miscalculation causing disruptions of operations, including, among other things, a temporary inability to process transactions, send invoices or engage in similar normal business activities.

Based on ongoing assessments, the Company determined that it will be required to modify or replace portions of its software so that its computer systems will function properly with respect to dates in the year 2000 and thereafter. The Company presently believes that with modifications to existing software and conversions to new software, the year 2000 issue will not pose significant operational problems for its computer systems. The Company estimates it will incur minimal expenses to modify and convert its systems and anticipates completing the year 2000 project by the year ending December 31, 1998.

While the Company believes that its systems will be year 2000 compliant, there can be no assurance until the year 2000 occurs that all systems will function adequately. In addition, the Company interconnects and uses various local exchange companies' facilities to service its customers, and such facilities currently utilize numerous, date-sensitive computer applications. If these facilities are not year 2000 compliant, or if the systems of other local exchange companies, long-distance carriers and others upon which the Company relies are not year 2000 compliant, it could have a material effect on the Company's business, operating results and financial condition.

EXHIBIT E

BIRCH'S PROPOSED INITIAL TARIFFS

TARIFF
of
BIRCH TELECOM OF THE SOUTH, INC.

This Tariff, filed with the Tennessee Regulatory Authority, contains the rates, terms and conditions applicable to the provision of intrastate interexchange telecommunications services and non-switched local exchange telecommunications services in the State of Tennessee by Birch Telecom of the South, Inc. This Tariff is on file with the Tennessee Regulatory Authority and copies may be inspected during normal business hours at the Company's principal place of business.

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CONCURRING CARRIERS

None

CONNECTING CARRIERS

None

OTHER PARTICIPATING CARRIERS

None

1. EXPLANATION OF SYMBOLS

The following symbols shall be used in this Tariff for the purpose indicated below:

(C) to signify changed rule or regulation*

(D) to signify discontinued rate or regulation

(E) to signify eliminated text, rate or regulation

(I) to signify increased regulation

(M) to signify matter relocated without change

(N) to signify new rate or regulation

(R) to signify reduced regulation

(S) to signify reissued material

(T) to signify a change in text but no change in rate or regulation

(Z) to signify a correction

****When used in reference to a rate, the symbol (C) indicates that a change in the method of applying a rate which will result in either an increase or a decrease for certain customers.***

2. APPLICATION OF TARIFF

The service rates and regulations set forth in this Tariff are generally applicable to the provision of intrastate interexchange telecommunications services and non-switched local exchange telecommunications services by Birch Telecom of the South, Inc. (the "Company").

3. DEFINITIONS

As used in this Tariff, the following terms shall have the following meanings unless the context otherwise requires:

Company, the – Birch Telecom of the South, Inc., unless the context indicates otherwise.

Commission – Tennessee Regulatory Authority, unless the context indicates otherwise.

Customer — The person, firm, corporation or other legal entity which contracts with the Company to receive telecommunications services from the Company.

Customer Premises – One Customer Premises is all space in the same building occupied by a Customer and all space occupied by the same Customer in different buildings on the same property.

Circuit — A communications path of a specific bandwidth or transmission speed between two or more points of termination.

Facilities — All Company-owned or operated equipment and Cable Facilities used to provide telecommunications services.

Individual Case Basis — A service arrangement in which the conditions, rates, and charges are developed based on the specific circumstances of the case.

LATA – Local Access and Transport Area

Premises — A building or structure on property not separated by a public right-of-way. The property may be divided by a private right-of-way or easement, such as a railroad right-of-way.

Personal Account Code – A numeric or alpha-numeric sequence which uniquely identifies a travel card.

Private Line Service - An unswitched full-time transmission service utilizing the Facilities to connect two or more designated locations of the same Customer or User.

Terminating Facilities — All equipment placed in a structure that converts the transmitted signal to a requested service type, connects the structure to the Company's network and provides a point of interface/connection to which the Customer can connect its equipment. This may include electronic equipment, cable, wiring, connecting panels and blocks.

User — A person, firm, or corporation designated as a user of common carrier services furnished to the Customer. A User must be specifically named in the Customer's application for services.

4. PROVISION OF NON-SWITCHED LOCAL EXCHANGE SERVICE

4.1 The Company shall provide non-switched local exchange telecommunications service to Customers which enter into written contracts with the Company specifying the services to be provided by the Company, the rates to be charged, and other terms and conditions of service. Certain general terms and conditions applicable to the provision of service by the Company are set forth in this Tariff. Terms not specifically governed by this Tariff will be individually negotiated with each prospective Customer. The Company will not provide services to any Customer until a contract has been executed. On a proprietary basis, the Company will provide copies of customer contracts to the Commission's Staff on request.

4.2 Obligations of Customer

4.2.1. Conditions for Use: Service may be used for the transmission of information of the Customer provided that:

A. The Customer has requested service in accordance with the terms and conditions set forth in this Tariff; or the Customer has entered into a written contract with the Company;

B. The Customer shall not use service for any purpose or in any manner directly or indirectly in violation of the law or in aid of any unlawful act or undertaking; and

C. The Customer, upon request, shall furnish such information and access to its location(s) and/or User's location(s) as may be required to permit the Company to design and maintain the Facilities to provide service and to assure that the service arrangement is in accordance with the provisions of this Tariff and the contract entered into between the Customer and the Company.

4.2.2. General Obligations

The Customer shall be responsible for:

A. Ensuring compatibility, installation, and maintenance of equipment and systems provided by the Customer or User with the interface equipment provided and/or sanctioned by the Company.

B Damage to, or destruction of, Facilities caused by the negligence or willful act of the Customer or User or its agents.

C. Reimbursing the Company for any loss caused by the theft of Facilities installed on the Customer's or User's premises.

D. The provision of the power, wiring, and outlets required to operate the Facilities installed on the Customer's or User's Premises.

4. PROVISION OF NON-SWITCHED LOCAL EXCHANGE SERVICE (continued)

4.2 Obligations of Customer (continued)

4.2.2. General Obligations (continued)

E. The provision, installation, and maintenance of sealed conduit with explosive-proof fittings between equipment furnished by the Company in explosive atmosphere and points outside the hazardous area where connection may be made with the Facilities. The Customer may be
required to install and maintain the Company's equipment within the hazardous area if, in the opinion of the Company, injury or damage to its employees or property might result from installation or maintenance by the Company.

F. Obtaining permission for the Company's agents or employees to enter the Premises of the Customer or User at any reasonable hour for the purpose of installing, inspecting, repairing, or removing the Facilities.

G. Making the Company's service components and equipment available periodically for maintenance purposes at a time agreeable to both the Company and the Customer, and providing for reasonable access to those facilities and equipment.

H. All actions or omissions of a person, firm, or corporation appointed by the Customer as its agent causing harm to facilities or services. No self-imposed limitations of an agent's authority shall be binding on the Company.

I. Any breach by the Customer of the terms and conditions contained in this Tariff or in the contract between the Customer and the Company governing service.

4.2.3 Payment of Rates and Charges: The Customer is responsible for payment of all rates and charges as specified in this Tariff and/or the contract with the Company, for services furnished by the Company to the Customer or User. The Company will submit invoices to the Customer, which are due and payable upon receipt at the Customer's general office or at such other places as may be designated by the Customer. Invoices not paid within thirty (30) days are subject to late charges and interest, with interest compounded monthly at 1.5% per month, or such other amount otherwise allowed by law, to compensate Company for administrative costs incurred due to such late payments. In addition, failure to pay any past or currently due amounts may result in termination of service as described in Section 4.10 of this Tariff. Any billing errors shall be adjusted to the known date of error or for a period of one year, whichever is shorter.

4. PROVISION OF NON-SWITCHED LOCAL EXCHANGE SERVICE (continued)

4.3 Obligations of the Company

4.3.1 Undertakings: The undertaking of the Company is to furnish service as ordered and specified by the Customer, and as limited by the terms and conditions of this Tariff and the contract entered into between the Customer and the Company. This offering is subject to the availability of Facilities. The Company undertakes to maintain and repair any equipment which it furnishes to the Customer, unless otherwise specified in the contract entered into between the Customer and the Company. The Customer or User may not rearrange, disconnect, remove, or attempt to repair any equipment installed by the Company without the prior written consent of the Company.

4.3.2 Limitations. The Company shall not be responsible for installation, operation, or maintenance of any Terminating Facilities or communications systems purchased or connected to service by a Customer, unless otherwise specified in the contract entered into between the Customer and the Company. Service is not represented as adapted to the use of any specific equipment or system. The responsibility of the Company shall be limited to the furnishing of service and maintenance and operation of such service. The furnishing of service will require certain physical arrangements of the Facilities of the Company and is therefore subject to the availability of such Facilities.

4.3.3 Liability and Indemnification:

A. The Company shall not be liable for damage arising out of mistakes, omissions, interruptions, delays, errors, or defects in transmission occurring in the course of furnishing service. The Company will not be liable for any direct, indirect, incidental, special, consequential, exemplary, or punitive damages to a Customer or User as a result of any service provided by the Company or use of the Facilities, or the acts, omissions or negligence of the Company's employees or agents.

B. The sole remedy for a Customer or User with respect to failure of the Company to maintain proper standards or maintenance and operation or failure to exercise reasonable supervision shall in no event exceed an amount equivalent to the credit for a service interruption specified in the contract between the Company and the Customer or User.

C. The Company does not guarantee or make any warranty with respect to equipment provided by it for use in an explosive atmosphere. The Customer or User indemnifies and holds the Company harmless from any and all loss, claims, suits, or other action, or any liability whatsoever, whether suffered, made, instituted or asserted by the Customer or User or by any other party or persons, and for any loss, damage, or destruction of any property, whether owned by the Customer or User or others, caused or claimed to have been caused directly or indirectly by the installation, operation, failure to maintain, removal, presence, condition, location, or use of said equipment so provided.

4. PROVISION OF NON-SWITCHED LOCAL EXCHANGE SERVICE (continued)

4.3 Obligations of the Company (continued)

4.3.3 Liability and Indemnification (continued)

D. The Company shall not be liable for any defacement of or damage to the Premises of a Customer, User, or any third party resulting from the furnishing of Facilities or the attachment of the instruments, apparatus, and associated wiring furnished by the Company on such Premises or by the installation or removal thereof, when such defacement or damage is not the result of negligence of the agents or employees of the Company.

E. The Company shall not be liable for any claim, loss, or refund as a result of loss or theft of Personal Account Codes issued for use with the Company's services.

E. The Company shall be indemnified and saved harmless by the Customer or User against:

1. Claims for libel, slander, and infringement of copyright arising from the material transmitted over the Facilities.

2. Claims for infringement of patents arising from, combining with, or using in connection with, the Facilities and systems or apparatus of the Customer or User; and

3. All other claims arising out of any act or omission of the Customer or User or their agents in connection with the Facilities, or information transmitted over the Facilities.

4.3.4 Provision of Facilities

A. Upon agreement between the Company and the Customer, the Company will provide all Facilities necessary for service.

B. Provided the necessary Facilities are available, service will be furnished by the Company. Where Facilities are not available, terms for provision of service will be individually negotiated with the Customer.

4.4. Service Period

The period for which service will be provided by the Company to the Customer or User shall be the period specified in the contract between the Customer and the Company.

4.5 Individual Case Basis (ICB) Arrangements

The Company may, in response to a bona fide request from a Customer or User or potential Customer or User, develop a bid for a special service arrangement not currently offered by the Company. An Individual Case Basis arrangement will be offered to the Customer for acceptance in writing. Such Individual Case Basis arrangements may specify, among other things, length of service, minimum volume of service required, and the rates and charges for the proposed service.

4. PROVISION OF NON-SWITCHED LOCAL EXCHANGE SERVICE (continued)

4.6 Special Construction

Provision of service may require special construction of Facilities and equipment by the Company. Special construction arrangements of Facilities may be undertaken by the Company at the request of the Customer or User, or upon determination by the Company that such charge should apply in that particular instance.

4.6.1. Survey and Design. Prior to engaging in any special construction, survey and design studies may be required. Should that be the case, the Company and the Customer may agree to arrange for the performance of those studies, the review and acceptance thereof by both the Company and the Customer, and the appropriate charges therefor. Failure to agree on the performance of such studies, the acceptability thereof, or the charges therefor, shall constitute grounds for denial of the requested service by the Company.

4.6.2. Charges for Special Construction. All recurring and non-recurring charges for special construction shall be set forth in the contract between the Company and the Customer, and shall be the responsibility of the Customer, regardless of the projected charges for the provision of service by the Company.

4.7. Service Offerings

The Company will provide point-to-point and point-to-multipoint, Private Line Services connecting a Customer's or User's locations to one another, or connecting a Customer's or User's location to interexchange carrier points of presence.

4.8 Service Rates

The rates charged by the Company for the provision of its services to Customers or Users will be offered on an Individual Case Basis and will be structured to at least recover the Company's costs of providing such services. The terms of specific Individual Case Basis contracts will be made available to the Commission upon request on a proprietary basis.

4.9 Special Charges

4.9.1 Out-of-Normal Work Hours: The charges specified in this Section 4.9 do not contemplate work being performed by Company employees at a time when overtime wages apply, due to the request of the Customer, nor do they contemplate work once begun being interrupted by the Customer. If the Customer requests labor be performed at hours of the day or days of the week other than during normal working hours or days (9:00 a.m. to 5:00 p.m., Monday through Friday), or during holidays, or if the Customer interrupts work once begun, an additional charge may be imposed, equal to the actual higher costs incurred by the Company for overtime and materials.

4. PROVISION OF NON-SWITCHED LOCAL EXCHANGE SERVICE (continued)

4.9 Special Charges (continued)

4.9.2 Maintenance and Service Charge: The Customer may be responsible for the cost incurred by the Company in connection with a maintenance and/or service visit to the Customer's or User's Premises when the difficulty or trouble results from the equipment or Facilities provided by the Customer or User, or when failure in the Company's equipment or Facilities is attributable to the Customer or User or its agents. That cost shall be based upon the current labor rate and material costs of the Company in effect at the time of the visit.

4.10 Service Cancellations

4.10.1 Discontinuance of Service by the Company: The Company, by such notice to the Customer as may be specified in the contract between the Customer and the Company, and in compliance with applicable regulations, may discontinue furnishing service without incurring any liability beyond that stated in the contract, upon:

A. Non-payment of any undisputed sum due to the Company by a Customer; or

B. A breach of any of Customer's representations or warranties contained in the contract between the Customer and the Company, or a violation by the Customer of any covenant, term or condition governing the furnishing of service as specified in this Tariff or in the contract for service between the Customer and the Company.

4.10.2 Cancellation of Service by the Customer Prior to End of the Contract Period: When the Customer cancels the service prior to the end of the term of the contract, the Customer may be required to pay a cancellation charge in the amount specified in the contract between the Customer and the Company.

4.10.3 Cancellation of Application for Service: Where the prospective Customer cancels an application for service prior to the start of installation or special construction of Facilities by the Company, no charge shall be made to the prospective Customer. Where the installation of Facilities has been started prior to the cancellation, the prospective Customer shall pay a cancellation charge in the amount specified in the contract between the Customer and the Company. Installation or special construction of facilities for a Customer is considered to have started from the latest contract date or when the Company incurs any expense in connection therewith, whichever occurs earlier.

4.11 Service Interruptions

4.11.1 General: The Company agrees to use its reasonable best efforts to assure continuous full-time operation of the service. The customer is considered to have experienced a service interruption when the Circuit becomes unavailable for use or the quality of transmission is such that the Circuit is effectively unusable.

4. PROVISION OF NON-SWITCHED LOCAL EXCHANGE SERVICE (continued)

4.11 Service Interruptions (continued)

4.11.2 Service Restoration: The Company agrees to use its reasonable best efforts to respond to the Customer's reasonable request for maintenance in connection with the service as soon as reasonably possible. The Company shall have no obligation to perform maintenance which requires access to the Customer's or other premises or buildings when that access cannot be provided to the Company by the Customer. The Company agrees to use its reasonable best efforts to minimize the duration of any service interruption.

4.11.3 Liability: The Company shall not be liable for any incidental, indirect, or consequential damages as the result of any service interruption.

4.11.4 Credits: The amount of credit for any service interruption, if any, shall be specified in the contract between the Customer and the Company.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE

5.1 The Company shall provide intrastate interexchange telecommunications service to Customers according to the terms and conditions of this Tariff.

5.2. Rules and Regulations

5.2.1 Undertaking of the Company

A. The Company undertakes to furnish telecommunications service pursuant to the terms of this Tariff in connection with one-way and/or two-way information transmission between points in different exchanges within the state of Tennessee.

B. The furnishing of service under this Tariff is subject to the availability on a continuing basis of all the necessary facilities and is limited to the capacity of the Company's facilities as well as facilities the Company may obtain from other carriers to furnish service from time to time as required at the sole discretion of the Company.

C. The Company reserves the right to limit or to allocate the use of existing facilities, or of additional facilities, offered by the Company, when necessary because of lack of facilities, or due to some other cause beyond the Company's control.

D. The Company may undertake equipment or facilities additions, removals or rearrangements; routine preventive maintenance; or other service-affecting activities that may occur in normal operation of the Company's business. Generally, such activities are not specific to an individual Customer but affect many Customers' services. No specific advance notification period is applicable to all service activities. With some emergency or unplanned service-affecting conditions, such as an outage resulting from wiring or equipment damage, notification to the Customer may not be possible.

E. Applications for initial or additional service made verbally or in writing become a contract upon the establishment of the service or facility.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.2. Rules and Regulations (continued)

5.2.2 Limitations of Service

A. Service is offered subject to the availability of the necessary facilities and equipment, necessary arrangements with other carriers and billing capabilities, and is subject to the provisions of this Tariff. The Company reserves the right not to provide service to or from a location where legally prohibited.

B. The Company reserves the right to discontinue furnishing service when necessitated by conditions beyond its control, or when the Customer is using the service in violation of any provision in this Tariff, the rules and regulations of the Commission, or the law.

5.2.3 Use of Service

A. Permitted Uses

Services provided under this tariff may be used for any lawful purpose for which the service is technically suited.

A. Minimum Service Period

The minimum period of service is one month (30 days), unless otherwise stated in this Tariff.

B. Fixed Service Period

If Customer and the Company have agreed to a specified term of service, then following expiration of the initial term of service, or any extension thereof, service shall continue on a month-to-month basis at the then current rates unless terminated by either party upon 30 days'written notice.

C. Termination

Any termination shall not relieve Customer of its obligation to pay any charges incurred under this Tariff or in any service order prior to termination. The rights and obligations which by their nature extend beyond the termination of the term of the service order shall survive such termination.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.2. Rules and Regulations (continued)

5.2.4 Liability

A. The liability of the Company for any claim or loss, expense or damage, due to any interruption, delay, error, omission, or defect in any service, facility, or transmission provided under the Tariff shall not exceed the amount of the credit allowance described in Section 5.2.5 herein. The extension of credit allowances as described in Section 5.2.5 shall be the sole remedy of Customer and sole liability of the Company for any interruption, delay, error, omission, or defect in any service, facility, or transmission provided under the Tariff. In no event will the Company be liable for any direct, indirect, consequential, incidental, exemplary, punitive, or special damages, or for any lost income or profits, even if advised of the possibility of the same.

B. The Company shall not be liable for any claim or loss, expense, or damage, due to any interruption, delay, error, omission, or other defect in service, facility, or transmission provided under this Tariff, if caused by or resulting from: any person or entity other than the Company; any malfunction of any service or facility provided by any Person other than the Company; labor difficulties; fire, flood, earthquake, or any other act of God; explosion; war; riot or civil disturbance; any law, order, regulation, direction, action or request of any federal, state or local government or any department, agency, commission, bureau, or other instrumentality of federal, state or local government; or by any other cause beyond the Company's control.

C. The Company shall not be liable for and shall be fully indemnified and held harmless by Customer against any claim of loss, expense, or damage, including indirect, special, or consequential damage for:

1. Defamation, libel, slander, invasion of privacy, infringement of copyright or patent, unauthorized use of any trademark, trade name, or service mark, unfair competition, interference with or misappropriation, or violation of any contract, proprietary or creative right, or any other injury to any person, property, or entity arising from the material, data, information, or content revealed to, transmitted, processed, handled, or used by the Company under this Tariff;

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.2. Rules and Regulations (continued)

5.2.4 Liability (continued)

C. (continued)

2. Any claim, loss, damage, expense or liability for infringement of any copyright, patent, trade secret, or any proprietary or intellectual property right of the Company or any third party, arising from any act or omission by the Customer, including, without limitation, use of the Company's services and facilities in a manner not contemplated by this Tariff or any agreement between the Customer and the Company; or

3. Any personal injury or death of any person or for any loss of or damage to Customer Premises or any other property, whether owned by Customer or others, caused directly or indirectly by the installation, maintenance, location, condition, operation, failure, presence, use, or removal of equipment or wiring provided by the Company, if not caused by gross negligence of the Company.

D. No agent or employee of any other carrier shall be deemed to be an agent or employee of the Company.

E. THE COMPANY MAKES NO WARRANTY REGARDING THE PROVISION OF SERVICE PURSUANT TO THIS TARIFF, INCLUDING BUT NOT LIMITED TO THE IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE.

5.2.5 Interruption of Service

Customer will be entitled to a credit allowance for an interruption of service which is not caused by or does not result from the negligence or act of Customer or to the failure of channels, equipment, power supplies, and/or communications systems provided by Customer or Persons other than the Company. A credit allowance is subject to the provisions of this section and the other sections of this Tariff, including, but not limited to, the general liability provisions set forth in Section 5.2.4 herein and the terms of Section 5.2.6 herein. Customer is obligated to notify the Company immediately of any interruption in service for which the Customer desires a credit allowance.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5 2. Rules and Regulations (continued)

5.2.6 Responsibility of the Customer

A. All Customers assume general responsibilities in connection with the provisions and use of the Company's service. When facilities, equipment, and/or communications systems provided by others are connected to the Company's facilities, Customer assumes additional responsibilities. Customers are responsible for:

1. Placing orders for service; paying all appropriate charges for service rendered by the Company; complying with the Company's regulations governing the service; and assuring that its users comply with regulations.

2. Providing:

   (a) the name(s) and address(es) of the person(s) responsible for the payment of service charges; and
   (b) the name(s), telephone number(s), and address(es) of the Customer contact person(s).

3. Paying the Company for the replacement or repair of the Company's equipment when the damage results from:

   (a) the negligence or willful act of Customer or user;

   (b) improper use of service; or

   (c) any use of equipment or service provided by others.

4. A Customer who subscribes to the Company's intrastate interexchange services and resells these services to others shall be responsible for complying with all laws and regulations of the State of Tennessee, which relate in any way to its provision of intrastate interexchange telephone service, including, but not limited to, laws and regulations regarding consumer protection, billing and collection practices, tariffing obligations, and payment of applicable taxes.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.2. Rules and Regulations (continued)

5.2.6 Responsibility of the Customer (continued)

B. Credit Allowances

1. Credit for failure of service will be allowed only when failure of service is caused by or occurs in facilities or equipment owned, provided and billed for, by the Company.

2. Credit allowances for failure of service starts when Customer notifies the Company of the failure or when the Company becomes aware of the failure and ceases when the operation has been restored and an attempt has been made to notify Customer.

3. Customer shall notify the Company of failures of service and make reasonable attempts to ascertain that the failure is not caused by Customer Provided Equipment, any act or omission of the Customer, or in wiring or equipment.

4. Only those portions of the service disabled will be credited. No credit allowances will be made for:

(a) interruptions of service resulting from the Company performing routine maintenance;

(b) interruptions of service for implementation of a Customer order for a change in the service;

(c) interruptions caused by the negligence or willful act of omission of Customer or its authorized user; or

(d) interruptions of service because of the failure of service or equipment provided by Customer, authorized user, or other carriers.

The Company's liability for damages arising out of mistakes, interruptions, omissions, delays, errors, or defects in transmission which occur in the course of furnishing service or facilities, in no event shall exceed an amount equivalent to the proportionate charge to the Customer for the period during which the faults in transmission occur.

C. Cancellation by Customer

1. Customer may cancel service any time after meeting the minimum service period.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.2. Rules and Regulations (continued)

5.2.6 Responsibility of the Customer (continued)

D. Payment and Charges for Service

1. Charges for service are applied on recurring and nonrecurring bases. Service is billed on a monthly basis on or about the same day each month. Service continues to be provided until canceled by Customer or by the Company in accordance with provisions of this Tariff.

2. The Company will not alter the residential billing cycle unless affected customers are sent a bill insert or other written notice explaining the alteration not less than 30 days prior to the effective date of the alteration. Such notification is not required when a customer requests a number or billing change or when the customer disconnects and reconnects service or transfers service from one premises to another.

3. Payment will be due pursuant to applicable Commission rules. The Company includes its name and its toll-free telephone number on all invoices.

4. The Customer is responsible for payment of all charges for service furnished to the Customer, including, but not limited to all calls originated at the Customer's number(s); received at the Customer's number(s), e.g., collect, 800; billed to the Customer's number(s) via third-party billing; incurred at the specific request of the Customer; or placed using a calling card issued to the Customer. Charges based on actual usage during a month will be billed monthly in arrears. All fixed monthly and nonrecurring charges for services ordered will be billed monthly in advance.

5. Service may be denied pursuant to the Commission's rules regarding disconnection of service for nonpayment. Restoration of service will be subject to all applicable installation charges.

6. Customer is liable for all costs associated with collecting past due charges, including all attorney's fees.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.2. Rules and Regulations (continued)

5.2.6 Responsibility of the Customer (continued)

D. Payment and Charges for Service (continued)

7. The Company sets forth the following on residential bills:

(a) the number of access lines for which charges are stated.
(b) the beginning or ending dates of the billing period.
(c) the date the bill becomes delinquent if not paid on time.
(d) the unpaid balance (if any).
(e) an itemization of the amount due for toll service, including the date and duration of each toll call.
(f) an itemization of the amount due for taxes, franchise fees, and other surcharges as may be necessary and appropriate.
(g) the total amount due.
(h) if applicable, the amount of a deposit and interest accrued on a deposit which has been credited to the charges stated.
(i) a telephone number where inquiries may be made.
(j) if a deposit is held by the company.

8. If notice of a dispute as to charges is not received in writing, in person or via telephone message by the Company within 30 days after billing is received by the Customer, the invoice shall be considered correct and binding on the Customer, unless extraordinary circumstances are demonstrated. Any disputed charges that cannot be resolved between Customer and the Company may be appealed to the Commission.

E. Deposits and Advance Payments

1. Advance Payments

The Company may require a Customer or applicant for service to make an advance payment (1) if the applicant is unable to establish that he had a previous account with a telephone utility for a period of at least 12 months for which all undisputed charges were satisfactorily paid, or (2) if the applicant has had no previous telephone service or has had previous telephone service of less than 12 months, the applicant's credit record will be accessed and evaluated by means of a mechanized retrieval system between the Company and national recognized credit bureaus. No security payment will be required of those applicants who meet the Company's criteria, as evaluated by the scoring model. The criteria used in assessing a score is as follows: collection judgments, written-off accounts, outstanding collection accounts, various degrees of delinquency history from 30-180 days and not paid in full or current at the time of scoring, bankruptcies, liens, other public records. The advance payment will not exceed an amount equal to all nonrecurring charges and two month's estimated recurring charges, as a condition of continued or new service.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.2. Rules and Regulations (continued)

5.2.6 Responsibility of the Customer (continued)

E. Deposits and Advance Payments (continued)

1. Advance Payments (continued)

The advance payment will be credited to the Customer's initial bill and, to the extent that a credit balance remains after the amount of the initial bill has been satisfied, then the credit balance will be applied to subsequent bills in the same manner until there is no balance remaining on the advance payment.

2. Deposits

The Company reserves the right to examine the credit record of all service applicants as stated above and require a security deposit, not to exceed two month's estimated recurring charges, when determined to be necessary to assure future payment. The security deposit will be computed by the Company in accordance with Commission rules and regulations.

Deposits held will accrue interest at a rate which is equal to a rate of one percent (1%) above the prime lending rate as published in The Wall Street Journal. This amount shall be adjusted annually by using the prime lending rate published in The Wall Street Journal for the last business day of September of each year with the revised rate to be implemented on the first of October of each year.

If Customer pays all undisputed charges for 12 consecutive billing cycles, the deposit shall be promptly refunded along with accrued interest, or credited to future charges on subsequent bills.

F. Bad Check Charge

The Company will bill Customer a one-time charge of $25.00 if Customer's check for payment of service is returned for insufficient or uncollected funds, closed accounts, or any other insufficiency or discrepancy necessitating return of the check at the discretion of the drawee bank or other financial institution.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.2. Rules and Regulations (continued)

5.2.6 Responsibility of the Customer (continued)

G. Late Payment Charge

The Company may apply a late payment charge if any portion of the Customer's payment is received by the Company after the payment due date, or if any portion of the payment is received by the Company in funds which are not immediately available upon presentment. The late payment charge shall be applied to the portion of the payment not received by the date due, multiplied by a factor. The late factor shall be 1.5% per month.

Collection procedures are unaffected by the application of the late payment charge. The late payment charge does not apply to final amounts.

5.2.7 Responsibility of the Company

A. Provision of Services

The Company shall use reasonable efforts to make services available to a Customer on or before a particular date, subject to the provisions of and compliance by the Customer with the regulations contained in this Tariff and applicable rules of the Commission.

B. Credit Allowance – Information Records

For listings in alphabetical telephone directories and information records, no liability shall be attached to the Company.

C. Cancellation Credit

Where the Company cancels a service and the final service period is less than the monthly billing period, a credit will be issued for any amounts billed in advance, prorated at 1/30th of the monthly recurring charge for each day after the service was discontinued. This credit will be issued to Customer or applied against the balance remaining on Customer's account.

D. Disconnection of Service by the Company

The Company may discontinue service or cancel an application for service, pursuant to applicable Commission rules, without incurring any liability for any of the following reasons:

1. Nonpayment of an undisputed delinquent charge; or

2. Without notice for tampering with the Company's equipment, hazardous conditions, or Customer use of equipment where it adversely affects the Company's equipment or services; or

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.2. Rules and Regulations (continued)

5.2.7 Responsibility of the Company (continued)

D. Disconnection of Service by the Company (continued)

3. Without notice in the event of a violation of any law, rule, or regulation of any government authority having jurisdiction over the service; or
4. Without notice in the event the Company is prohibited from furnishing services by order of a court or other federal, state or local government authority, bureau, agency or commission, or
5. Without notice if the Customer refuses to furnish information to the Company regarding the Customer's credit-worthiness, its past or current use of common carrier communications services or its planned use of service(s); or
6. Without notice if the Customer provides false information to the Company regarding the Customer's identity, address, credit-worthiness, past or current use of common carrier communications services, or its planned use of the Company's service(s); or
7. Without notice if the Customer states that it will not or fails to comply with a request of the Company for security for the payment for service(s) or advance payments, as specified in this Tariff; or
8. Without notice if the Customer uses service to transmit a message, locate a person or otherwise give or obtain information without payment for the service; or
9. Without notice if the Customer uses, or attempts to use, service with the intent to avoid the payment, either in whole or in part, of the tariffed charges for the service by using tricks, schemes, false or invalid numbers, false credit devices, electronic devices, or other means; or
10. Without notice if the Customer's use of equipment adversely affects the Company's service to others or endangers public safety or health; or
11. Without notice if upon condemnation of any material portion of the Customer's facilities used by the Company to provide service to the Customer or if a casualty renders all or any material portion of such facilities inoperable beyond feasible repair; or
12. Without notice for fraudulent use of the Company's network.

Residential service may not be discontinued by the Company for failure to pay charges not subject to the Commission's jurisdiction unless specifically authorized in the Company's tariffs approved by the Commission.

Residential service may be discontinued during normal business hours on or after the date specified in the notice of discontinuance. Service shall not be discontinued on a day when the

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.2. Rules and Regulations (continued)

5.2.7 Responsibility of the Company (continued)

D. Disconnection of Service by the Company (continued)

offices of the Company are not available to facilitate reconnection of service or on a day immediately preceding such a day.

Residential customers shall have a minimum of 21 days from the rendition of a bill to pay the charges stated.

5.2.8 Restoration of Service

If service is disconnected for nonpayment, service will be reestablished only upon receipt of payment of all charges due, which include charges for service and facilities during the period of disconnection and which may include a service restoration fee. If the Customer has a history of payments returned for insufficient funds, the Company may require payment by cash, money order, personal check or certified check. If payment is made by personal check, restoration will be effected upon clearance of the check. When a Customer's service has been disconnected in accordance with this Tariff and the service has been terminated through the completion of the Company's service order, service will be reestablished only upon a basis of an application for new service.

5.2.9 Taxes and Surcharges

A. Customer will be billed and is responsible for payment of applicable federal, state and local taxes, fees, assessments and surcharges assessed in conjunction with service used. All charges and fees subject to Commission jurisdiction, except taxes and franchise fees, will be submitted to the Commission for prior approval.

B. All taxes, surcharges and assessments (i.e., sales tax, municipal utilities tax, franchise fee, etc.) will be listed as separate line items and are not included in the quoted rates.

5.2.10 Start of Billing

For billing purposes, the start of service is the day of acceptance by the Customer of the Company's service or equipment.

5.2.11 Terminal Equipment

The Company's facilities and service may be used with or terminated in Customer provided terminal equipment or Customer provided communications systems, such as PBX, key systems or other telecommunications devices. Such terminal equipment shall be furnished and maintained at the expense of the Customer. The Customer is responsible for all costs at its premises, including personnel, wiring, electrical power, and the like, incurred in the use of the Company's service. When such terminal equipment is used, the equipment shall comply with the generally accepted minimum protective criteria standards of the telecommunications industry as endorsed by the Federal Communications Commission.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.3 Service Offerings

5.3.1 Toll Service

Provides facilities to complete interLATA, intrastate or intraLATA, interexchange calls between two points. Customer makes call by dialing directly or with operator assistance. Direct Dialing includes 1 + Area Code (where necessary) + telephone number, or, in some cases for IntraLATA, users must access the Company's network by dialing 1010678 then 1 + Area Code + Number. For operator assistance a customer dials O only, O + telephone number or O + NPA + telephone number for IntraLATA calls.

5.3.2 Travel Card Service

Travel card service provides facilities to complete interLATA and intraLATA calls between two points when the Customer is away from his/her premises. The requesting Customer is provided with a travel calling card which includes instructions for its use.

5.3.3 800 Service

800 Service provides for facilities for the Customer(s) to receive interLATA and intraLATA calls. The Customer will be assigned unique 800 number(s) that, when dialed, will be routed via the Company's network and terminate at Customer's designated local access line(s).

5.3.4 Directory Assistance

The Company furnishes Directory Assistance Service whereby Customers may request assistance in determining telephone numbers in accordance with the rates and terms stated in Section 5.4. Service Rates.

5.3.5 Conference Service

Conference Service provides a simultaneous connection between three or more points within the state of Tennessee.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.4 Service Rates

5.4.1 Toll Service

From Customer's Premises in Tennessee to any point in Tennessee:

	Per Minute	Minimum	Billing Increment
Business-1 Year Term (1)	.09	6 seconds	6 seconds
Business	.09	6 seconds	6 seconds
Residence	.10	1 minute	1 minute

5.4.2 800 Service

Monthly minimum per 800 number(4)	5.00
Monthly charge per 800 number	5.00

From points in Tennessee to Customer's Premises in Tennessee:

	Per Minute	Minimum	Billing Increment
Business-1 Year Term(1)	.09	6 seconds	6 seconds
Business	.09	6 seconds	6 seconds
Residence	.10	1 minute	1 minute

Payphone origination charge - $.30 per call

(1) Business customers subscribing to the Company's local exchange service who commit to a one year service term as defined in the Company's Local Exchange Services Tariff Tenn. PSC No. 1 receive a discounted rate on their long distance service. Refer to the Company's Local Exchange Services Tariff Tenn. PSC No. 1 for information on term cancellation penalties.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.4 Service Rates (continued)

5.4.3 Travel Card Service

From any point in Tennessee to points in Tennessee:

	Per Minute	Minimum	Billing Increment
Business and Residence(1)	$.25	6 seconds	6 seconds
Residence	.25	1 minute	1 minute

Travel Card Operator Services - $.50 per call

Payphone origination charge - $.30 per call

5.4.4 Directory Assistance

$.60 per call per inquiry

5.4.5 Conference Service

	Per Minute	Minimum	Billing Increment
Business	$.25	6 seconds	6 seconds
Residence	.25	1 minute	1 minute

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.4 Service Rates (continued)

5.4.6 Birch Basic Business Line and Trunk (1)

A. Toll Service

From Customer's Premises in Tennessee to any point in Tennessee:

	Per Minute	Minimum	Billing Increment
Business (2)	$.10	1 minute	1 minute
Business (3)	.10	6 seconds	6 seconds
Business-1 Year Term(3)	.09	6 seconds	6 seconds
Business	.09	6 seconds	6 seconds

B. 800 Service

From points in Tennessee to Customer's Premises in Tennessee:

	Per Minute	Minimum	Billing Increment
Business (3)	$.10	6 seconds	6 seconds
Business-1 Year Term(3)	.09	6 seconds	6 seconds
Business	.09	6 seconds	6 seconds

Payphone origination charge - $.30 per call

C. Travel Card Service

From any point in Tennessee to points in Tennessee:

	Per Minute	Minimum	Billing Increment
Business (2)	$.25	6 seconds	6 seconds
Business (3)	.20	6 seconds	6 seconds
Business-1 Year Term (3)	.20	6 seconds	6 seconds

Travel Card Operator Services - $.50 per call

Payphone origination charge - $.30 per call

See Sheet No. 30 for footnotes.

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5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.4 Service Rates (continued)

5.4.6 Birch Basic Business Line and Trunk (1) (continued)

Footnotes

(1) Business Customers subscribing to the Company's local exchange business packages as defined in the Company's Local Exchange Service Tariff Tenn. PSC No. 1 will receive a discounted rate on their long distance service.
(2) Applies to Birch Business Packages Customers not subscribing to Birch Long Distance Service.
(3) Applies to Birch Business Packages Customers subscribing to Birch Long Distance Service for IntraLATA, Intrastate and Interstate except Alaska and Hawaii.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.4 Service Rates (continued)

5.4.7 Birch Voice T1 Service (1)

A. Toll Service

From Customer's Premises in Tennessee to any point in Tennessee:

	Per Minute	Minimum	Billing Increment
Business (2)	$.10	1 minute	1 minute
Business (3)	.07	6 seconds	6 seconds

B. 800 Service

From points in Tennessee to Customer's Premises in Tennessee:

	Per Minute	Minimum	Billing Increment
Business (3)	$.10	6 seconds	6 seconds
Business-1 Year Term(3)	.09	6 seconds	6 seconds
Business	.09	6 seconds	6 seconds

Payphone origination charge - $.30 per call

C. Travel Card

From any point in Tennessee to points in Tennessee:

	Per Minute	Minimum	Billing Increment
Business	$.20	6 seconds	6 seconds

Travel Card Operator Services - $.50 per call

Payphone origination charge - $.30 per call

(1) Business Customers subscribing to the Company's local exchange business service as defined in the Company's Local Exchange Service Tariff Tenn. PSC No. 1 will received a discounted rate on their long distance service.
(2) Applies to Birch Business Packages Customers not subscribing to Birch Long Distance Service.
(3) Applies to Birch Business Customers subscribing to Birch Long Distance Service for IntraLATA, Intrastate and Interstate except Alaska and Hawaii.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.4 Service Rates (continued)

5.4.8 Birch Integrator Business Package (1)

A. Toll Service

From Customer's Premises in Tennessee to any point in Tennessee:

	Per Minute	Minimum	Billing Increment
Business (2)	$.10	1 minute	1 minute
Business (3)	.07	6 seconds	6 seconds

B. 800 Service

From points in Tennessee to Customer's Premises in Tennessee:

	Per Minute	Minimum	Billing Increment
Business (3)	$.10	6 seconds	6 seconds
Business-1 Year Term(3)	.09	6 seconds	6 seconds
Business	.09	6 seconds	6 seconds

Payphone origination charge$.30 per call

C. Travel Card Service

From any point in Tennessee to points in Tennessee:

	Per Minute	Minimum	Billing Increment
Business	$.20	6 seconds	6 seconds

Travel Card Operator Services - $.50 per call

Payphone origination charge - $.30 per call

(1) Business Customers subscribing to the Company's local exchange business package as defined in the Company's Local Exchange Service Tariff Tenn. PSC No. 3 will receive a discounted rate on their long distance service.
(2) Applies to Birch Business Packages Customers not subscribing to Birch Long Distance Service.
(3) Applies to Birch Business Packages Customers subscribing to Birch Long Distance Service for IntraLATA, Intrastate and Interstate except Alaska and Hawaii.

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.4 Service Rates (continued)

5.4.9. Birch Business Volume Commitment Plans – Rates

The volume commitment level can be met by a combination of Toll, 800 and Calling Card Services usage.

1. Toll Service

Total Usage – No Volume Commitment	Rate Per Minute	Minimum	Billing Increment
	(1)		

Total Usage – $25.00 Volume Commitment	Rate Per Minute	Minimum	Billing Increment
Intrastate	$.08	6 seconds	6 seconds
Interstate	.08	6 seconds	6 seconds
Alaska, Hawaii, Virgin Islands and Puerto Rico	.11	6 seconds	6 seconds

Total Usage – $100.00 Volume Commitment	Rate Per Minute	Minimum	Billing Increment
Intrastate	$.07	6 seconds	6 seconds
Interstate	.07	6 seconds	6 seconds
Alaska, Hawaii, Virgin Islands and Puerto Rico	.11	6 seconds	6 seconds

Total Usage – $500.00 Volume Commitment	Rate Per Minute	Minimum	Billing Increment
Intrastate	$.065	6 seconds	6 seconds
Interstate	.065	6 seconds	6 seconds
Alaska, Hawaii, Virgin Islands and Puerto Rico	.11	6 seconds	6 seconds

Total Usage – $1,000.00 Volume Commitment	Rate Per Minute	Minimum	Billing Increment
Intrastate	$.06	6 seconds	6 seconds
Interstate	.06	6 seconds	6 seconds
Alaska, Hawaii, Virgin Islands and Puerto Rico	.11	6 seconds	6 seconds

Total Usage – $2,500.00 Volume Commitment	Rate Per Minute	Minimum	Billing Increment
Intrastate	$.055	6 seconds	6 seconds
Interstate	.055	6 seconds	6 seconds
Alaska, Hawaii, Virgin Islands and Puerto Rico	.11	6 seconds	6 seconds

(1) See Section 5.4 preceding for rate per minute.

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5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.4 Service Rates (continued)

5.4.9. Business Volume Commitment Plans – Rates (continued)

2. 800 Service

Monthly Usage for Volume Commitment	Rate per minute
No Volume Commitment	.09
$25.00 Volume Commitment	.09
$100.00 Volume Commitment	.085
$500.00 Volume Commitment	.08
$1,000.00 Volume Commitment	.075
$2,500.00 Volume Commitment	.07

3. Travel Card

Monthly Usage for Volume Commitment	Rate per minute
No Volume Commitment	$.20
$25.00 Volume Commitment	.20
$100.00 Volume Commitment	.20
$500.00 Volume Commitment	.20
$1,000.00 Volume Commitment	.20
$2,500.00 Volume Commitment	.20

5. PROVISION OF INTRASTATE INTEREXCHANGE SERVICE (continued)

5.5 Promotions

From time to time, the Company may elect to offer special promotions to its customers. These promotions will generally consist of a reduced price, a waiver of installation charges, or a free service with a purchase of another service.

Any promotional waiver or discounted rate will apply only one time per customer for each service in any given wire center prefix during the course of the promotional period, subject to prior notification and approval by the Commission.

The Company will provide written notice to the Commission no less than seven (7) days prior to the beginning of each promotion period identifying the promotion and the exchanges within which the promotion will be offered. If facilities permit, all residence and/or business customers will be offered the same opportunity to take advantage of the same terms and conditions under the promotions in which to subscribe to residence or business services.

Birch Telecom of the South, Inc.

Local Exchange Services Tariff

This Tariff, filed with the Tennessee Regulatory Authority, contains the terms and conditions applicable to local exchange telecommunication services in the State of Tennessee by Birch Telecom of the South, Inc. (the "Company"). The Company provides exchange telecommunications services on resale and facilities-based bases. Copies of this Tariff may be inspected during normal business hours at the Company's principal place of business located at:

Birch Telecom of the South, Inc.
2020 Baltimore Avenue
Kansas City, MO 64108

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David E. Scott, President
2020 Baltimore Avenue
Kansas City, MO 64108

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EXPLANATION OF SYMBOLS

AT ....Addition to text

C ....Correction

CP...........Change in practice

CR ....Change in rate

CT...........Change in text

DR ....Discontinued rate

FC...........Change in format, lettering or numbering

MT..........Move of text

NR ....New rate

RT...........Removal of text

Birch Telecom of the South, Inc.
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1. DEFINITIONS AND ABBREVIATIONS

The following terms, whether or not capitalized in this Tariff, shall have the meanings set forth below:

900 Call Restriction – Allows customers to restrict 900 prefix outgoing calls from being placed over their exchange access lines.

Auto Redial – Enables the customer to automatically redial the last outgoing telephone number. When the telephone number is busy, the Company's equipment will keep trying to call the number being redialed for a maximum of 30 minutes.

Business – When used in relation to service, means service provided in offices, stores, factories and all other places for business use.

Call Blocker – Enables the customer to block calls from preselected telephone numbers and/or the last incoming call (without knowing the number). To block specified telephone numbers, the customer builds a screening list. To block an unknown number after receiving a call, the customer enters a code to add the number to their screening list. If facilities are unavailable to provide incoming call screening via the customer's list, standard call completion will occur. Customers whose telephone numbers are blocked are directed to a Company recorded announcement.

Call Forwarding – Automatically routes incoming calls to a designated answering point selected by the subscriber, regardless of whether the user's station is idle or busy. The subscriber may change the designated answering point using the telephone key pad.

Call Forwarding-Busy Line – Automatically routes incoming calls to a pre-designated answering point when the called line is busy.

Call Forwarding-Busy Line/Don't Answer – Allows incoming calls that encounter a busy condition or are not answered after a predetermined number of rings to be automatically forwarded to a predesignated telephone number within the exchange or the Long Distance Telecommunications Network. The Call Forwarding customer is responsible for the payment of charges (e. g., tolls charges) for each call between the Call Forwarding equipped telephone line and the line to which the call is being forwarded.

Call Forwarding-Don't Answer – Automatically routes incoming calls to a pre-designated answering point when the called line is not answered after a preset number of rings.

Call Return – Enables a Customer to automatically redial the telephone number of the last incoming call. If that telephone number is busy, the Company's equipment will keep trying to call the number being redialed for a maximum of 30 minutes.

Call Transfer – Provides the capability to transfer or add a third party, using the same line.

1. DEFINITIONS AND ABBREVIATIONS (continued)

Call Transfer Disconnect – Enables business customers to add on another line to an established call creating a three-way call. The Call Transfer Disconnect subscriber may disconnect from the three-way call and allow the other two parties to continue talking, thereby freeing their line for the purpose of originating another call. The Call Transfer Disconnect feature cannot be used to expand a calling scope and is, therefore, not available to customers subscribing to an optional flat-rate local, toll or expanded calling plan. Call Transfer Disconnect cannot be used to avoid toll charges. Call Transfer Disconnect customers are responsible for any toll or other charges associated with calls they originate.

Call Waiting – Provides the user with a burst of tone to indicate that another call is waiting. The second call can either be answered by flashing the switchhook or hanging up the phone and being rung back by the caller.

Call Waiting ID – Allows for the display of the name and/or number of a new caller when user is already talking on the telephone and receives another phone call on the customer's CPE and allows the customer to decide to answer the new incoming call or not.

Call Waiting ID Options – Allows Call Waiting ID customer to identify the name and/or number of an incoming caller when already talking on the telephone and receive another phone call on customer's CPE. The customer may decide how to handle the second caller from a menu choice known as Disposition Codes appearing on the customer's CPE as menu options.

Cancel Call Waiting – Allows a user to cancel the Call Waiting feature on a per call basis by dialing a specific two digit code.

Caller ID – Number – Identifies the 10-digit number of the calling party before the call is answered. Specialized answering equipment is required to display the calling party information. The calling party may block the display of their number by dialing a code prior to placing the call.

Caller ID – Name – Identifies the name associated with the calling number before the phone is answered. This feature requires Caller ID – Number.

1. DEFINITIONS AND ABBREVIATIONS (continued)

Caller ID on Call Waiting – Provides calling number and calling name delivery following the Call Waiting tone.

Caller ID Blocking – Blocks the delivery of the number and name to the called party on a per call basis. Can either be "selective" or "complete."

Calling Features – Optional telephone services allowing customers to efficiently manage the call flow generated over their exchange access lines.

Collect Call – Denotes a billing arrangement by which the charge for a call may be reversed provided the charge is accepted at the called service point. A collect call may be billed to a calling card or third party number. In the case of a telephone which is identified as Customer-Owned Pay Telephone Service, the charges must be billed to a calling card or third number, or the call may be reoriginated from the called service point.

Company, the – Birch Telecom of the South, Inc. unless the context indicates otherwise.

Commission – The Tennessee Regulatory Authority, unless the context indicates otherwise.

Conference Telephone Service– The furnishing of simultaneous connection between three or more exchange access arrangements. If Long Distance Message Telecommunications rates would apply on a connection between any two of the exchange access arrangements so connected, conference service will be furnished in accordance with Section 4.6 of this Tariff.

CPE – Customer Provided Equipment.

Customer – The Person which orders or uses the service and is responsible for the payment of rates and charges and compliance with tariff regulations.

Customer Account – A customer's record relating to the service or equipment billed to a single telephone number. Service may be all on one premises or extended to other premises as long as it is part of the main telephone system and billed to the main telephone number.

Customer Alerting Enablement – Allows residence and business lines to receive an audible alerting tone (intermittent dial tone) transmitted from the central office.

Customer Premises – One Customer Premises is all space in the same building occupied by a Customer and all space occupied by the same Customer in different buildings on the same property.

Customer Provided Equipment (CPE) – Equipment provided by the Customer.

1. DEFINITIONS AND ABBREVIATIONS (continued)

Demarcation Point – That point of interconnection between the Company's facilities and the wiring at the Customer Premises. The Demarcation Point shall consist of wire or a jack conforming to Subpart F of Part 68 of the Federal Communications Commission's rules and regulations (a network interface).

The network interface may be located at a point other than the normal demarcation point where the network interface is already established by the presence of network equipment on the effective date of this Tariff. For multi-unit structures (e.g., apartments, college campuses, shopping centers), the structure owner shall make the final decision on whether the structure shall be treated as a multi-unit structure with one Demarcation Point per unit or, as a single unit with one Demarcation Point for the entire structure. The structure owner shall have the option of having the Demarcation Point placed at a location other than that determined by the Company, provided the structure owner pays any additional construction costs and such location is consistent with the minimum point of entry standard.

With regard to premises for any structure that is built to be mobile (e.g., mobile homes, recreational vehicles), the Company may place the Demarcation Point on a post or pole at or near the pad where such structure is intended to rest. Boat docks and similar premises may be treated by the Company as a single unit premises, with the Demarcation Point being placed on the shore.

Direct Inward Dialing (DID) – Allows an incoming call to reach a station line without attendance assistance.

Direct Outward Dialing (DOD) – A service attribute that routes outgoing calls directly to the exchange network without attendant assistance.

Directory Assistance – Service whereby Customers may request assistance in determining telephone numbers when the listed name is provided.

Directory Assistance Call Completion (DACC) – Service whereby customers may request completion of local or intraLATA long distance calls to a requested number by either the Directory Assistance operator (Semi-Automated) or the Directory Assistance audio response system that provides the requested directory number (Fully Automated).

Directory Listing – The publication in the BellSouth Telecommunications, Inc. White Pages directory of information relative to the customers' telephone numbers ("the Directory"), by which telephone users are enabled to ascertain the telephone number of a desired telephone.

Additional Listings – A separate and alphabetically distinct listing for the names of anyone else living at the end user's home or, for example, partners in a business.

Alternate Listings – A listing of an alternate telephone number to be called in case no answer is received at the primary call number.

Dual Name Listings – A listing provided for two persons who reside at the same address or for a person known by two first names.

1. DEFINITIONS AND ABBREVIATIONS (continued)

Directory Listing (continued)

Extra Lines – An extra line (consisting of five words or any fraction thereof) under the Primary Listing for the proper placement of telephone calls and not for advertising purposes or to show store hours.

Foreign Listings – Allows the Customer to have a Directory listing outside of his/her local area.

Night Number Terminal Service – Allows callers to be routed to a specific line or trunk in a hunt group. The Night Number is strapped in the central office to either a telephone number or a terminal working at the end user's location.

Nonlisted Service – A listing, at the customer's request, is omitted from the Directory, but appears on Directory Assistance records.

Nonpublished Exchange Service – A listing, at the customer's request, is omitted from the Directory but appears on Directory Assistance with NP instead of the telephone number.

Primary Listing – One listing in the Directory, at no charge, when applying for telephone service.

Regular Extra Listings – A listing for the same address and phone number as, and in addition to, the Primary Listing in the Directory.

Residence Bold or Script Listings – Special print styles (bold or script) available for listings in the residence Directory.

Residence Family Space Listings – Allows the Customer to have first names or nicknames of family members placed within a customized space outlines with a bold box.

Residence Custom Extra Line Listing – A customized extra line(s) associated with the end user's alphabetical residential listing which allows the end user to further describe himself or herself. Subject to approval by the Company, one to eight lines of descriptive information may be placed between the end user's name and address in their directory listings.

Residence Logo Listing – Allows an end user to choose a logo from a pre-selected menu of approved logos, which will appear with the end user's listing in the Directory. The entire listing will be enclosed within a box with the logo itself appearing in a space below the listed name and above the listed address.

Secretarial Listings – A listing contracted for by a Customer in the secretarial services business whereby that Customer's patrons, with their permission, are listed alphabetically in the Directory with the Customer's telephone number.

1. DEFINITIONS AND ABBREVIATIONS (continued)

Disconnection – The temporary cessation of telecommunications service.

DN – Dependent Number. See "Multi-Directory Numbers.

Dual Tone Multi-Frequency (DTMF) – The pulse type employed by tone dial station sets.

Exchange – A telephone system which provides for service within a specified area known as the "Exchange Area."

Exchange Access Line – A central office line which provides access to the exchange telephone network for local and long distance telephone service and includes the service, central office equipment and all outside plant facilities furnished by the Company.

Exchange Service – The furnishing of service for telephone communication within local service areas in accordance with the provisions of this Tariff.

Extended Area Service – A Local Exchange Service that is provided between two or more contiguous exchange areas.

Flat Rate Service – Exchange Service furnished for a specified sum without regard to the amount of use.

Hunting – Series – A hunting arrangement that provides for sequential hunt over members identified within the hunt group. The hunt for an idle line begins at the telephone number dialed and proceeds sequentially through the lines identified in the hunt group until an idle line is found or the last assigned number within the hunt group is reached. If an idle line is found, the hunt stops and the idle line is rung. If all lines are busy, the caller receives a busy signal.

Hunting – Circle – A hunting arrangement similar to sequential hunting except, if no idle line is found by the time the last line in the group is reached, the hunt circles back to the first line in the group and hunts up tc but not including the line where the hunt started.

Hunting – Preferential – Some or all of the lines in a hunt group may have an associated preferential hunt list. This hunt list permits a pre-hunt over a subset or preferential group of lines before hunting through the multiline hunt group.

1. DEFINITIONS AND ABBREVIATIONS (continued)

Individual (1-Party) Line Service – A grade of Exchange Service which provides for a maximum of one main station on a line.

Intercept Referral Service-Basic – Used when a customer disconnects service or changes his telephone number. Calls to the intercepted telephone number are referred to an operator or a recorded message. The caller is provided with information such as a new telephone number and/or name and/or address. This service is provided to residential customers for a minimum of 30 days, while capacity on facilities exists.

Intercept Referral Service-Special – Same as Intercept Referral Service – Basic, plus it provides additional information to the caller.

Intercom Calling – Enables single line customers to set up internal communications (intercom) between multiple telephone extensions. The customer establishes intercom calls by dialing a code and hanging up the telephone handset. The code activates distinctive ringing to alert intercom users of an intercom call. Three-Way Calling is necessary for the operation of Intercom Calling. This feature is obsolete except for existing customers at existing locations.

Interexchange Channel – That portion of a channel which interconnects exchanges in which the stations are located.

LATA – Local Access and Transport Area (LATA) denotes a geographic area established for the administration of telecommunications service. It encompasses designated local operating Company exchanges which are grouped to serve common social, economic and miscellaneous purposes.

Local Messages – A local message is a telephone conversation of any prescribed length between two telephone stations. It is the measurement upon which the charges for telephone communications are based when the calling station and the station to which communications is established are both within the same local service area.

Local Service Area – That area within which a Customer can make telephone calls at exchange rates.

Multi-Directory Numbers – Allows customers to establish up to three telephone numbers on the same access line. Each number is assigned a distinctive ring. The billing telephone number is the "master" number and has a standard ring. The other number(s) are dependent numbers and are assigned individual distinctive rings.

Multiline Hunt Group – Rotary (hunting) service provided in Electronic Switching System (ESS) offices where a standard seven-digit number is assigned only to the first line in a customer's number group. Subsequent lines are designated by using two-, three- or four-digit numbers dependent on the type of ESS office. The Company reserves the right to determine when Multiline Hunt Group numbers are assigned.

1. DEFINITIONS AND ABBREVIATIONS (continued)

Night Number Service – Allows calls to be routed to a specific line or trunk in a hunt group. The Night Number is strapped in the Central Office to either a telephone number of a terminal working at the end user's location. Night numbers associated with a terminal will not hunt.

Operator Services

Non-Automated – Where the person originating the call dials zero or a special access number (e. g., an 800/888 number), and the operator dials the number and collects billing information for completion of the call.

Semi-Automated – Where the personal originating the call dials zero or a special access number (e. g., an 800/888 number), (or 1+ calls from pay telephones), then dials the desired telephone number, and the operator collects billing information for completion of the call.

Fully Automated – Fully automated service is where the person originating the call dials zero or a special access number (e.g., an 800/888 number), then dials the desired telephone number, and then dials the service selection codes as instructed by the automated billing equipment, and the call is completed without the assistance of an operator.

Person – An individual, corporation, limited liability company, partnership, or any other entity.

Priority Call – Provides the customer with a distinctive ring or Call Waiting tone (if the customer has subscribed to Call Waiting), when the customer is called from preselected telephone numbers. The customer can construct or modify the telephone number screening list by dialing a unique code. The Company's equipment will screen incoming calls against the screening list and provide a distinctive ring for telephone numbers on the list.

Remote Call Forwarding – A service whereby calls placed to a telephone number are automatically forwarded by central office equipment to another number designated by the end user. The Remote Call Forwarding number may be either a different exchange (remote) or another central office area within the same exchange (local). Additional paths may be provided to handle multiple calls to the Remote Call Forwarding number as long as there are at least an equal number of lines at the terminating end. Any toll portions of calls are billed to the Customer.

1. DEFINITIONS AND ABBREVIATIONS (continued)

Remote Access to Call Forwarding – Allows the user to activate and/or deactivate the Call Forwarding feature from any remote location, using a Touch-tone phone.

Residence or Residential – When used in relation to service, means service provided in private residence for personal non-business use.

Selective Call Forwarding – Enables the customer to forward incoming calls from preselected telephone numbers to another telephone number. The customer can construct or modify a telephone number screening list by dialing an activation code. The Company equipment will screen incoming calls against the customer's list and forward only those telephone numbers on the list.

Sent-Paid – Denotes a billing arrangement whereby a call is charged to the service point originating the call.

Series Completion – Telephone numbers assigned in a rotary (hunting) number group where each number assigned is a standard seven-digit number. The Company reserves the right to determine when series completion numbers are assigned.

Simultaneous Call Forwarding – Provides the customer that also subscribes to an appropriate call forwarding service with the ability to forward multiple incoming calls simultaneously to another telephone number designated by the customer. The line/trunks at the Simultaneous Call Forwarding customer's terminating location must equal or exceed the aggregated number of potential originating calls from all customer locations. The Simultaneous Call Forwarding customer is responsible for the payment of charges (e. g., toll charges) for each call between the Simultaneous Call Forwarding equipped telephone and the line to which the call is being forwarded. This service cannot be used to avoid toll.

Speed Calling – Allows a subscriber to establish a speed calling list, which associates telephone numbers with a unique q-digit and/or 2-digit speed calling code. Initial entry and changes to the speed calling list are directly input from the associated subscriber line. This feature is available as an eight code list or a thirty code list. Code lists may include local and/or toll telephone numbers.

Station – Telephone equipment from or to which calls are placed.

1. DEFINITIONS AND ABBREVIATIONS (continued)

Three-Way Calling – Allows a station in the talking state to add a third party to the call. This feature may be used on both incoming and outgoing calls.

Toll Restriction – Allows the customer to establish, on a per line basis, call restrictions by the calling party.

Trunk – A commercial channel between two switching (i.e., Central Office, PBX) systems.

Termination – The permanent cessation of telecommunications service.

Two-Point Service, Person-to-Person – That service where the person originating the call specifies to the Company operator a particular person, department or office to be reached.

Two-Point Service, Station-to-Station – That service where the person originating the call dials the telephone number desired or gives to the Company operator the telephone number of the desired service point, or gives only the name and address under which the number of the service point is listed, and does not specify a particular person, department or office to be reached.

2. RULES AND REGULATIONS

2.1 Undertaking of the Company

2.1.1 The Company undertakes to furnish telecommunications service pursuant to the terms of this Tariff in connection with one-way and/or two-way information transmission between points within a calling scope in portions of the State of Tennessee, as specified herein.

2.1.2 The furnishing of service under this Tariff is subject to the availability on a continuing basis of all the necessary facilities and is limited to the capacity of the Company's facilities as well as facilities the Company may obtain from other carriers to furnish service from time to time as required at the sole discretion of the Company.

2.1.3 The Company reserves the right to limit or to allocate the use of existing facilities, or of additional facilities, offered by the Company, when necessary because of lack of facilities, or due to some other cause beyond the Company's control.

2.1.4 The Company may undertake service-affecting activities that may occur in normal operation of the Company's business. Such activities may include, but are not limited to, equipment or facilities additions, removals or rearrangements and routine preventive maintenance. Generally, such activities are not specific to an individual Customer but affect many Customers' services. No specific advance notification period is applicable to all service activities. With some emergency or unplanned service-affecting conditions, such as an outage resulting from wiring or equipment damage, notification to the Customer may not be possible.

2.1.5 Customers may be required to enter into written service orders which shall contain or reference a specific description of the service ordered, the rates to be charged, the duration of the services, and the terms and conditions in this Tariff. Customers will also be required to execute any other documents as may be reasonably requested by the Company.

2.1.6 Applications for initial or additional service made verbally or in writing become a contract upon the establishment of the service or facility.

2.2 Limitations of Service

2.2.1 The Company offers service to all Persons who desire to purchase service from the Company consistent with all provisions of this Tariff. Persons interested in the Company's services shall submit information to the Company which fully satisfies the Company and identifies the services requested.

2.2.2 Service is offered subject to the availability of the necessary facilities and equipment, necessary arrangements with other carriers and billing capabilities, and is subject to the provisions of this Tariff. The Company reserves the right not to provide service to or from a location where legally prohibited.

2. RULES AND REGULATIONS (continued)

2.2 Limitations of Service (continued)

2.2.3 The Company reserves the right to discontinue furnishing service when necessitated by conditions beyond its control, or when the Customer is using the service in violation of any provision in this Tariff, the rules and regulations of the Commission, or the law.

2.2.4 Title to all facilities provided by the Company under this Tariff remains with the Company. Prior written permission from the Company is required before any assignment or transfer. All regulations and conditions contained in this Tariff shall apply to all such permitted assignees or transferees, as well as all conditions for service.

2.3 Use of Service

2.3.1 Permitted Uses

Service may not be used for any unlawful purposes, or for any purpose for which any payment or other compensation is received by the Customer, except when the Customer is a duly authorized and regulated common carrier.

2.3.2 Minimum Service Period

The minimum period of service is one month (30 days), unless otherwise stated in this Tariff.

2.3.3 Fixed Service Period

If Customer and the Company have agreed to a specified term of service under any service order, then following expiration of the initial term of service, or any extension thereof, service shall continue on a month-to-month basis at the then current rates unless terminated by either party upon 30 days' written notice.

2.3.4 Termination

Any termination shall not relieve Customer of its obligation to pay any charges incurred under this Tariff or in any service order prior to termination. The rights and obligations which by their nature extend beyond the termination of the term of the service order shall survive such termination.

2.4 Liability

2.4.1 The liability of the Company for any claim or loss, expense or damage, due to any interruption, delay, error, omission, or defect in any service, facility, or transmission provided under this Tariff or any service order shall not exceed the amount of the credit allowance described in Section 2.6 herein. The extension of credit allowances as described in Section 2.6 shall be the sole remedy of Customer and sole liability of the Company for any interruption, delay, error, omission, or defect in any service, facility, or transmission provided under this Tariff or any service order. In no event will the Company be liable for any direct, indirect, consequential, incidental, exemplary, punitive, or special damages, or for any lost business, goodwill, income or profits, even if advised of the possibility of the same.

2. RULES AND REGULATIONS (continued)

2.4 Liability (continued)

2.4.2 The Company shall not be liable for any claim or loss, expense, or damage for any interruption, delay, error, omission, or other defect in service, facility, or transmission provided under this Tariff or any service order, if caused by or resulting from: any person or entity other than the Company; any malfunction of any service or facility provided by any Person other than the Company; labor difficulties; fire, flood, earthquake, or any other act of God; explosion; war; riot or civil disturbance; any law, order, regulation, direction, action or request of any federal, state or local government or any department, agency, commission, bureau, or other instrumentality of federal, state or local government; or by any other cause beyond the Company's control.

2.4.3 The Company shall not be liable for and shall be fully indemnified and held harmless by Customer against any claim of loss, expense, or damage, including indirect, special, or consequential damage for:

A. Defamation, libel, slander, invasion of privacy, infringement of copyright or patent, unauthorized use of any trademark, trade name, or service mark, unfair competition, interference with or misappropriation, or violation of any contract, proprietary or creative right, or any other injury to any person, property, or entity arising from the material, data, information, or content revealed to, transmitted, processed, handled, or used by the Company under this Tariff;

B. Connecting, combining, or adapting the Company's facilities with Customer's apparatus or systems;

C. Any loss, destruction or damage to property of the Company, the Customer, or any third party, or the death or injury to persons, including, but not limited to, employees or invitees of either party, to the extent caused by or resulting from the negligent or intentional act or omission of the Customer, its employees, agents, representatives, family members or invitees;

D. Any claim, loss, damage, expense or liability for infringement of any copyright, patent, trade secret, or any proprietary or intellectual property right of the Company or any third party, arising from any act or omission by the Customer, including, without limitation, use of the Company's services and facilities in a manner not contemplated by this Tariff or any agreement between the Customer and the Company; or

E. Any personal injury or death of any person or for any loss of or damage to Customer Premises or any other property, whether owned by Customer or others, caused directly or indirectly by the installation, maintenance, location, condition, operation, failure, presence, use, or removal of equipment or wiring provided by the Company, if not caused by gross negligence of the Company.

2. RULES AND REGULATIONS (continued)

2.4 Liability (continued)

2.4.4 Emergency 911 Service (E911) is offered solely as an aid in handling assistance calls in connection with fire, police and other emergencies. The Company is not responsible for any losses, claims, demands, suits or any liability whatsoever, whether suffered, made, instituted or asserted by the Customer or by any other party or person for any personal injury to or death of any person or persons, and for any loss, damage or destruction of any property, whether owned by the Customer or others, caused or claimed to have been caused by: (1) mistakes, omissions, interruptions, delays, errors or other defects in the provision of this service, or (2) installation, operation, failure to operate, maintenance, removal, presence, condition, location or use of any equipment and facilities furnishing this service.

The Company is not responsible for any infringement or invasion of the right of privacy of any person or persons, caused directly or indirectly, by the installation, operation, failure to operate, maintenance, removal, presence, condition, occasion or use of Emergency 911 Service features and the equipment associated therewith, or by any services furnished by the Company including, but not limited to, the identification of the telephone number, address or name associated with the telephone used by the party or parties accessing Emergency 911 Service, and which arise out of the negligence or other wrongful act of the Company, the Customer, its users, agencies or municipalities, or the employees or agencies of any one of them.

When a Customer with a nonpublished telephone number places a call to the Emergency 911 Service, the Company will release the name and address of the calling party, where such information can be determined, to the appropriate local governmental authority. By subscribing to service under this Tariff, Customer acknowledges and agrees with the release of information as described above.

The Company will supply subscriber information to update the Emergency 911 Service database at the time the Company submits subscriber orders for basic local exchange telecommunications service to BellSouth Telecommunications, Inc..

At the time the Company provides basic local service to a customer by means of the Company's own cable pair, or over any other exclusively owned facility, the Company will be obligated to make the necessary equipment or facility additions in the 911 service provider's equipment in order to properly update the database for 911. At that time, the Company will be obligated to provide facilities to route calls from the end users to the proper PSAP.

The Company recognizes the authority of the E911 customer to establish service specifications and grant final approval or denial of service configurations offered by the Company.

The Company will collect 911 surcharges and remit all surcharge revenue to the appropriate governmental.

2.4.5 No agent or employee of any other carrier shall be deemed to be an agent or employee of the Company.

2. RULES AND REGULATIONS (continued)

2.4.6 THE COMPANY MAKES NO WARRANTY REGARDING THE PROVISION OF SERVICE PURSUANT TO THIS TARIFF, INCLUDING BUT NOT LIMITED TO THE IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE.

2.5 Interruption of Service

Customer will be entitled to a credit allowance for an interruption of service which is not caused by or does not result from the negligence or act of Customer or to the failure of channels, equipment, power supplies, and/or communications systems provided by Customer or Persons other than the Company. A credit allowance is subject to the provisions of this section and the other sections of this Tariff, including, but not limited to, the general liability provisions set forth in Section 2.4 herein and the terms of Section 2.6 herein. Customer is obligated to notify the Company immediately of any interruption in service for which the Customer desires a credit allowance. Before giving such notice, Customer shall ascertain that the interruption is not being caused by any action or omission of Customer within his or her control, or is not in wiring on Customer's side of the Demarcation Point or equipment, power supplies, or communications systems, if any, furnished by Customer or Persons other than the Company.

2.6 Responsibility of the Customer

2.6.1 All Customers assume general responsibilities in connection with the provisions and use of the Company's service. When facilities, equipment, and/or communications systems provided by others are connected to the Company's facilities, Customer assumes additional responsibilities. Customers are responsible for:

A. Placing orders for service; paying all appropriate charges for service rendered by the Company; complying with the Company's regulations governing the service; and assuring that its users comply with regulations.

B. Providing:

1. the name(s) and address(es) of the person(s) responsible for the payment of service charges; and
2. the name(s), telephone number(s), and address(es) of the Customer contact person(s).

C. Paying the Company for the replacement or repair of the Company's equipment when the damage results from:

1. the negligence or willful act of Customer or user;

2. improper use of service; or

3. any use of equipment or service provided by others.

2. RULES AND REGULATIONS (continued)

2.6 Responsibility of the Customer (continued)

2.6.1 (continued)

D. Providing at no charge, as specified from time to time by the Company, any needed personnel, equipment, space and power to operate the Company's facilities and equipment installed on the Customer Premises, and the level of heating and air conditioning necessary to maintain a proper operating environment on such premises.

E. Obtaining, maintaining, and otherwise having full responsibility for all rights-of-way and conduit necessary for installation of and associated equipment used to provide services to the Customer from the cable building entrance or property line to the location of the equipment space described above. Any costs associated with the obtaining and maintaining the rights-of-way described herein, including the costs of altering the structure to permit installation of the Company provided facilities, shall be borne entirely by, or may be charged by, the Company to the Customer.

F. Providing the Company's authorized employees, contractors, or agents access to the Customer's premises at all reasonable hours for any purpose reasonably pertinent to furnishing of telephone service.

G. Complying with all laws and regulations applicable to, and obtaining all consents, approvals, licenses and permits as may be required with respect to the location of the Company's facilities and equipment in any Customer Premises or the rights-of-way for which the Customer is responsible under this section; and granting or obtaining permission for the Company's employees, contractors, or agents to enter the premises of the Customer at any time for the purpose of installing, inspecting, maintaining, repairing, or, upon termination service as stated herein, removing the facilities or equipment of the Company, and not creating or allowing to be placed any liens or other encumbrances on the Company's equipment or facilities;

H. A Customer who subscribes to the Company's Exchange Service and resells these services to others shall be responsible for complying with all laws and regulations of the State of Tennessee, which relate in any way to its provision of local telephone service, including, but not limited to, laws and regulations regarding consumer protection, billing and collection practices, tariffing obligations, and payment of applicable taxes. The Company has no obligation to provide notice to, or otherwise communicate with, Customers regarding local telephone service provided by another carrier.

I. Providing a safe place to work and complying with all laws and regulations regarding the working conditions on the premises at which the Company's employees, contractors, or agents shall be installing or maintaining the Company's facilities and equipment.

2. RULES AND REGULATIONS (continued)

2.6 Responsibility of the Customer (continued)

2.6.2 Availability of Service for Maintenance, Testing, and Adjustment

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

2.6.3 Credit Allowances

A. Credit for failure of service or equipment will be allowed only when failure is caused by or occurs in facilities or equipment owned, provided and billed for, by the Company.

B. Credit allowances for failure of service or equipment starts when Customer notifies the Company of the failure or when the Company becomes aware of the failure and ceases when the operation has been restored and an attempt has been made to notify Customer.

C. Customer shall notify the Company of failures of service or equipment and make reasonable attempts to ascertain that the failure is not caused by Customer Provided Equipment, any act or omission of the Customer, or in wiring or equipment located on the Customer's side of the Demarcation Point.

D. Only those portions of the service or equipment disabled will be credited. No credit allowances will be made for:

1. interruptions of service resulting from the Company performing routine maintenance;

2. interruptions of service for implementation of a Customer order for a change in the service;

3. interruptions caused by the negligence or willful act of omission of Customer or its authorized user; or

4. interruptions of service because of the failure of service or equipment provided by Customer, authorized user, or other carriers.

2. RULES AND REGULATIONS (continued)

2.6 Responsibility of the Customer (continued)

2.6.3 Credit Allowances (continued)

E. Credit Allowance – Directory

For errors or omissions in listings in alphabetical telephone directories and information records furnished without additional charge, the Company shall have no liability.

Subject to the provision of Section 2.4 of this Tariff, the Company shall allow, for errors or omissions in alphabetical telephone directories (excluding the use of bold face type), or in information records, an amount within the following limits:

1. For listings in alphabetical telephone directories furnished at additional charge, as set forth herein, an amount not in excess of the charge for that listing during the effective life of the directory in which the error or omission occurred.

2. For listings in the information records furnished at additional charge, as set forth herein, an amount not in excess of the charge for the listing during the period of omission or error.

2.6.4 Cancellation by Customer

A. Customer may cancel service any time after meeting the minimum service period. Termination charges will apply if Customer cancels prior to the expiration of a one-year or other fixed term service contract. Such termination charge will be equal to one month's usage as projected in the Company's proposal for service, or the actual average monthly usage to date, whichever is higher, plus the monthly account charge for the remainder of the contract period.

B. If Customer orders service requiring special facilities dedicated to the Customer's use and then cancels the order before the service begins, or before completion of the minimum service period, or before completion of some other period mutually agreed upon by Customer and the Company, a charge will be made to Customer for the nonrecoverable portions of expenditures or liabilities incurred expressly on behalf of Customer by the Company and not fully reimbursed by installation and monthly charges. If based on the order, any construction has either begun or been completed, but no service provided, the nonrecoverable cost of such construction shall be borne by Customer.

2. RULES AND REGULATIONS (continued)

2.6 Responsibility of the Customer (continued)

2.6.5 Payment and Charges for Service

A. Charges for service are applied on recurring and nonrecurring bases. Service is billed on a monthly basis on or about the same day each month. Service continues to be provided until canceled by Customer or by the Company in accordance with provisions of this Tariff.

B. Payment will be due pursuant to applicable Commission rules. The Company includes its name and its toll-free telephone number on all invoices.

C. The Customer is responsible for payment of all charges for service furnished to the Customer, including, but not limited to all calls originated at the Customer's number(s); received at the Customer's number(s), e.g., collect, 800; billed to the Customer's number(s) via third-party billing; incurred at the specific request of the Customer; or placed using a calling card issued to the Customer. Charges based on actual usage during a month will be billed monthly in arrears. All fixed monthly and nonrecurring charges for services ordered will be billed monthly in advance.

D. Service may be denied pursuant to the Commission's rules regarding disconnection of service for nonpayment. Restoration of service will be subject to all applicable installation charges.

E. Customer is liable for all costs associated with collecting past due charges, including all attorney's fees.

2. RULES AND REGULATIONS (continued)

2.6 Responsibility of the Customer (continued)

2.6.5 Payment and Charges for Service (continued)

F. Billing information provided to each customer on a monthly basis shall include but not be limited to:

1. The number of access lines for which charges are stated.
2. Each applicable telephone number and/or account number.
3. The beginning or ending dates of the billing period.
4. The date the bill becomes delinquent if not paid on time.
5. The unpaid balance (if any).
6. The amount for basic service and an itemization of the amount due for toll service, if applicable, including the date and duration of each toll call.
7. An itemization of the amount due for taxes, franchise fees, 911 surcharges, universal service fund charge, local number portability charge, end user common line charges, primary interexchange carrier charges and other surcharges as may be necessary and appropriate, including any of the foregoing charges passed through to the Company by Bell South Telecommunications, Inc.
8. The total amount due.
9. If applicable, the amount of a deposit and interest accrued on a deposit which has been credited to the charges stated.
10. A telephone number where inquiries may be made.
11. If a deposit is held by the company.
12. Optional services may be billed as a total of all optional services for which a flat monthly charge is made.
13. Credit for service outages will also be reflected.

G. During the first billing period in which a residential customer receives service, the Company provides each customer an insert or other written notice which contains an itemized account of the charges for the equipment and service for which the customer has contracted.

H. If notice of a dispute as to charges is not received in writing, in person or via telephone message by the Company within 30 days after billing is received by the Customer, the invoice shall be considered correct and binding on the Customer, unless extraordinary circumstances are demonstrated. Any disputed charges that cannot be resolved between Customer and the Company may be forwarded to the Commission's Consumer Services Division.

2. RULES AND REGULATIONS (continued)

2.6 Responsibility of the Customer (continued)

2.6.6 Advance Payments and Deposits

A. Advance Payments

The Company may require a Customer or applicant for service to make an advance payment (1) if the applicant is unable to establish that he had a previous account with a telephone utility for a period of at least 12 months for which all undisputed charges were satisfactorily paid, or (2) if the applicant has had no previous telephone service or has had previous telephone service of less than 12 months, the applicant's credit record will be accessed and evaluated by means of a mechanized retrieval system between the Company and nationally recognized credit bureaus. No security payment will be required of those applicants who meet the Company's criteria, as evaluated by the scoring model. The criteria used in assessing a score is as follows: collection judgments, written-off accounts, outstanding collection accounts, various degrees of delinquency history from 30-180 days and not paid in full or current at the time of scoring, bankruptcies, liens, other public records. The advance payment will not exceed an amount equal to all nonrecurring charges and two month's estimated recurring charges, as a condition of continued or new service. In addition, where special construction is involved, the advance payment may also include an amount equal to the estimated nonrecurring charges for the special construction and two month's estimated recurring charges. The advance payment will be credited to the Customer's initial bill and, to the extent that a credit balance remains after the amount of the initial bill has been satisfied, then the credit balance will be applied to subsequent bills in the same manner until there is no balance remaining on the advance payment.

B. Deposits

The Company reserves the right to examine the credit record of all service applicants as stated above and require a security deposit, not to exceed two month's estimated recurring charges, when determined to be necessary to assure future payment. The security deposit will be computed by the Company in accordance with Commission rules and regulations.

Cash Deposits will accrue interest at a rate that shall be equal to the current interest rate established by the Director of the Public Utility Division for consumer deposits. If the deposit is made within 30 days of receipt of deposit, no interest payment will be paid. If the Company retains the deposit more than 30 days, payment of interest shall be made retroactive to the date of deposit.

Payment of the interest to the customer shall be annually if requested by the customer, or at the time the deposit is returned or credited to the customer's account. The deposit shall cease to draw interest on the date it is returned or credited to the customer's account. The deposit shall cease to draw interest after the discontinuance of service.

2. RULES AND REGULATIONS (continued)

2.6 Responsibility of the Customer (continued)

2.6.6 Advance Payments and Deposits (continued)

B. Deposits (continued)

If Customer pays all undisputed charges for 12 consecutive billing cycles, the deposit shall be promptly refunded along with accrued interest, or credited to future charges on subsequent bills.

1. Residential Customers Requirements

No deposit will be required:

a. If it can be verified that the residential applicant has been a customer of any telephone company in Tennessee for the same kind of service within the last two (2) years, and is not delinquent in payment of any telephone service account and during the last 12 consecutive months of service did not have more than two occasions in which a bill for telephone service was paid after becoming delinquent, did not present a dishonored check, and never had service disconnected for nonpayment, or

b. If the residential applicant furnishes in writing a satisfactory guarantee to secure payment of bills for the service required. Guaranty contracts shall be on a form provided by the Company which shall include the Company's right to transfer charges from a defaulted bill of the guaranteed account to the account or accounts of the guarantor. Guarantors must be present Company customers and must be acceptable as guarantors to the Company.

2. Business Customers Requirements

If the credit of an applicant for Business Service has not been established satisfactorily to the Company, the applicant may be required to make a deposit.

3. Existing Customers Requirements

A present customer may be required to post a new or additional deposit as a condition of continued service if undisputed charges have become delinquent in two out of the last 12 billing periods or if the customer has had service disconnected during the last 12 months, has presented a dishonored check or has had significant changes in toll or recurring charges.

2. RULES AND REGULATIONS (continued)

2.6 Responsibility of the Customer (continued)

2.6.6 Advance Payments and Deposits (continued)

B. Deposits (continued)

4. Amount of Deposit or Guaranty Contract

The amount of the deposit shall not exceed an amount equal to one months' recurring charges where billed in advance, or two months' charges when billed in arrears, plus two months' toll or nonrecurring charges, determined by actual or anticipated usage.

5. Refund of Deposits or Return of Guaranty Contracts

If service is not connected, or after disconnection of service, the Company shall promptly and automatically refund the customer's deposit plus accrued interest on the balance, if any, in excess of the unpaid bills for service furnished. A transfer of service from one premises to another within the service area of the Company shall not be deemed a disconnection for application of deposits, and no additional deposit may be required unless otherwise permitted.

When the customer has paid bills for 12 consecutive months without having service disconnected for nonpayment and without having more than two occasions in which a bill was delinquent, and has not presented a dishonored check, and when the customer is not delinquent in the payment of the current bills, the Company shall promptly and automatically refund the deposit plus accrued interest in the form of a credit to the customer's bill, or void the guarantee. If the customer does not meet these refund criteria, the deposit and interest may be retained.

The deposit and interest may be retained pending the resolution of a dispute with respect to charges secured by the deposit.

2.6.7 Bad Check Charge

The Company will bill Customer a one-time charge of $25.00 if Customer's check for payment of service is returned for insufficient or uncollected funds, closed accounts, or any other insufficiency or discrepancy necessitating return of the check at the discretion of the drawee bank or other financial institution.

2. RULES AND REGULATIONS (continued)

2.6 Responsibility of the Customer (continued)

2.6.8 Late Payment Charge

The Company may apply a late payment charge if any portion of the Customer's payment is received by the Company after the payment due date, or if any portion of the payment is received by the Company in funds which are not immediately available upon presentment. The late payment charge shall be applied to the portion of the payment not received by the date due, multiplied by a factor. The late factor shall be 1.5% per month.

Collection procedures are unaffected by the application of the late payment charge. The late payment charge does not apply to final amounts.

2.7 Responsibility of the Company

2.7.1 Provision of Equipment and Facilities

A. The Company shall use reasonable efforts to make services available to a Customer on or before a particular date, subject to the provisions of and compliance by the Customer with the regulations contained in this Tariff and applicable rules of the Commission.

B. The Company shall use reasonable efforts to maintain facilities and equipment that it furnishes to the Customer. The Customer may not, nor may the Customer permit others to, rearrange, disconnect, remove, attempt to repair or otherwise interfere with any of the facilities or equipment installed by the Company, except upon the written consent of the Company.

C. The Company may substitute, change, or rearrange any equipment or facility at any time and from time to time, but shall not thereby materially reduce the technical parameters of the service provided to the Customer.

D. Subject to the arrangement of the Company and to all of the regulations contained in this Tariff, special construction of facilities may be undertaken on a reasonable efforts basis at the request of the customer. Special construction is that construction undertaken and characterized by one or more of the following:

1. Facilities requested are not presently available, and there is no other requirement for the facilities so constructed.

2. Facilities requested are of a type other than that which the Company would normally utilize in the furnishing of its services.

3. Facilities requested are over a route other than that which the Company would normally utilize in the furnishing of its services.

2. RULES AND REGULATIONS (continued)

2.7 Responsibility of the Company (continued)

2.7.1 Provision of Equipment and Facilities (continued)

D. (continued)

4. Facilities requested are in a quantity greater than that which the Company would normally construct.

5. Facilities are requested on an expedited basis.

6. Facilities are requested on a temporary basis until permanent facilities are available.

7. Facilities are requested in advance of normal construction.

2.7.2 Calculation of Credit Allowance

Pursuant to limitations set forth in Section 2.6.3, when service is interrupted the credit allowance will be computed on the following basis:

A. No credit shall be allowed for an interruption of less than twenty four hours.

B. Customer will be credited at the proportionate monthly charge involved for each twenty-four hours or fraction thereof of interruption.

2.7.3 Cancellation of Credit

Where the Company cancels a service and the final service period is less than the monthly billing period, a credit will be issued for any amounts billed in advance, prorated at 1/30th of the monthly recurring charge for each day after the service was discontinued. This credit will be issued to Customer or applied against the balance remaining on Customer's account.

2. RULES AND REGULATIONS (continued)

2.7 Responsibility of the Company (continued)

2.7.4 Disconnection of Service by the Company

The Company may discontinue service or cancel an application for service, pursuant to applicable Commission rules, without incurring any liability for any of the following reasons:

A. Nonpayment of a bill for regulated telecommunications services within the period;
B. Failure to make a security deposit;
C. Violation of or noncompliance with any provision of law, or of the tariffs or terms and conditions of service of the telecommunications service provider filed with and approved by the Commission:
D. Refusal to permit the telecommunications service provider reasonable access to its telecommunications facilities for recovery, maintenance, and inspection thereof.
E. Interconnection of a device, line, or channel to telecommunications service provider facilities or equipment contrary to the telecommunications service provider's terms and conditions of service on file with and approved by the Commission.
F. Use of telephone service in such manner as to interfere with reasonable service to other end-users.

Residential service may be discontinued during normal business hours on or after the date specified in the notice of discontinuance. Service shall not be discontinued on a day when the offices of the Company are not available to facilitate reconnection of service or on a day immediately preceding such a day.

Residential service shall not be discontinued unless written notice by first-class mail is sent or delivered to the Customer at least five days prior to the date of the proposed discontinuance.

Customers shall have a minimum of 12 days from the rendition of a bill to pay the charges stated.

At least 24 hours preceding a discontinuance, the Company shall make reasonable efforts to contact the Customer to advise it of the proposed discontinuance and what steps must be taken to avoid it.

2. RULES AND REGULATIONS (continued)

2.7 Responsibility of the Company (continued)

2.7.4 Disconnection of Service by the Company (continued)

Insufficient reasons for denial or disconnection of service:

A. Nonpayment for telephone service by a previous occupant at the premises for which service is sought, or by reason of nonpayment of any amount back-billed due to misapplication of rates provided the applicant enters into a deferred payment plan. The Company shall not disconnect or suspend service without mailing or delivering a bill to the customer for the amount due.

B. Residential service will not be disconnected for failure to pay a bill for a business service.

C. Business service will not be disconnected for failure to pay a bill for a residential service.

D. Service will not be withheld from a customer whose name was fraudulently used to obtain service at another location without the end user's permission or knowledge.

E. The Company shall not deny service to a customer for nonpayment of an amount past due for more than three (3) years, if the company cannot substantiate the charges with a copy of the customer's bill.

F. Service shall not be discontinued to a current customer in good standing who accepts an additional household member owing a previous bill to the Company, unless that additional household member is listed on the lease arrangements or another utility service as a responsible party, or unless the household member shared service with the customer at a different or same location.

G. The Company shall not provide billing and collection for any provider of intrastate telecommunications services who does not have proper authority to operate in the State of Tennessee.

H. Local exchange service shall not be denied or terminated for nonpayment of non-regulated services or disputed charges.

2. RULES AND REGULATIONS (continued)

2.7 Responsibility of the Company (continued)

2.7.4 Disconnection of Service by the Company (continued)

The Company's Notice of Disconnection shall contain the following information:

The words "NOTICE OF DISCONNECTION" or words with the same meaning, in print type larger than the print type of the notice text.

The name, address and telephone number of the Customer.

A statement of the reason for the proposed disconnection and the cost (to the Customer) for reconnection.

The date on or after which service will be disconnected unless appropriate action is taken.

The telephone number in bold print of the Company where the customer may make an inquiry.

A statement that the customer must contact the Company regarding the disconnection, prior to contacting the Commission's Consumer Services Division.

The address and telephone number of the Commission's Consumer Services Division, in print size which is smaller than the print size used for the Company's telephone number

The services that are being disconnected, whether local and/or toll, and if the service to be disconnected is local service, a statement that the customer must also contact their IXC if such customer wishes to terminate such service in order to avoid incurring additional charges for such service.

The following additional information shall be in the notice unless said information can be obtained in the telephone directory and the notice refers the customer to the location in the directory where the information can be obtained:

A. A statement of how a customer may avoid the disconnection of service, including a statement that the customer must notify the Company on the day of payment as to the place and method of such payment when the bill is paid at a place other than the office of the Company.

B. A statement that informs the customer where payments may be made or how to obtain a listing of authorized payment agencies.

2. RULES AND REGULATIONS (continued)

2.7 Responsibility of the Company (continued)

2.7.5 Equal Access

The Company will allow Customers the choice of intraLATA and interLATA interexchange carriers.

2.8 Restoration of Service

If service is disconnected for nonpayment, service will be reestablished only upon receipt of payment of all charges due, which include charges for service and facilities during the period of disconnection and which may include a service restoration fee. If the Customer has a history of payments returned for insufficient funds, the Company may require payment by cash, money order, personal check or certified check. If payment is made by personal check, restoration will be effected upon clearance of the check. When a Customer's service has been disconnected in accordance with this Tariff and the service has been terminated through the completion of the Company's service order, service will be reestablished only upon a basis of an application for new service.

During the period of disconnection, Customer's telephone number will not be reassigned. Once service has been terminated, the telephone number may be reassigned to another Customer.

2.9 Taxes and Surcharges

2.9.1 Customer will be billed and is responsible for payment of applicable E911, Telecommunications Relay Service (TRS), universal service fund charges, local number portability charge, end user common line charges, primary interexchange carrier charges, and all federal, state and local taxes, fees, assessments and surcharges assessed in conjunction with service used. In addition to any of the foregoing charges paid directly by the Company, the Company will also pass through to the Customer an amount equal to the government fees, taxes, and surcharges that the Company pays through BellSouth Telecommunications, Inc..

2.9.2 All taxes, surcharges and assessments (i.e., sales tax, municipal utilities tax, franchise fee, E911, TRS) will be listed as separate line items and are not included in the quoted rates.

2.10 Start of Billing

For billing purposes, the start of service is the day of acceptance by the Customer of the Company's service or equipment.

2. RULES AND REGULATIONS (continued

2.11 Service Connection and Facilities on Customer's Premises

The Company shall furnish and maintain all facilities including protective apparatus, to provide telecommunications service except as may be otherwise specified in this Tariff. All facilities shall conform to the established construction standards of the Company.

Except as otherwise specified in this Tariff, all equipment furnished by the Company in connection with a Customer's service shall be carefully used and only duly authorized employees of the Company or its contractors or agents shall be allowed to connect, disconnect, change or alter in any manner any or all such facilities.

Customer will be held responsible for loss of or damage to any facilities furnished by the Company unless such loss or damage is due to causes beyond the Customer's control.

At the termination of service the Company may remove any and all of its property located at the Customer Premises, as provided for in this Tariff.

No equipment apparatus, circuit or device not furnished by the Company shall be attached to or connected with the facilities furnished by the Company, whether physically, by induction or otherwise, except as provided in this Tariff. In case any such unauthorized attachment or connection is made, the Company shall have the right to remove or disconnect the same; or suspend the service during the continuance of said attachment or connection; or to terminate the service.

2.12 Telephone Number Intercept

Whenever a Customer's telephone number is changed after a directory is published, the Company will intercept all calls to the former number for 30 days and give the calling party the new number, provided existing central office equipment will permit and the Customer so desires.

2.13 Disputes

In the event of a dispute between a customer and the Company regarding any bill for telephone service, the Company shall make an investigation as required by the particular case, and report the results to the customer. In the event the dispute is not resolved, the Company shall inform the customer of the complaint procedures of the Commission.

Notwithstanding any other section of the Company's tariffs, the customer's service shall not be subject to discontinuance for nonpayment of that portion of a bill under dispute pending the completion of the determination of the dispute, but in no event to exceed 60 days. The customer is obligated to pay any billings not disputed.

3. SERVICE AREAS

3.1 Local Exchanges and Local Calling Scope

The Company will serve all Exchanges served by BellSouth Telecommunications, Inc.

4. SERVICES

4.1 Exchange Access Lines

4.1.1 Main Service

A. Business (1)(2)

Description	Rate Group A
Flat Rate 1-Party	$34.00
Flat Rate Trunk	34.00

B. Residence(1)(2)

Description	Rate Group A
Flat Rate 1-Party	$34.00
Flat Rate Trunk	34.00

For application in this tariff, such regulations, rates and charges shall be interpreted to apply on a "per request, per line/trunk" basis.

Footnotes

(1) The rates for main service do not include a telephone instrument.
(2) The rates for main service include Touch-Tone and Series Completion Hunting.

4. SERVICES (continued)

4.1 Exchange Access Lines (continued)

4.1.1 Main Service (continued)

C. Service and Equipment Charges

1. Service Charges

	Residence	Business
1. Charge to install main service access line, per access line (1)	$50.00	$50.00
2. Charge to change telephone number per access line	10.00	10.00
3. Charge to change or rearrange group billing on existing service, per occasion	10.00	10.00
4. Charge to change to or from Optional Extended Area Service, per access line	10.00	10.00
5. Charge to establish or rearrange hunting sequence, per access line	10.00	10.00
6. Charge to change type of signaling supervision (loop start to group start or vice-versa), per access line	10.00	10.00
7. Charge to change Directory Listing	10.00	10.00
8. Charge to change class of service, per access line - Residence to Business - Business to Residence	10.00	10.00

(1) In addition, apply a nonrecurring charge of $6.00 when a customer has not subscribed to Touch-tone Service previously from the Company.

4. SERVICES (continued)

4.1 Exchange Access Lines (continued)

4.1.2 Line Status Verification and Busy Line Interrupt

A. Rates

1. Line Status Verification, per request $2.00

2. Busy Line Interrupt, per request 3.00

4.1.3 Local Operator Assistance

A. Rates

Description	Rate
Station-to-Station Service	
Calling Card	
Non-Automated	$1.65
Semi-Automated	1.65
Fully Automated	.45
Collect	
Non-Automated	$1.65
Semi-Automated	1.65
Fully Automated	1.65
Billed to a Third Number	
Non-Automated	$1.65
Semi-Automated	1.65
Fully Automated	1.65
Sent-Paid	
Non-Automated	$1.65
Semi-Automated	1.65
Person-to-Person Service	
Non-Automated	$3.00
Semi-Automated	3.00

4. SERVICES (continued)

4.1 Exchange Access Lines (continued)

4.1.4 Hunting Line Services

A. Rates and Charges

Business Line and Trunk	Monthly Rates
1. Circle Hunting, per access line	$2.00
2. Preferential Hunting, per access line(2)	2.00

Residence Line and Trunk	Monthly Rates
1. Circle Hunting, per access line	$2.00
2. Preferential Hunting, per access line(2)	2.00

(1) Rates apply per line equipped with a preferential list.

4. SERVICES (continued)

4.2 General Exchange Services

4.2.2 Rates & Charges—Calling Features

A. Per Line and Trunk

	Business Monthly Rates	Residence Monthly Rates	Service Charge
Auto Redial	$3.00	$3.00	$10.00
Call Blocker	3.00	3.00	10.00
Call Forwarding	3.00	3.00	10.00
Call Forwarding Busy Line/No Answer	3.00	3.00	10.00
Caller ID (2)	5.00	5.00	10.00
Call Return	3.00	3.00	10.00
Call Transfer Disconnect	10.00	10.00	10.00
Call Waiting /Cancel Call Waiting(1)	5.00	5.00	10.00
Call Waiting Caller ID	10.00	10.00	10.00
Call Waiting Caller ID Options	12.00	12.00	10.00
Three-way Calling	3.00	3.00	10.00
Multi-Distinctive Ringing			
- 1st Dependent DN	5.00	5.00	10.00
- 2nd Dependent DN	1.00	1.00	10.00
Priority Call	3.00	3.00	10.00
Remote Access to Call Forwarding	3.00	3.00	10.00
Speed Calling 30	3.00	3.00	10.00
Selective Call Forwarding	3.00	3.00	10.00
Simultaneous Call Forwarding (3)(4)	3.00	3.00	10.00

See Sheet No. 70 for footnotes.

4. SERVICES (continued)

4.2 General Exchange Services (continued)

Footnotes–Business and Residence Rates & Charges—Calling Features

(1) This rate is inclusive of the Cancel Call Waiting option where available.

(2) Caller ID with Name and Number—Caller ID with Name and Number (Caller ID) enables the terminating Customer to identify the calling party by displayed name and/or number before the call is answered. Caller ID Customers must provide and connect their own compatible CPE.

Any calling party may prevent the delivery of their calling name and/or number to the called party by dialing an access code (*67 on their Touch Tone pad or 1167 from a rotary telephone) immediately prior to placing a call. The access code will activate per call blocking, which is available at no charge.

If the calling party activates blocking, the name and/or number will not be transmitted across the line to the called party. Instead, Caller ID customer will receive an anonymous indicator. This anonymous indicator notifies the Caller ID customers that the calling party has elected to block the delivery of their name and telephone number. The blocking of CPN will not be provided on calls originating from Customer-Owned Pay Telephone Service. If the Caller ID customer also subscribes to Anonymous Call Rejection, the calling party will be routed to a telephone company recording advising the caller that the called party will not accept calls whose CPN has been blocked.

Line blocking for the delivery of the calling name and/or number is available upon request, at no charge, to the following entities and their employees/volunteers, for lines over which the official business of the agency is conducted including those at the residences of employees/volunteers, where an executive officer of the agency registers with the Company a need for blocking; (a) private, nonprofit, tax-exempt, domestic violence intervention agencies and (b) federal, state and local law enforcement agencies.

Line blocking customers can unblock their calling name and/or number information on a per call basis, at no charge, by dialing an access code (*82 on their Touch Tone pad or 1182 from a rotary phone) immediately prior to placing a call.

The Company shall not be liable for any claims for damages caused or claimed to have been caused, directly or indirectly, by the transmission to a Caller ID customer of a name or telephone number which the calling party or the Caller ID customer finds erroneous, offensive, embarrassing, or misleading for any reason, including but not limited to the way in which the calling party's name has been abbreviated.

Telephone calling party name and/or number (CPN) information transmitted via Caller ID is intended solely for the use of the Caller ID subscriber. Resale of this information is prohibited by this Tariff. CPN will not be displayed if the called party is off-hook or if the called party answers during the first ring interval. CPN will be displayed for calls made from another central office only if it is linked by appropriate facilities. Caller ID is not available on operator-handled calls.

(3) One Call Forwarding feature is applicable per line/trunk arranged.

(4) One Simultaneous Call Forwarding feature and one Call Forwarding feature are applicable per line/trunk (non-hunting) used to establish connection.

4. SERVICES (continued)

4.2 General Exchange Services (continued)

4.3.3 A. Birch Basic Business Line and Trunk

Birch Basic Business Line and Trunk is available within the Exchange Area as defined in Section 3 of this Tariff.

	Monthly Rate	
	Rate Group A	Installation Charge(1)
One Flat Rate 1-Party Line	$34.00	$50.00
One Flat Rate Trunk	$34.00	$50.00
One Direct Inward Dialing (DID) Flat Rate Trunk (2)(3(4)	$60.00	$50.00

B. Birch Basic Residence Line and Trunk

Birch Basic Residence Line and Trunk is available within the Exchange Area as defined in Section 3 of this Tariff.

	Monthly Rate	
	Rate Group A	Installation Charge(1)
One Flat Rate 1-Party Line	$34.00	$50.00
One Flat Rate Trunk	$34.00	$50.00
One Direct Inward Dialing (DID) Flat Rate Trunk (2)(3(4)	$60.00	$50.00

(1) Installation charges on account will be waived when service is converted from Customer's current local exchange carrier to Birch and for new Birch lines added at that time. The charge will apply for new Birch lines added on a date after service is converted, for new Birch lines ordered without converting existing local exchange carrier service, and for new service.
(2) The rates for this service do not include a telephone instrument.
(3) This service offering is subject to the availability of necessary facilities.
(4) See Section 4.6 for DID Number Blocks and Termination Options.

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4. SERVICES (continued)

4.2 General Exchange Services (continued)

4.3.4 Birch Basic Business Line - Feature List

Any of the following calling features may be added to the Birch Basic Business Line. The following rates apply only when these calling features are added to the Birch Basic Business Line. To add calling features to any other service, please refer to Section 4.3 for applicable rates.

Birch Basic Feature List	Monthly Rate	Installation Charge
• Speed Calling 30	$3.00	$10.00
• Call Forwarding -Variable	3.00	10.00
• Call Forwarding – Busy/Don't Answer	3.00	10.00
• Selective Call Forwarding	3.00	10.00
• Remote Access to Call Forwarding	3.00	10.00
• Three-Way Calling	3.00	10.00
• Call Waiting/Cancel Call Waiting	5.00	10.00
• Call Waiting ID	10.00	10.00
• Call Waiting Options	12.00	10.00
• Call Return	3.00	10.00
• Auto Redial	3.00	10.00
• Priority Call	3.00	10.00
• Call Blocker	3.00	10.00
• Caller ID on Call Waiting	10.00	10.00
• Multi-Directory Numbers		10.00
– 1st Dependent DN	5.00	
– 2nd Dependent DN	1.00	

4. SERVICES (continued)

4.2 General Exchange Services (continued)

4.3.5 Birch Bells Business Features Package

Birch Bells Business Features Package is available within the Exchange Area as defined in Section 3 of this Tariff.

	Monthly Rate
Any three features from the Bells Feature List below.	$7.00

Any of the following calling features may be added to the Birch Bells Business Features Package. The following rates apply only when these calling features are added to the Birch Bells Business Features Package. To add calling features to any other service, please refer to Section 4.3 for applicable rates.

Birch Bells Feature List	Monthly Rate	Installation Charge
• Speed Calling 30	$3.00	$10.00
• Call Forwarding Variable	3.00	10.00
• Call Forwarding Busy and/or Don't Answer	3.00	10.00
• Caller ID – Name and Number	5.00	10.00
• Three-Way Calling	3.00	10.00
• Selective Call Forwarding	3.00	10.00
• Remote Access to Call Forwarding	3.00	10.00
• Call Waiting/Cancel Call Waiting	5.00	10.00
• Call Return	3.00	10.00
• Auto Redial	3.00	10.00
• Priority Call	3.00	10.00
• Call Blocker	3.00	10.00
• Multi-Directory Numbers		10.00
– 1st Dependent DN	5.00	
– 2nd Dependent DN	1.00	

4. SERVICES (continued)

4.2 General Exchange Services (continued)

4.3.6 Birch Bells & Whistles Business Features Package

Birch Bells & Whistles Business Features Package is available within Exchange Area as defined in Section 3 of this Tariff.

	Monthly Rate
Any seven features from the Bells and Whistles Feature List	$13.00

Any of the following calling features may be added to the Birch Bells & Whistles Business Features Package. The following rates apply only when these calling features are added to the Birch Bells & Whistles Business Features Package. To add calling features to any other service, please refer to Section 4.3 for applicable rates.

Birch Bells & Whistles Feature List	Monthly Rate	Installation Charge
• Call Forwarding Variable	$ 3.00	$10.00
• Call Forwarding Busy and/or Don't Answer	3.00	10.00
• Caller ID – Name and Number	5.00	10.00
• Three-Way Calling	3.00	10.00
• Speed Calling 30	3.00	10.00
• Selective Call Forwarding	3.00	10.00
• Remote Access to Call Forwarding	3.00	10.00
• Call Waiting/Cancel Call Waiting	5.00	10.00
• Call Waiting ID (4)	10.00	10.00
• Call Waiting Options	12.00	10.00
• Call Return	3.00	10.00
• Auto Redial	3.00	10.00
• Priority Call	3.00	10.00
• Call Blocker	3.00	10.00
• Simultaneous Call Forwarding	3.00	10.00
• Multi-Directory Numbers		10.00
- 1st Dependent DN	5.00	
- 2nd Dependent DN	1.00	
• Call Transfer Disconnect	10.00	10.00

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4. SERVICES (continued)

4.2 General Exchange Services (continued)

4.3.7 Birch Basic Residence Line - Feature List

Any of the following calling features may be added to the Birch Basic Residence Line. The following rates apply only when these calling features are added to the Birch Basic Residence Line. To add calling features to any other service, please refer to Section 4.3 for applicable rates.

Birch Basic Feature List	Monthly Rate	Installation Charge
• Speed Calling 30	$3.00	$10.00
• Call Forwarding -Variable	3.00	10.00
• Call Forwarding – Busy/Don't Answer	3.00	10.00
• Selective Call Forwarding	3.00	10.00
• Remote Access to Call Forwarding	3.00	10.00
• Three-Way Calling	3.00	10.00
• Call Waiting/Cancel Call Waiting	5.00	10.00
• Call Waiting ID	10.00	10.00
• Call Waiting Options	12.00	10.00
• Call Return	3.00	10.00
• Auto Redial	3.00	10.00
• Priority Call	3.00	10.00
• Call Blocker	3.00	10.00
• Caller ID on Call Waiting	10.00	10.00
• Multi-Directory Numbers		10.00
– 1st Dependent DN	5.00	
– 2nd Dependent DN	1.00	

4. SERVICES (continued)

4.2 General Exchange Services (continued)

4.3.8 Birch Bells Residence Features Package

Birch Bells Residence Features Package is available within the Exchange Area as defined in Section 3 of this Tariff.

	Monthly Rate
Any three features from the Bells Feature List below.	$7.00

Any of the following calling features may be added to the Birch Bells Residence Features Package. The following rates apply only when these calling features are added to the Birch Bells Residence Features Package. To add calling features to any other service, please refer to Section 4.3 for applicable rates.

Birch Bells Feature List	Monthly Rate	Installation Charge
• Speed Calling 30	$3.00	$10.00
• Call Forwarding Variable	3.00	10.00
• Call Forwarding Busy and/or Don't Answer	3.00	10.00
• Caller ID – Name and Number	5.00	10.00
• Three-Way Calling	3.00	10.00
• Selective Call Forwarding	3.00	10.00
• Remote Access to Call Forwarding	3.00	10.00
• Call Waiting/Cancel Call Waiting	5.00	10.00
• Call Return	3.00	10.00
• Auto Redial	3.00	10.00
• Priority Call	3.00	10.00
• Call Blocker	3.00	10.00
• Multi-Directory Numbers		10.00
– 1st Dependent DN	5.00	
– 2nd Dependent DN	1.00	

4. SERVICES (continued)

4.2 General Exchange Services (continued)

4.3.9 Birch Bells & Whistles Residence Features Package

Birch Bells & Whistles Residence Features Package is available within Exchange Area as defined in Section 3 of this Tariff.

	Monthly Rate
Any seven features from the Bells and Whistles Feature List	$13.00

Any of the following calling features may be added to the Birch Bells & Whistles Residence Features Package. The following rates apply only when these calling features are added to the Birch Bells & Whistles Residence Features Package. To add calling features to any other service, please refer to Section 4.3 for applicable rates.

Birch Bells & Whistles Feature List	Monthly Rate	Installation Charge
• Call Forwarding Variable	$ 3.00	$10.00
• Call Forwarding Busy and/or Don't Answer	3.00	10.00
• Caller ID – Name and Number	5.00	10.00
• Three-Way Calling	3.00	10.00
• Speed Calling 30	3.00	10.00
• Selective Call Forwarding	3.00	10.00
• Remote Access to Call Forwarding	3.00	10.00
• Call Waiting/Cancel Call Waiting	5.00	10.00
• Call Waiting ID (4)	10.00	10.00
• Call Waiting Options	12.00	10.00
• Call Return	3.00	10.00
• Auto Redial	3.00	10.00
• Priority Call	3.00	10.00
• Call Blocker	3.00	10.00
• Simultaneous Call Forwarding	3.00	10.00
• Multi-Directory Numbers		10.00
– 1st Dependent DN	5.00	
– 2nd Dependent DN	1.00	
• Call Transfer Disconnect	10.00	10.00

4. SERVICES (continued)

4.3 Toll Services

This tariff section applies to Long Distance Message Telecommunications Service furnished or made available by the Company over service components located wholly within or partly within the Local Access and Transport Areas (LATAs) of the State of Tennessee between two or more points within LATAs of the State of Tennessee and where the respective rate centers of such points are also located in said State.

Service is furnished subject to the availability of the service components required. The Company will determine which of those components shall be used and made modifications to those components at its option.

4.4.1 Two-Point Service

A. Operator Service Charges

Description	Rate
Station-to-Station Service	
Calling Card	
Non-Automated	$1.65
Semi-Automated	1.65
Fully Automated	.45
Collect	
Non-Automated	$1.65
Semi-Automated	1.65
Fully Automated	1.65
Billed to a Third Number	
Non-Automated	$1.65
Semi-Automated	1.65
Fully Automated	1.65
Sent-Paid	
Non-Automated	$1.65
Semi-Automated	1.65
Person-to-Person Service	
Non-Automated	$3.00
Semi-Automated	3.00
Other Services	
Line Status Verification	$2.00
Busy Interrupt	3.00

4. SERVICES (continued)

4.4 Directory Services

4.5.1 Directory Listings

Listings are regularly provided in connection with all classes of Exchange Service, unless the customer subscribes to Nonpublished or Nonlisted Service. The contract period for directory listings where the listing is printed in the directory is the directory period. Where the listing has not been printed in the directory, the period is one month.

A. Primary Listings

One listing, termed the Primary Listing, is provided without charge. One copy of the telephone directory for the service area in which Customer is a subscriber will be delivered to Customer within 10 days after service is installed.

1. Dual Name Listings

	Monthly Rate
Dual Name Listing – Business	--
Dual Name Listing – Residence	--

2. Access Service customers who order primary directory listings will be charged the business or residence regular extra listing rate as appropriate. Other types of directory listings will be provided upon request at the rates specified.

	Monthly Rate	Service Charge
Access Service Business Listing, each	$1.75	$18.00
Access Service Residence Listing, each	1.75	18.00

B. Regular Extra Listings

	Monthly Rate	Service Charge
Business extra listings, each	$1.75	$18.00
Residence extra listings, each	1.75	18.00

4. SERVICES (continued)

4.4 Directory Services (continued)

4.5.1 Directory Listings (continued)

C. Special Types of Extra Listings

1. Alternate Listings

	Monthly Rate	Service Charge
Business alternate listings, each	$1.75	$18.00
Residence alternate listings, each	1.75	18.00

2. Extra Lines

The regular extra listing rate applicable in the exchange in which the listing appears applies to each extra line listing.

3. Foreign Listings

The regular extra listing rate applicable in the exchange in which the listing appears applies to each Foreign Listing.

D. Nonpublished Exchange Service

	Monthly Rate	Service Charge
Residence Nonpublished Exchange Service, each nonpublished telephone number	$1.40	$18.00

E Nonlisted Service

	Monthly Rate	Service Charge
Residence Nonlisted Service, each		
Primary	$1.40	$18.00
Additional	1.40	18.00

4. SERVICES (continued)

4.4 Directory Services (continued)

4.5.2 Directory Assistance Service

A. Rates

1. Where the customer places a sent-paid direct dialed call to Directory Assistance, the charge for each call (maximum of two numbers requested) is $.60.

2. Where the customer places a call to the Directory Assistance attendant via an operator or has Directory Assistance Service Charges are billed to a third number; or a special billing number, the charge for each call (maximum of two requests per call) is $.60.

4.5.3 Directory Assistance Call Completion

1. Rates

Directory Assistance Call Completion	Rate
Fully-Automated DACC	
- Sent-Paid Non-Coin	$ .25
- Collect	1.65
- Bill to Third Number	1.65
Semi-Automated DACC	
- Sent-Paid	1.65
- Collect	1.65
- Bill to Third Number	1.65
Person-to-Person	3.00

4. SERVICES (continued)

4.4 Directory Services (continued)

4.5.4 National Listing Service

A. Service Description

National Listing Service (NLS) is a service whereby customers may request listing information for areas outside their LATA or home NPA. Requests for listings that are intraLATA or within the customers home NPA are billed under the current Directory Assistance plan as described in Section 4.6 of the Local Exchange Tariff.

Callers access NLS by dialing 1+411 or 0+411. Only calls made for listings outside the customers' local directory assistance scope as defined above will be eligible for NLS.

B. Regulations

The regulations and rates set forth below apply to all calls from customers who request assistance in determining telephone number information of national subscribers as defined in xxx. above.

The customer will be charged for each listing request made during the call. The NLS rate applies per listing request whether or not a number is provided including requests for numbers which are non-published, non-listed or not found. There are no allowances associated with NLS.

There are no exemptions from billing for requests for NLS.

C. Rates

	Charge Per Listing Request
Sent Paid Request	$0.95
Alternately Billed Requests	1.10

4. SERVICES (continued)

4.5 Miscellaneous Services

4.6.1 Toll Restriction

A. Rates and Charges

The following rates and charges apply in addition to the established rates and charges for the services with which this feature is associated.

	Monthly Rates	Installation Charge	Service Charge
Toll Restriction, per Business line equipped	$18.00	$2.00	$6.75
Toll Restriction, per Residence line equipped	18.00	2.00	6.75

4.6.2 900 Call Restriction

A. Rates and Charges

The following rates and charges apply in addition to the established rates and charges for the services with which this feature is associated.

	Nonrecurring Charge	Service Charge
900 Call Restriction		
Per Business line equipped	$10.50(1)	$6.75(1)
Per Residence line equipped	None	None

(1) Not applicable to churches, schools and charitable organizations.

4. SERVICES (continued)

4.5 Miscellaneous Services

4.6.3 DID Service

A. Rates

	Monthly Rate	Installation Charge	Service Charge
Direct Inward Dialing Service to Customer Premises-Located Switching System:			
First 100 Direct Inward Dialing Numbers assigned, minimum charge	$25.00	$125.00(1)	$6.75
Each additional block of 100 Direct Inward Dialing Numbers assigned over the initial block of 100 numbers	25.00	125.00(1)	6.75
First 10 Direct Inward Dialing Numbers assigned	4.00	100.00(1)	6.75
Each additional 10 Direct Inward Dialing Numbers assigned over the initial block of 10 numbers	4.00	10.00(1)	6.75
Direct Inward Dialing Line Termination			
- With Dial Pulse (DP) signaling, per line	(3)	--	6.75
- With Multi-frequency (MF) signaling, per line	(3)	--	6.75
- With Dual Tone Multi-frequency (DTMF) signaling, per line	(3)	--	6.75
Removal of a number from DID number group, per number (2)	--	10.00	6.75

(1) The installation charge does not apply when a customer moves service within the same central office and there is no telephone number change.
(2) Offered subject to availability of facilities.
(3) See Section 4.3 for DID Trunk Rates.

Birch Telecom of the South, Inc.
David E. Scott, President
2020 Baltimore Avenue
Kansas City, MO 64108

4. SERVICES (continued)

4.5 Miscellaneous Services (continued)

4.6.4 Night Number Terminal Arrangement

A. Rates

	Monthly Rate	Installation and Move Charge	Service Charge
Night Number Terminal Arrangement: Terminals, each	$3.00	--	$6.75

4.6.5 Restoration of Suspended Service

A. The following Service and Equipment Charge will apply for restoring service after its temporary suspension by the Company, as covered in the Rules and Regulations of this Tariff.

	Business	Residence
Service and Equipment Charge	$22.50	$21.75

In addition to the Service and Equipment Charge, the customer will be required to pay all charges due, including the charges for the period of denial.

4. SERVICES (continued)

4.5 Miscellaneous Services (continued)

4.6.6 Intercept Referral Service

A. Rates and Charges

1. The charges shown are nonrecurring. No other charges apply except for those charges listed in this section.

Service	If the period of service requested by the customer is: Up to 90 Days	91 – 180 Days	181 – 365 Days
(a) Residence and Simple Business Customers			
I. Special Intercept Referral Service			
(i) Location Intercept Referral Service	$48.00	$96.00	$144.00
(ii) Multiple Intercept Referral Service			
(1) Fully-Automated	66.00	132.00	198.00
(2) Operator-Handled	108.00	216.00	324.00
(iii) Name Intercept	48.00	96.00	144.00
(b) DID			
I. Basic Intercept Referral Service			
(i) Each number referred individually (per telephone number)	20.00	40.00	60.00
(ii) Block of sequential numbers referred to one message (per block)	110.00	220.00	330.00

4. SERVICES (continued)

4.5 Miscellaneous Services (continued)

4.6.6 Intercept Referral Service (continued)

A. Rates and Charges (continued)

1. The charges shown are nonrecurring. No other charges apply except for those charges listed in this section. (continued)

Service	If the period of service requested by the customer is: Up to 90 Days	91 – 180 Days	181 – 365 Days
(b) DID (continued)			
II. Special Intercept Referral Service			
(i) Location Intercept Referral Service			
(1) Each number referred individually (per telephone number)	$ 68.00	$ 136.00	$ 204.00
(2) Block of sequential numbers referred to one message (per block)	500.00	1,000.00	1,500.00
III. Multiple Intercept Referral Service			
(i) Fully-Automated			
(1) Each number referred individually (per telephone number)	86.00	172.00	258.00
(2) Block of sequential numbers referred to one message (per block)	500.00	1,000.00	1,500.00
(ii) Operator-Handled			
(1) Each number referred individually (per telephone number)	128.00	256.00	384.00

4. SERVICES (continued)

4.5 Miscellaneous Services (continued)

4.6.6 Intercept Referral Service (continued)

A. Rates and Charges (continued)

1. The charges shown are nonrecurring. No other charges apply except for those charges listed in this section. (continued)

Service	If the period of service requested by the customer is: Up to 90 Days	91 – 180 Days	181 – 365 Days
(b) DID (continued)			
III. Multiple Intercept Referral Service (continued)			
(iii) Name Intercept Referral Service			
(1) Each number referred individually (per telephone number)	$ 68.00	$ 136.00	$ 204.00
(2) Block of sequential numbers referred to one message (per block)	500.00	1,000.00	1,500.00

4. SERVICES (continued)

4.6 Switched Access Services

The Company concurs with the description of and rates for Switched Access Services contained in BellSouth Telecommunications Inc.'s Tennessee Access Services Tariff approved and on file with the Commission.

4. SERVICES (continued)

4.7 Promotions

From time to time, the Company may engage in promotional offerings or trials designed to attract new Customers, to stimulate usage, to test potential new services, and/or to increase existing Customer awareness of the Company's services. In connection with those promotional offerings or trials, the Company may offer special rate incentives and waive in full or in part Installation/Move Charges and service and equipment charges. These offerings may be limited to certain services, dates, times of day and/or locations determined by the Company.

The Company shall notify the Director of the Public Utility Division (PUD) by letter specifying the service(s) offered, terms and conditions of the promotion, location and dates of each promotional period, which notice shall be provided in accordance with applicable Commission rules.

EXHIBIT F

BIRCH'S SMALL AND MINORITY -OWNED TELECOMMUNICATIONS BUSINESS PARTICIPATION PLAN

BIRCH TELECOM OF THE SOUTH, INC.

SMALL AND MINORITY-OWNED TELECOMMUNICATIONS
BUSINESS PARTICIPATION PLAN

Pursuant to T.C.A. §65-5-212, as amended, Birch Telecom of the South, Inc. ("Birch") submits this small and minority-owned Telecommunications Business Participation Plan ("Plan") as part of its Application for a Certificate of Public Convenience and Necessity to provide resold and facilities-based local exchange and interexchange telecommunication services in the State of Tennessee.

I. PURPOSE

The purpose of T.C.A. §65-5-212 is to provide opportunities for small and minority-owned business to provide goods and services to telecommunications service providers. Birch is committed to the goals of T.C.A. §65-5-212 and to taking steps to support the participation of small and minority-owned telecommunications businesses in the telecommunications industry. Birch will endeavor to provide opportunities for small and minority-owned telecommunications businesses to compete for contracts and subcontracts for goods and services. As part of its procurement process, Birch will make efforts to identify and inform minority-owned and small businesses that are qualified and capable of providing goods and services to Birch of such opportunities. Birch's representatives intend to contact the Department of Economic and Community Development, the administrator of the small and minority-owned telecommunications assistance program, to obtain a list of qualified vendors. Moreover, Birch will seek to increase awareness of such opportunities so that companies not otherwise identified will have sufficient information to participate in the procurement process.

II. DEFINITIONS

As defined in T.C.A. §65-5-212:

Minority-Owned Business. Minority-owned business shall mean a business which is solely owned, or at least fifty-one percent (51%) of the assets or outstanding stock of which is owned, by an individual who personally manages and controls daily operations of such business, and who is impeded from normal entry into the economic mainstream because of race, religion, sex or national origin and such business has annual gross receipts of less than four million dollars ($4,000,000).

Small Business. Small business shall mean a business with annual gross receipts of less than four million dollars ($4,000,000).

III. ADMINISTRATION

Birch's Plan will be overseen and administered by the individual named below, hereinafter referred to as the Administrator, who will be responsible for carrying out and promoting Birch's full efforts to provide equal opportunities for small and minority-owned businesses. The Administrator of the Plan will be:

Gregory C. Lawhon, Esq.
Senior Vice President of Public Policy and General Counsel
Birch Telecom of the South, Inc.
2020 Baltimore Avenue
Kansas City, Missouri 64108
Voice: (816) 300-3000
Fax: (816) 300-3247

The Administrator's responsibilities will include:

(1) maintaining an updated Plan in full compliance with T.C.A. §65-5-212 and the rules and orders of the Tennessee Regulatory Authority.

(2) establishing and developing policies and procedures necessary for the successful implementation of the Plan.

(3) preparing and submitting such forms as may be required by the Tennessee Regulatory Authority, including the filing of required annual updates.

(4) serving as the primary liaison to and cooperate with the Tennessee Regulatory Authority, other agencies of the State of Tennessee, and small and minority-owned businesses to locate and use qualified small and minority-owned businesses as defined in T.C.A. §65-5-212.

(5) searching for and developing opportunities to use small and minority-owned businesses and encouraging such businesses to participate in and bid on contracts and subcontracts.

(6) providing records and reports and cooperate in any authorized surveys as required by the Tennessee Regulatory Authority.

(7) establishing a record-keeping system to track qualified small and minority-owned businesses and efforts to use such businesses.

(8) providing information and educational activities to persons within Birch and training such persons to seek out, encourage, and promote the use of small and minority-owned businesses.

In performance of these duties, the Administrator will utilize a number of resources, including:

Chambers of Commerce
The Tennessee Department of Economic and Community Development
The United States Department of Commerce's Small Business Administration
The United States Department of Commerce's Office of Minority Business
The National Minority Supplier Development Counsel
The National Association of Women Business Owners
The National Association of Minority Contractors
Historically Black Colleges, Universities, and Minority Institutions

The efforts to promote and ensure equal opportunities for small and minority-owned businesses are primarily spelled out in the Administrator's duties above. Additional efforts to provide opportunities to small and minority-owned businesses will including offering, where appropriate and feasible, small and minority-owned businesses assistance with technical, insurance, bonding, licensing, production, and deadline requirements.

IV. RECORDS AND COMPLIANCE REPORTS

Birch will maintain records of qualified small and minority-owned business and efforts to use the goods and services of such businesses. In addition, Birch will maintain records of educational and training activities conducted or attended and of the internal procurement procedures adopted to support this Plan.

Birch will submit records required by the Tennessee Regulatory Authority concerning the Plan. Moreover, Birch will cooperate fully with any surveys and studies required by the Tennessee Regulatory Authority.

By Gregory C. Lawhon

Gregory C. Lawhon, Esq.
Senior Vice President of Public Policy and
General Counsel
Birch Telecom of the South, Inc.
2020 Baltimore Avenue
Kansas City, Missouri 64108
Voice: (816) 300-3000
Fax: (816) 300-3247

Dated: April 26, 2000

EXHIBIT G

BIRCH'S INTRALATA TOLL DIALING PARITY PLAN

INTRALATA TOLL DIALING PARITY PLAN OF
BIRCH TELECOM OF THE SOUTH, INC.

I. INTRODUCTION

Birch Telecom of the South, Inc. ("Birch"), through its agreement with BellSouth Telecommunications, Inc. ("BellSouth") (from whom it will purchase unbundled switching), will implement the following processes which are designed to give end user customers the opportunity to designate a carrier for their intraLATA toll call traffic in those market areas in the State of Tennessee in which Birch provides local exchange services. IntraLATA toll calls will automatically be directed to the designated carrier without the customer having to dial an access code.

Birch will comply with all pertinent Federal Communications Commission ("FCC") and Tennessee Regulatory Authority ("Authority") rules with regard to the provision of intraLATA toll dialing parity. Birch intends to implement its intraLATA toll dialing parity plan within all the exchanges in which it provides service in the State of Tennessee shortly after the date it begins service but no later than thirty (30) days after being certified by the Tennessee Regulatory Authority as a Competing Telecommunications Provider.

II. POLICIES

BellSouth's unbundled switching functionality purchased by Birch will deploy two-PIC technology in its switches enabling customers to pre-subscribe to either the same or two different carriers for their intraLATA and interLATA service.

Appropriate tariffs will be filed in accordance with this plan. Any revisions necessary to further comply with this plan will be made following Birch's certification as a Competing Telecommunications Provider by the Tennessee Regulatory Authority and Birch's commencement of service.

Birch will offer customers the ability to access all participating carriers by dialing the appropriate access code (10XXX/101XXXX).

All eligible Birch end user telephone line numbers will be pre-subscribed and have a PIC associated with them. Birch will not automatically assign toll customers to itself or any other carrier(s) unless and until the Tennessee Regulatory Authority implements intrastate, intraLATA toll dialing parity. *See* Section VII. – Pre-Subscription Information, below.

In the event that Birch offers access to telephone numbers, operator service, directory assistance, and directory listings, it will offer such services in a nondiscriminatory manner.

III. CARRIER INFORMATION

Interexchange carriers will have the option of offering intraLATA service only or intraLATA and interLATA service.

Interexchange carriers will have the option of participating in all market areas or in a specific market area.

Interexchange carriers will be required to return a completed Non-Disclosure Agreement and Participation Agreement(s).

Birch will not participate in billing disputes for intraLATA service between an alternative competing interexchange carrier and its customers.

Birch representatives will not initiate or accept three-way calls from an alternative interexchange carrier in order to discuss pre-subscription.

Carriers wishing to participate will be requested to submit Access Service Requests/Translation Questionnaires to the Access Tandem owner and to Birch.

IV. CALL ELIGIBILITY/TOLL DIALING PLAN

All local service customers of Birch will have calls routed according to the following plan:

If a Birch Customer Dials:	The Call is Handled By/Routed To:
911	PSAP on originating line number
411/555-1212	BellSouth's Directory Assistance Operator
0-	BellSouth's Operator
0 + intraexchange number	IntraLATA Toll Provider
1 + 7 or 10 digits	IntraLATA Toll Provider
0 + 7 or 10 digits interexchange number	InterLATA Toll Provider
10XXX or 101XXXX + 0-	XXX/XXXX Carrier
10XXX or 101XXXX + 0 + 7 or 10 digits	XXX/XXXX Carrier
10XXX or 101XXXX + 7 or 10 digits	XXX/XXXX Carrier

If a Birch customer originates a call to an alternative interexchange carrier's Operator by dialing 00-, the call will be routed to the PIC on that customer's line. If the customer originates a call to an alternative interexchange carrier's Operator by dialing an access code (e.g., 10XXX/101XXXX + 0-), the call will be routed to the XXX/XXXX carrier. In both cases, the carrier's switch is responsible for routing this call to the alternative interexchange carrier's Operator or to an announcement.

V. NETWORK INFORMATION

All originating intraLATA traffic will initially be routed via the incumbent LEC ("ILEC") Access Tandem(s). Following conversion, direct trunks between the ILEC switch and the interexchange carrier location(s) may be provided when warranted by traffic volume.

Interexchange carriers must have Feature Group D trunks in place (or ordered) between their point of presence and the incumbent LEC Access Tandem(s).

All originating intraLATA traffic will be routed to the designated carrier and traffic will only be blocked at the request of the end user customer and/or in compliance with regulatory requirements. Requests from carriers to block traffic or to remove customers from their network will not be honored. Calls that cannot be completed to a carrier will be routed to an announcement.

VI. CUSTOMER NOTIFICATION/EDUCATION PROCEDURES

Consistent with the IntraLATA toll dialing parity implementation date, Birch will include an insert in customer bills explaining to Tennessee consumers that they have a choice of intraLATA toll providers. The insert will also detail procedures for choosing IntraLATA toll providers.

VII. CUSTOMER CONTACT INFORMATION

Birch customer contact representatives will process customer-initiated PIC selections to Birch or to an alternative intraLATA carrier. Carriers will have the option of allowing the Birch representative to process PIC requests on their behalf.

Birch will not ballot or allocate its customer base. At the time of conversion, all customers will be "PIC'd" to Birch unless another carrier is chosen by the particular customer.

Birch customer contact representatives will respond to customer inquiries about intraLATA carriers in a competitively neutral fashion. If a customer requests information on alternative carriers other than Birch, a list of participating carriers will be read to that customer in random order by Birch representatives.

If the intraLATA toll carrier selected by the customer permits Birch to process orders on its behalf, Birch will accept the PIC change request. If the customer selects an intraLATA toll carrier that does not allow Birch to process PIC changes on its behalf, Birch will provide the customer with the carrier's toll-free number (if provided by the carrier).

Birch representatives will not discuss alternative carrier rates or services and will not provide customers with Carrier Identification Codes or access code dialing instructions.

VII. PRE-SUBSCRIPTION INFORMATION

In order to recover the costs associated with the implementation of intraLATA toll dialing parity, Birch will impose a PIC change charge on its customers for each eligible line where a PIC change is made. Birch will offer its customers a 90-day grace period following the implementation of this plan during which the customers may change intraLATA carriers without incurring a PIC change charge. Customers can make multiple PIC changes during these 90 days at no charge. After the 90-day period, Birch will assess the $5.00 PIC change charge for each PIC change made. Birch will offer interexchange carriers the option of having the PIC charge billed to the carrier or directly to the customer.

New line customers, including customers adding lines, will have the opportunity to select a participating carrier, or they will be assigned a NO PIC designation. If a customer cannot decide upon an intraLATA carrier at the time of order, Birch may extend a 30-day period following placement of the customer's service order for the customer to select an intraLATA carrier without charge. Such a customer will be assigned a NO PIC designation in the interim. After this 30-day period, Birch will assess the $5.00 PIC change charge as described above. Customers assigned a NO PIC designation as set forth in this paragraph will be required to dial an access code to reach an intraLATA carrier's network.

If a Birch customer denies requesting a change in intraLATA toll providers as submitted by an intraLATA carrier, and the intraLATA carrier is unable to produce a Letter of Agency signed by the customer or some other form of verification that is permitted by law, the intraLATA carrier will be assessed a $30.00 charge for the unauthorized PIC change and the PIC will be changed as per the customer's request. This penalty is in addition to any other penalties authorized by law.

Alternative interexchange carriers may submit PIC changes to Birch via a fax/paper interface.

Birch will process intraLATA PIC selections in the same manner and under the same intervals of time as interLATA PIC changes.

Carriers will be required to submit PIC changes in writing in an appropriate format. Birch will provide carriers with PIC order confirmation and reject information in writing in the same format. Specific details regarding the format in which PIC charges are to be submitted will be provided to participating carriers.

For customers who change their local service provider from the incumbent LEC to Birch and retain their incumbent LEC telephone number(s), Birch, as part of the PIC process, will provide the selected intraLATA carrier with both the retained (incumbent LEC) telephone number and the Birch telephone number.

Dated: April 27, 2000

EXHIBIT H

SAMPLE NOTICE OF APPLICATION AND CERTIFICATE OF SERVICE

DICKSTEIN SHAPIRO MORIN & OSHINSKY LLP
2101 L Street NW • Washington, DC 20037-1526
Tel (202) 785-9700 • Fax (202) 887-0689

April 27, 2000

VIA U.S. MAIL

Ardmore Telephone Company, Inc.
P.O. Box 549
Ardmore, TN 38449

Re: Notice of Filing by Birch Telecom of the South, Inc. for a Certificate of Public Convenience and Necessity as a Competing Telecommunications Service Provider Within the State of Tennessee

To whom it may concern,

On behalf of Birch Telecom of the South, Inc. ("Birch"), we hereby notify you that on April 28, 2000, Birch will file an application with the Tennessee Regulatory Authority for authority to provide resold and facilities-based local exchange and interexchange telecommunications services to consumers in the State of Tennessee.

Copies of the above-described application may be obtained by contacting Colin M. Alberts, Esq., at (202) 955-6658. Please contact Mr. Alberts for further information regarding this application.

Very truly yours,

Colin M. Alberts, Esq.
Counsel for Birch Telecom of the South, Inc.

1177 Avenue of the Americas • 41st Floor • New York, New York 10036-2714
Tel (212) 835-1400 • Fax (212) 997-9880
http://www.dsmo.com

BEFORE THE TENNESSEE REGULATORY AUTHORITY

In the Matter of Application of Birch Telecom of the South, Inc. for a Certificate of Public Convenience and Necessity as a Competing Telecommunications Service Provider Within the State of Tennessee	)))))	Docket No. ________

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Notice of Application of Certificate of Public Convenience and Necessity as a Competing Telecommunications Service Provider Within the State of Tennessee of Birch Telecom of the South, Inc. were served via first class mail on this 27th day of April 2000 on the following:

Ardmore Telephone Company, Inc.
P.O. Box 549
Ardmore, TN 38449

BellSouth
333 Commerce Street
Nashville, TN 37201-3300

Century Telephone of Adamsville
P.O. Box 405
Adamsville, TN 38310

Century Telephone of Claiborne
P.O. Box 100
New Tazewell, TN 37825

Century Telephone of Ooltewah-Collegedale, Inc.
P.O. Box 782
Ooltewah, TN 37363

Citizens Communications Company of Tennessee
P.O. Box 770
Bluefield, WV 24701

Citizens Communications Company of The Volunteer State
P.O. Box 770
Bluefield, WV 24701

Loretto Telephone Company, Inc.
P.O. Box 130
Loretto, TN 38469

Millington Telephone Company, Inc.
4880 Navy Road
Millington, TN 38053

Sprint-United
112 Sixth Street
Bristol, TN 37620

TDS Telecom-Concord Telephone Exchange, INc.
P.O. Box 22610
Knoxville, TN 37933-0610

TDS Telecom-Humphreys County Telephone Company
P.O. Box 552
New Johnson, TN 37134-0552

TDS Telecom-Tellico Telephone Company
P.O. Box 9
Tellico Plains, TN 37385-0009

TDS Telecom-Tennessee Telephone Company
P.O. Box 18139
Knoxville, TN 37928-2139

TEC-Crockett Telephone Company, Inc.
P.O. Box 7
Friendship, TN 38034

TEC-People's Telephone Company, Inc.
P.O. Box 310
Erin, TN 37061

TEC-West Tennessee Telephone Company, Inc.
P.O. Box 10
Bradford, TN 38316

United Telephone Company
P.O. Box 38
Chapel Hill, TN 37034