TC00-138

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TC00-138

DOCKET NO. TC00-138

In the Matter of

IN THE MATTER OF THE APPLICATION OF T-NETIX INTERNET SERVICES, INC. FOR A CERTIFICATE OF AUTHORITY TO PROVIDE TELECOMMUNICATIONS SERVICES IN SOUTH DAKOTA

Public Utilities Commission of the State of South Dakota

DATE		MEMORANDA
9/22	00	Filed and Docketed;
9/28	00	Weekly Filing;
10/20	00	Order Granting COA;
10/20	00	Docket Closed.

TC00-138

Lance J.M. Steinhart
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6455 East Johns Crossing
Suite 285
Duluth, Georgia 30097

Also Admitted in New York
and Maryland

Telephone: (770) 232-9200
Facsimile: (770) 232-9208

September 21, 2000

VIA OVERNIGHT DELIVERY

Mr. William Bullard
Executive Director
South Dakota Public Utilities Commission
500 East Capitol Avenue
Ave-Pierre, SD 57501-5070
(605) 773-3201

RECEIVED
SEP 2 2 2000
SOUTH DAKOTA PUBLIC
UTILITIES COMMISSION

Re: T-NETIX Internet Services, Inc.

Dear Mr. Bullard:

Enclosed please find one original and ten (10) copies of T-NETIX Internet Services, Inc.'s Application for Registration of a Telecommunications Company.

I have also enclosed a check in the amount of $250.00 payable to the "South Dakota Public Utilities Commission" for the filing fee, and an extra copy of this cover letter to be date stamped and returned to me in the enclosed self-addressed prepaid envelope.

If you have any questions or if I may provide you with any additional information, please do not hesitate to contact me.

Respectfully submitted,

Lance J.M. Steinhart
Attorney for T-NETIX Internet Services, Inc.

Enclosures
cc: Nancy K. Lee

TC00-138

APPLICATION FOR REGISTRATION
OF T-NETIX INTERNET SERVICES, INC.
FILED WITH THE
SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

RECEIVED
SEP 22 2000
SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF T-NETIX INTERNET SERVICES, INC.	
FOR AN ORDER AUTHORIZING THE REGISTRATION OF APPLICANT AS A TELECOMMUNICATIONS COMPANY	Docket No.

APPLICATION

Application is hereby made to the South Dakota Public Utilities Commission for an Order authorizing T-NETIX Internet Services, Inc. ("Applicant") to register as a telecommunications company within the State of South Dakota. The following information is furnished in support thereof:

1. <u>Name, Address and Telephone Number of Applicant:</u>
   T-NETIX Internet Services, Inc.
   67 Inverness Drive East
   Englewood, Colorado 80112
   Telephone: (303) 790-9111
   Toll-Free Customer Service: (800) 531-4245

2. <u>The name under which the Applicant will provide these services if different than in 1. above:</u>

   T-NETIX Internet Services, Inc.

3. <u>Applicant's corporate information:</u>

Applicant was organized in the State of Colorado on November 12, 1999. A copy of the Applicant's Articles of Incorporation is attached hereto as Exhibit A. A copy of Applicant's Certificate of Authority to transact business as a foreign corporation in the State of South Dakota is attached hereto as Exhibit B.

The Applicant has no principal office in South Dakota. The name and address of the Applicant's registered agent is:

National Corporate Research, Ltd.
C/O Marilyn Person
819 West Third
Pierre, South Dakota 57501

The names and address of each corporation, association, partnership, cooperative, or individual holding a 20% or greater ownership or management interest in the Applicant corporation and the amount and character of the ownership or management interest are as follows:

Name and Address	Shares Owned	Percentage of all Shares Issued and Outstanding and Voting Control
T-NETIX, Inc.		100%

All of the above can be reached through the company as set forth in Section 1 above.

4. <u>Partnership Information:</u>

Not Applicable.

5. <u>Description of Services Applicant intends to offer:</u>

Applicant is a reseller which intends to offer interexchange services, including 1+ and 101XXXX outbound dialing, 800/888 toll-free inbound dialing, directory assistance, data services and travel card services.

6. <u>Means by which the Applicant intends to provide services:</u>

Applicant does not own or maintain any transmission facilities or switching equipment in the State of South Dakota. The Applicant will provide services through MCI WorldCom, its underlying carriers. As a reseller, Applicant has no points of presence in the State of South Dakota, <u>thus Applicant neither owns, leases, nor operates any switching, transmission, or other physical facilities in the State of South Dakota, and no such facilities will be used by Applicant in providing service in the State of South Dakota.</u> Rather, Applicant will be engaged in reselling services provided by facilities-based carriers within the State of South Dakota.

7. <u>Geographic Areas in which services will be offered:</u>

Applicant intends to provide services on a statewide basis.

8. <u>Financial Qualifications:</u>

Applicant is financially qualified to provide intrastate interexchange telecommunications services within South Dakota. In particular, Applicant has adequate access to the capital necessary to fulfill any obligations it may undertake with respect to the provision of intrastate telecommunications services in the State of South Dakota. See Exhibit C, which is attached hereto, the Audited Financial Statements for the years ended December 31, 1998 and December 31, 1999, and Unaudited Financial Statements for the six months ended June 30, 2000 for T-NETIX, Inc., which demonstrates that Applicant has the financial ability to provide the services that it proposes to offer.

9. <u>Applicant's complaints and regulatory matters contact and how Applicant handles customer billings and customer service matters.</u>

All inquiries regarding regulatory matters should be addressed to:

Nancy K. Lee, Executive Vice President
67 Inverness Drive East
Englewood, Colorado 80112
Telephone: (303) 790-9111
Facsimile: (303) 790-9540
E-Mail: scott.spiek@t-netix.com

All inquiries regarding complaints should be addressed to:

Tim Russi, Vice President - Client Services
67 Inverness Drive East
Englewood, Colorado 80112
Telephone: (303) 790-9111; (800) 531-4245 (toll-free)
Facsimile: (303) 790-9540
E-Mail: tim.russi@t-netix.com

The Applicant's customers will be direct billed utilizing "real-time" completed call detail information from Applicant's underlying carriers. Applicant's toll-free number will be on all invoices and customer service will be provided in-house by the Applicant.

10. <u>Regulatory Status:</u>

Applicant is currently in the process of obtaining all required authorizations from the state regulatory agencies, except Alaska. Applicant is currently authorized to provide service in Iowa, Michigan, Montana, Texas, Utah and Virginia.

The Applicant is in good standing with the appropriate regulatory agency in the states where it is registered or certified. The Applicant has never been denied registration or certification nor withdrawn its request for registration or certification in any state.

11. Description of Marketing

Applicant intends to market its services to primarily to residential customers and to small to mid-sized businesses. All sales personnel will have telecommunications service experience. Applicant will market through direct sales by employees and agents. Applicant does not intend to engage in multilevel marketing at this time. Applicant's marketing materials are currently being developed and are not available at this time.

12. Cost Support:

Applicant intends to provide services at a price above its cost.

13. Federal Tax Identification Number:

84-1528424

14. The Number and Nature of Complaints filed against the Applicant with any state or federal regulatory commission regarding the unauthorized switching of a customer's telecommunications provider and the act of charging customers for services that have not been ordered:

None

15. Tariff

A copy of Applicant's proposed tariff is attached hereto as Exhibit E.

WHEREFORE, the undersigned Applicant requests that the South Dakota Public Utilities Commission enter an order granting this application.

DATED this 21st day of Sept, 2000.

T-NETIX Internet Services, Inc.

By:________________________________
Lance J.M. Steinhart, Its Counsel

6455 East Johns Crossing
Suite 285
Duluth, Georgia 30097
(770) 232-9200

State of Colorado

County of Arapahoe

Scott Spiek, being first duly sworn, deposes and says that he/she is the Executive Vice President - Technology of T-NETIX Internet Services, Inc., the Applicant in the proceeding entitled above, that he/she has read the foregoing application and knows the contents thereof; that the same are true of his/her knowledge, except as to matters which are therein stated on information or belief, and to those matters he/she believes them to be true.

Scott Spiek
Scott Spiek
Executive Vice President - Technology

Subscribed and sworn to before this 18th day of September 2000.

Lorraine L. Albrecht
Notary Public

My Commission expires: 11-30-03

LIST OF EXHIBITS

A - ARTICLES OF INCORPORATION

B - CERTIFICATE OF AUTHORITY

C - MARKETING MATERIAL

D - FINANCIAL INFORMATION

E - PROPOSED TARIFF

EXHIBIT A - ARTICLES OF INCORPORATION

STATE OF COLORADO

DEPARTMENT OF
STATE

CERTIFICATE

I, DONETTA DAVIDSON, SECRETARY OF STATE OF THE STATE OF COLORADO HEREBY CERTIFY THAT

ACCORDING TO THE RECORDS OF THIS OFFICE

T-NETIX INTERNET SERVICES, INC.
(COLORADO CORPORATION)

FILE # 19991212839 WAS FILED IN THIS OFFICE ON November 12, 1999 AND HAS COMPLIED WITH THE APPLICABLE PROVISIONS OF THE LAWS OF THE STATE OF COLORADO AND ON THIS DATE IS IN GOOD STANDING AND AUTHORIZED AND COMPETENT TO TRANSACT BUSINESS OR TO CONDUCT ITS AFFAIRS WITHIN THIS STATE.

Dated: November 12, 1999

Donetta Davidson

SECRETARY OF STATE

ARTICLES OF INCORPORATION
OF
T-NETIX INTERNET SERVICES, INC.

FILED - CUSTOMER COPY
DONETTA DAVIDSON
COLORADO SECRETARY OF STATE

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$ 65.00
SECRETARY OF STATE
11-12-1999 12:08:42

ARTICLE I
Name

The name of the Corporation is T-NETIX Internet Services, Inc.

ARTICLE II
Capital Stock

2.1 Authorized Shares. The Corporation shall have authority to issue 10,000 shares of a single class of common stock, without par value.

2.2 Preemptive Rights. Shareholders shall not have the preemptive right to acquire additional unissued or treasury shares of the Corporation or securities convertible into shares or carrying stock purchase warrants or privileges.

2.3 Cumulative Voting. Cumulative voting shall not be used in the election of directors or for any other purpose.

2.4 Transfer Restrictions. The Corporation shall have the right by appropriate action to impose restrictions upon the transfer of any shares of its common stock, or any interest therein, from time to time issued, provided that such restrictions, or notice thereof, shall be set forth upon the face or back of the certificates representing such shares of common stock.

ARTICLE III
Purpose and Powers

The purpose for which the Corporation is organized is to transact all lawful business for which corporations may be incorporated pursuant to the Colorado Business Corporation Act.

ARTICLE IV
Registered Office and Registered Agent

The street address of the initial registered office of the Corporation is 1200 17th Street, Suite 3000, Denver, Colorado 80202.

The name of the registered agent of the Corporation at such address is Russell P. Dawn. The written consent of the initial registered agent to the appointment as such is set forth below.

The address of the Corporation's initial principal office is 67 Inverness Drive East, Englewood, Colorado, 80112.

BJS

ARTICLE V
Board of Directors

The corporate powers shall be exercised by or under the authority of, and the business and affairs of the Corporation shall be managed under the direction of, a board of directors. The number of directors shall be fixed by or in accordance with the Bylaws of the Corporation.

The initial Board of Directors of the Corporation shall consist of one individual, whose name and address appear below, who is to serve as director of the Corporation until the first annual meeting of shareholders, or until his successor is elected and qualifies.

Name	Address
Alvyn A. Schopp	67 Inverness Drive East, Englewood, Colorado 80112

The directors shall be elected at each annual meeting of the shareholders, provided that vacancies may be filled by election by the remaining directors, though less than a quorum, or by the shareholders at a special meeting called for that purpose. Despite the expiration of his or her term, a director continues to serve until his or her successor is elected and qualifies.

ARTICLE VI
Quorum For Shareholders' Meetings

Except as bylaws adopted by the shareholders may provide for a greater quorum requirement, a majority of the outstanding shares shall constitute a quorum at any meeting of the shareholders. Except as bylaws adopted by the shareholders may provide for a greater voting requirement, and except as provided by the Colorado Business Corporation Act with respect to action on amendment to these Articles of Incorporation, on a plan of merger or share exchange, on the disposition of substantially all of the property of the corporation, on the granting of consent to the disposition of property by an entity controlled by the Corporation, and on the dissolution of the Corporation, action on a matter other than the election of directors is approved if a quorum exists and if the votes cast favoring the action exceed the votes cast opposing the action. Any bylaw adding, changing, or deleting a greater quorum or voting requirement for shareholders shall meet the same quorum requirement and be adopted by the same vote required to take action under the quorum and voting requirements then in effect or proposed to be adopted, whichever are greater.

ARTICLE VII
Indemnification

The Corporation shall indemnify, to the fullest extent permitted by applicable law in effect from time to time, any person, and the estate and personal representative of any such person, against all liability and expense (including attorneys' fees) incurred by reason of the fact that he is or was a director or officer of the Corporation or, while serving as a director or officer of the Corporation, he is or was serving at the request of the Corporation as a director, officer, partner, trustee, employee, fiduciary, or agent of, or in any similar managerial or fiduciary position of, another domestic or foreign corporation or other individual or entity or of an employee benefit plan. The Corporation shall also indemnify any person who is serving or has served the Corporation as director, officer, employee, fiduciary, or agent, and that person's estate and personal representative, to the extent and in the manner provided in any bylaw, resolution of the shareholders or directors, contract, or otherwise, so long as such provision is legally permissible.

ARTICLE VIII
Limitation of Director Liability

There shall be no personal liability of a director to the Corporation or to its shareholders for monetary damages for breach of fiduciary duty as a director, except that said personal liability shall not be eliminated to the Corporation or to the shareholders for monetary damages arising due to any breach of the director's duty of loyalty to the Corporation or to the shareholders, acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, acts specified in section 7-108-403 of the Colorado Business Corporation Act, or any transaction from which a director derived an improper personal benefit. Notwithstanding any other provisions herein, personal liability of a director shall be eliminated to the greatest extent possible as is now, or in the future, provided for by law.

ARTICLE IX
Incorporator

The name of the incorporator of the Corporation is Bryan M. Schwartz and the address of the incorporator is 1200 17th Street, Suite 3000, Denver, Colorado 80202-5839.

IN WITNESS WHEREOF, I, the undersigned (who, if a natural person is over the age of 18 years), being the incorporator designated in Article IX of the foregoing Articles of Incorporation, have executed said Articles of Incorporation as of the 12th day of November, 1999.

Bryan M. Schwartz

Bryan M. Schwartz, Incorporator

The undersigned consents to the appointment as the initial registered agent of T-NETIX Internet Services, Inc.

Russell P. Dawn

Russell P. Dawn, Authorized Signatory

EXHIBIT B - CERTIFICATE OF AUTHORITY

State of South Dakota

OFFICE OF THE SECRETARY OF STATE

Certificate of Authority

I, JOYCE HAZELTINE, Secretary of State of the State of South Dakota, hereby certify that the Application for a Certificate of Authority of T-NETIX INTERNET SERVICES, INC. (CO) to transact business in this state duly signed and verified pursuant to the provisions of the South Dakota Corporation Acts, have been received in this office and are found to conform to law.

ACCORDINGLY and by virtue of the authority vested in me by law, I hereby issue this Certificate of Authority and attach hereto a duplicate of the application to transact business in this state.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the Great Seal of the State of South Dakota, at Pierre, the Capital, this May 3, 2000.

Joyce Hazeltine

Joyce Hazeltine
Secretary of State

EXHIBIT C - MARKETING MATERIAL
Not Available

EXHIBIT D - FINANCIAL INFORMATION

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders
T-NETIX, Inc.:

We have audited the accompanying consolidated balance sheets of T-NETIX, Inc. and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of T-NETIX, Inc. and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1999, in conformity with generally accepted accounting principles.

KPMG LLP

Denver, Colorado
March 21, 2000

T-NETIX, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 1999	December 31, 1998
	(amounts in thousands)	
ASSETS		
Cash and cash equivalents	$ 118	$ 678
Accounts receivable, net (note 2)	16,868	16,489
Prepaid expenses	1,038	1,023
Inventories	710	269
Total current assets	18,734	18,459
Property and equipment, net (note 2)	33,858	31,498
Goodwill, net	6,401	5,824
Deferred tax asset	2,297	963
Intangible and other assets, net (note 2)	9,252	8,736
Total assets	$ 70,542	$65,479
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accounts payable	$ 11,914	$ 4,68[illegible]
Accrued liabilities (note 2)	7,606	5,67[illegible]
Debt (note 5)	7,366	21,35[illegible]
Total current liabilities	26,886	31,71[illegible]
Long term debt (note 5)	21,555	4,15[illegible]
Total liabilities	48,441	35,87[illegible]
Stockholders' equity (note 6):		
Preferred stock, $.01 stated value, 10,000,000 shares authorized; no shares issued	—	—
Common stock, $.01 stated value, 70,000,000 shares authorized; 12,699,400 and 12,225,634 shares issued and outstanding at December 31, 1999 and 1998, respectively	127	12[illegible]
Additional paid-in capital	35,791	33,05[illegible]
Accumulated deficit	(13,817)	(3,5[illegible]
Total stockholders' equity	22,101	29,6[illegible]
Commitments and contingencies (note 9)		
Total liabilities and stockholders' equity	$ 70,542	$65,4[illegible]

See accompanying notes to consolidated financial statements.

T-NETIX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	1999	1998	1997
	(amounts in thousands, except per share amounts)		
Revenue:			
Telecommunications services	$ 39,274	$43,089	$39,616
Direct call provisioning	27,517	22,736	19,051
Equipment sales and other	6,444	2,416	3,638
Total revenue	73,235	68,241	62,305
Expenses:			
Operating costs and expenses:			
Telecommunications services	17,674	17,014	15,262
Direct call provisioning	25,032	20,048	16,462
Cost of equipment sold and other	3,615	848	1,298
Total operating costs and expenses	46,321	37,910	33,022
Selling, general and administrative	13,794	13,401	11,816
Research and development	5,078	3,936	3,554
Impairment of telecommunications assets	4,632	—	—
Depreciation and amortization	11,620	10,174	9,546
Total expenses	81,445	65,421	57,938
Operating income (loss)	(8,210)	2,820	4,367
Merger transaction expenses	(1,017)	—	—
Interest and other income (expense), net	(2,137)	(2,354)	(1,583)
Earnings (loss) before income taxes	(11,364)	466	2,784
Income tax benefit (expense) (note 8)	1,117	(196)	(1,039)
Net earnings (loss)	$(10,247)	$ 270	$ 1,745
Basic earnings(loss) per common share	$ (0.82)	$ 0.02	$ 0.15
Diluted earnings (loss) per common share	$ (0.82)	$ 0.02	$ 0.13
Weighted average common shares — basic	12,511	12,172	11,909
Weighted average common shares — diluted	12,511	12,930	12,988

See accompanying notes to consolidated financial statements.

T-NETIX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount			
	(amounts in thousands)				
Balances at January 1, 1997	11,505	$ 115	$ 30,130	$ (3,279)	$ 26,966
Common stock issued upon exercise of stock options	155	2	204	—	206
Common stock issued in business acquisition	8	—	94	—	94
Common stock issued for cash	202	2	598	—	600
Dividends paid to preferred stockholders	—	—	—	(36)	(36)
Tax benefit from stock options exercised (note 8)	—	—	402	—	402
Net earnings	—	—	—	1,745	1,745
Balances at December 31, 1997	11,870	119	31,428	(1,570)	29,977
Common stock issued upon exercise of stock options	230	2	819	—	821
Conversion of preferred stock	149	1	592	—	593
Purchase of treasury stock	(32)	—	(98)	(26)	(124)
Stock compensation	—	—	75	—	75
Dividends paid to preferred stockholders	—	—	—	(9)	(9)
Tax benefit from stock options exercised (note 8)	—	—	198	—	198
Adjustments to conform year ends of combined companies	9	—	38	(2,235)	(2,197)
Net earnings	—	—	—	270	270
Balances at December 31, 1998	12,226	122	33,052	(3,570)	29,604
Common stock issued upon exercise of stock options	98	1	256	—	257
Common stock issued for intangible asset (note 3)	375	4	2,483	—	2,487
Net loss	—	—	—	(10,247)	(10,247)
Balances at December 31, 1999	12,699	$ 127	$ 35,791	$(13,817)	$ 22,101

See accompanying notes to consolidated financial statements.

T-NETIX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	1999	1998	1997
	(amounts in thousands)		
Cash flows from operating activities:			
Net earnings (loss)	$(10,247)	$ 270	$ 1,745
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	11,620	10,174	9,546
Impairment loss and investment write-off	4,632	600	—
Deferred income tax expense (benefit)	(1,117)	15	570
Loss (gain) on sale of property and equipment	(206)	(83)	6
Stock compensation expense	—	75	—
Changes in operating assets and liabilities:			
Change in accounts receivable, net	(263)	1,680	(5,306)
Change in prepaid expenses	(48)	(678)	(146)
Change in inventory	(441)	(164)	15
Change in intangibles and other assets	(593)	(227)	(371)
Change in accounts payable	6,972	(549)	(4,834)
Change in accrued liabilities	1,907	(670)	1,356
Cash provided by operating activities	12,216	10,443	2,581
Cash used in investing activities:			
Capital expenditures	(14,560)	(6,190)	(9,061)
Acquisition of business or business assets	(1,377)	(2,679)	(175)
Proceeds from disposal or property and equipment	473	121	13
Other investing activities	(980)	(2,460)	(1,208)
Cash used in investing activities	(16,444)	(11,208)	(10,431)
Cash flows from financing activities:			
Net proceeds (payments) under line of credit	11,489	(2,318)	6,765
Payments of debt	(8,078)	(3,064)	(3,396)
Proceeds from debt	—	5,731	3,722
Common stock issued for cash under option plans	257	821	206
Common stock issued for cash	—	—	600
Treasury stock purchased	—	(124)	—
Dividends on preferred stock	—	(9)	(36)
Redemption on preferred stock	—	(7)	—
Cash provided by (used in) financing activities	3,668	1,030	7,861
Net increase (decrease) in cash and cash equivalents	(560)	265	11
Adjustment to conform year ends of combined companies	—	48	—
Cash and cash equivalents at beginning of year	678	365	354
Cash and cash equivalents at end of year	$ 118	$ 678	$ 365
Cash paid for interest	$ 2,568	$ 1,773	$ 1,502
Cash paid for income taxes	$ 217	$ 622	$ 95

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies

General

T-NETIX, Inc. and subsidiaries ("T-NETIX" or the "Company") was incorporated in Colorado in 1986. The Company has three reportable segments the Corrections Division, the Internet Services Division and the SpeakEZ Division ("SpeakEZ").

The Corrections Division primarily manages its specialized telecommunications hardware and software systems for long distance and local exchange carriers on a contractual basis. The long distance and local exchange carriers in turn pay a fee per call to the Company for each billable call made from a phone subject to a contract with the Company. The Company also receives revenue from billing collect calls made from correctional facilities in which the Company's specialized telecommunications hardware and software systems are located. The Internet Services Division provides interLATA Internet services to Internet subscribers and buys and resells Internet bandwidth. SpeakEZ engages in the research and development and sales and marketing of speaker verification technology.

Basis of Presentation

On June 14, 1999, the Company completed a merger with Gateway Technologies, Inc. ("Gateway"), a privately held provider of inmate calling services. As a result of the merger, Gateway became a wholly owned subsidiary of the Company. Prior to the merger, the Company changed its year-end from July 31 to December 31. Gateway's year-end was December 31.

The merger was accounted for as a pooling of interests. As a result, the Company's financial statement have been restated to combine Gateway's financial statements as if the merger had occurred at the beginnin of the earliest period presented. Information concerning common stock and per share data has been restatec on an equivalent share basis.

The consolidated statements of operations and cash flows for the years ended December 31, 1998 an 1997 have been recast to reflect the results of operations and cash flows for T-NETIX for the years ende July 31, 1998 and 1997, respectively, combined with Gateway for the years ended December 31, 1998 an 1997.

As a result of T-NETIX and Gateway having different fiscal year ends prior to 1999, the results o operations of T-NETIX for the five month period ended December 31, 1998, have been excluded from th reported results of operations. The net loss for the period and common stock transactions during that perio have been accounted for as an adjustment of stockholders' equity at January 1, 1999. T-NETIX had revenu expenses, and net loss of $15,041,000, $17,606,000, and $2,235,000, respectively, for the five month peric ended December 31, 1998.

Liquidity

The Company incurred losses from continuing operations in the current year of $10.2 million and had working capital deficit of $8.2 million at December 31, 1999. The Company received a waiver from its lende relating to various covenant violations on its bank credit facility. In connection with the waiver, the lende agreed to revise the existing covenant requirements if the Company can raise $7 million of additional financi on or before April 14, 2000. The funds raised are required to be used to reduce the outstanding balance on t credit facility. These factors among others may indicate that the Company may not be able to meet obligations as they become due or the Company may have to significantly reduce installations and curtail ot operations.

(1) Summary of Significant Accounting Policies (continued)

The Company has taken steps to obtain the additional financing, on or before the deadline of April 14, 2000, by entering into term sheets to issue convertible preferred securities to a non-related party and subordinated debt instruments to one of the Company's directors. Management believes that they will complete the above financing arrangements in the time frame imposed by the lenders. Should the Company be unable to complete the financing arrangements or an alternative financing arrangement by the deadline currently imposed by the lenders, the Company would again be in breach of the loan agreement covenants and the lenders could commence immediate collection activity.

In addition, the Company is taking steps to increase cash flow from operations and obtain additional financing to ensure that the Company is able to carry out its fiscal 2000 business plan. There can be no assurance that the Company will be successful in increasing its cash flow from operations or that additional financing will be available, or if available, will be obtained on acceptable terms.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Risks and Uncertainties

A majority of the Company's revenue is generated from services provided to significant telecommunications customers. The loss of a major customer could affect operating results adversely.

Cash Equivalents

Cash equivalents consist of highly liquid investments, such as certificates of deposit and money market funds, with original maturities of 90 days or less.

Fair Value of Financial Instruments

The reported amounts of the Company's financial instruments including cash and cash equivalents, receivables, accounts payable, and accrued liabilities approximate fair value due to their short maturities. The reported amounts of debt approximate fair value due to market interest rates that these debts bear.

Concentrations of Credit Risk

Financial instruments which potentially expose the Company to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company's revenue is primarily concentrated in the United States in the telecommunications industry. The Company had trade accounts receivable from 5 customers that comprised 28% and 31% of total trade accounts receivable at December 31, 1999 and 1998, respectively. The Company does not require collateral on accounts receivable balances and provides allowances for potential credit losses. An allowance for doubtful accounts has been established based

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(1) Summary of Significant Accounting Policies (continued)

on historical experience and management's evaluation of outstanding accounts receivable at the end of the accounting period.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method. Provisions, when required, are made to reduce excess and obsolete inventories to their estimated net realizable values.

Property and Equipment

Property and equipment is stated at cost, including costs necessary to place such property and equipment in service. Major renewals and improvements are capitalized, while repairs and maintenance are charged to operations as incurred.

Construction in progress represents the cost of material purchases and construction costs, including interest capitalized during construction, for telecommunications hardware systems in various stages of completion. During the years ended December 31, 1999, 1998 and 1997, interest capitalized was insignificant.

Depreciation is computed on a straight-line basis using estimated useful lives of 3 to 7 years for telecommunications equipment and 5 to 10 years for office equipment. No depreciation is recorded on construction in progress until the asset is placed in service.

Intangible and Other Assets

Other assets include intellectual property assets, capitalized computer software, patent defense and application costs, deposits and long-term prepayments and other intangible assets. Patents and intangible assets are stated at cost. Amortization is computed on the straight-line basis over 17 years for patent costs and periods ranging from 3 to 7 years for other intangibles. Amortization charged to expense was $1,500,000, $936,000, and $796,000 for the years ended December 31, 1999, 1998 and 1997, respectively.

Goodwill

Goodwill, representing the excess of the cost over the net tangible and identifiable assets of the acquire businesses, is stated at cost and is amortized, principally on a straight-line basis, over the estimated futu periods to be benefited 5 to 10 years. On an annual basis, the Company reviews the recoverability of goodwi based primarily on an analysis of undiscounted cash flows from the acquired business. Accumulate amortization amounted to $1,103,000 and $364,000 at December 31, 1999 and 1998, respectively.

Impairment of Long-Lived Assets

The Company reviews its property and equipment and unamortized intangible assets whenever events changes in circumstances indicate that the carrying amount may not be recoverable. The Company estima the future cash flows expected to result from operations and if the sum of the expected undiscounted fut cash flows is less than the carrying amount of the long-lived asset, the Company recognizes an impairment l by reducing the unamortized cost of the long-lived asset to its estimated fair value.

During the year ended December 31, 1999, the Company recorded an impairment charge of telecom- nications assets of $4,632,000. Impaired telecommunications assets consisted of software development c construction in progress, and inmate calling platform assets. Two events occurred in 1999 indicated that carrying value of certain equipment and intangible assets may not be recoverable.

(1) Summary of Significant Accounting Policies (continued)

In September, 1999, the Company completed an evaluation of the future viability of its new inmate calling platform ("DL Platform") which it had been developing over the past two years. The merger with Gateway allowed the Company to consider an alternative to the DL Platform. The Company determined that the Gateway ComBridge Platform ("ComBridge"), would be the platform to install for both new customers and upgrades of existing customers. However, over the last year the Company had been awarded certain contracts where the DL Platform was to be deployed. Since the Company believes that it would not be cost effective to maintain and support two separate systems, the Company proceeded to renegotiate all existing contracts to install ComBridge instead of the DL Platform. During the quarter ended September 30, 1999, the Company successfully completed these negotiations. Due to the abandonment of the DL Platform, the Company no longer has any anticipated cash flow to support the carrying value of assets related to the DL Platform. Capitalized costs relating to the DL Platform included software development costs, components (consisting of primarily telephony cards) and other supporting computer peripheral equipment. The estimated impairment, being the excess of the carrying amounts over the respective estimated fair value of these assets, is approximately $3,669,000 for the year ended December 31, 1999. As a result, software development costs at December 31, 1999 were impaired by $2,093,000 and construction in progress relating to these products was impaired by $1,576,000. All of these charges are applicable to the Corrections Division.

In addition, the Company deployed a version of its old inmate calling platform that resides in its customer's network locations. The Company has recently experienced a reduction in call volumes and revenues for this platform. The customer has indicated to the Company that it does not intend to use the platform as a source of future services. Additionally, since the platform was based on the predecessor to the DL Platform, there is not an upgrade path available for the new platform. Any new feature or service offering would be evaluated based on the new ComBridge Platform. The reduction in call volumes caused the estimated fair value of these assets to be less than the existing book value. The Company estimated the fair value of these assets based on the discounted cash flows from each service location. After consideration of minimal salvage value of these assets due to their specific use, the Company recorded an impairment charge of approximately $963,000. This charge was applicable to the Corrections Division.

Revenue Recognition

Revenue and expenses from telecommunications services and direct call provisioning are recognized at the time the telephone call is completed. Provision is made for uncollectible accounts in the period direct call provisioning revenue is recorded. Revenue from equipment sales is recognized when the equipment is shipped to customers. Internet services are recognized as the services are provided. The Company records deferred revenue for advance billings to customers, or prepayments by customers prior to the completion of installation or prior to the provision of contractual bandwidth usage.

The Company recognizes revenue from the sale of computer software in accordance with the American Institute of Certified Public Accountants ("AICPA"), Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended by Statement of Position 98-4, "Deferral of the Effective Date of a Provision of SOP 97-2" ("SOP 98-4").

SOP 97-2 and SOP 98-4 generally require revenue earned on software arrangements involving multiple elements (i.e. software products, upgrades/enhancements, post contract customers support, installation, training , etc.) to be allocated to each element based on the relative fair value of the elements. The fair value of an element must be recognized upon delivery of the products. The revenue allocated to post contract customer support generally is recognized ratably over the term of the support and the revenue allocated to service elements (such as training and installation) generally is recognized as the services are performed. If a vendor does not have evidence of the fair value of all elements in a multiple-element arrangement, all revenue from the arrangement is deferred until such evidence exists or until all elements are delivered.

(1) Summary of Significant Accounting Policies (continued)

In December 1998, the AICPA issued Statement of Position 98-9, "Modification of 97-2, Software Revenue Recognition, With Respect to Certain Transactions" ("SOP 98-9"). SOP 98-9 requires the use of the "residual method" for recognition of revenue when vendor-specific objective evidence exists for undelivered elements but does not exist for delivered elements of a software arrangement. The Company will be required to comply with the provisions of SOP 98-9 for transactions entered into beginning January 1, 2000. The Company believes the adoption of SOP 98-9 will not have a material effect on its consolidated financial statements, results of operations or financial condition.

Research and Development

Costs associated with the research and development of new technology or significantly altering existing technology are charged to operations as incurred. Software development costs have been accounted for in accordance with Statement of Financial Accounting Standards No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*. Under the standard, capitalization of software development costs begins upon the establishment of technological feasibility, subject to net realizable value considerations. Capitalized software costs are amortized over the economic useful life of the software product, which is generally estimated to be three years.

The American Institute of Certified Public Accountants ("AICPA") Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use ("SOP 98-1") provides guidance for the accounting for computer software developed or obtained for internal use including the requirement to capitalize specified costs. There were no such costs capitalized pursuant to SOP 98-1 at December 31, 1999 and 1998.

401(k) Plan

The Company established a 401(k) plan for all of its full time employees effective January 1, 1994. In June 1998, the Company implemented a matching program. The program calls for the Company to match 25% of an employee's contribution up to 6% of the individual employee's total salary. Matching contributions and plan expenses were $111,000 for the year ended December 31, 1999 and were not significant for the year ended December 31, 1998.

Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes. Accordingly, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which those differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in income tax rates is recognized in the results of operations in the period that includes the enactment date.

Earnings (Loss) Per Common Share

Earnings (loss) per common share are presented in accordance with the provisions of Statement of Financial Accounting Standards No. 128, *Earnings Per Share* (SFAS 128). Basic earnings per share exclud dilution for common stock equivalents and is computed by dividing income or loss available to comm shareholders by the weighted average number of common shares outstanding during the period. Dilut earnings per share reflect the potential dilution that could occur if securities or other contracts to iss common stock were exercised or converted into common stock. For the year ended December 31, 19

(1) Summary of Significant Accounting Policies (continued)

375,000 common stock equivalents were not included in the diluted earnings per share calculation, as their effect would be anti-dilutive. For the years ended December 31, 1998 and 1997 diluted common and common equivalent shares outstanding includes 758,000 and 1,080,000, respectively of common share equivalents, consisting of stock options, determined under the treasury stock method.

Stock Compensation

The Company accounts for employee stock options under the provisions APB Opinion No. 25, *"Accounting for Stock Issued to Employees"* ("APB 25") and has adopted the "disclosure only" alternative described in Statement of Financial Accounting Standards No. 123, *"Accounting for the Stock-Based Compensation"* ("SFAS 123"), which requires pro forma disclosure of compensation expense using a fair value based method of accounting for stock-based compensation plans.

Comprehensive Income

Statement of Financial Accounting Standards 130, *"Reporting Comprehensive Income,"* (SFAS 130) establishes standards for reporting and display of comprehensive income and its components in a full set of general-purpose financial statements. The objective of SFAS 130 is to report a measure of all changes in equity of an enterprise that result from transactions and other economic events of the period other than transactions with stockholders ("comprehensive income"). Comprehensive income is the total of the net income (loss) and all other non-owner changes in equity. For the year ended December 31, 1999, 1998 and 1997, the Company's comprehensive earnings (loss) was equal to net earnings (loss).

Recently Issued Accounting Pronouncement

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities." This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. The statement requires companies to recognize all derivatives as either assets or liabilities, with the instruments measured at fair value. The accounting for changes in fair value, gains or losses, depends on the intended use of the derivative and its resulting designation. In June, 1999, the Financial Accounting Standards Board issued SFAS 137, "Accounting for Derivative Instruments and Hedging Activities Deferral of the Effective Date of FASB No. 133 — An amendment of FASB Statement No. 133." SFAS 137 defers the effective date of SFAS 133 to all fiscal quarters of all fiscal years beginning after June 15, 2000. The Company does not expect the adoption of SFAS 133 to have a material impact on its financial position or results of operations.

Reclassification

Certain amounts in the 1998 and 1997 financial statements have been reclassified to conform to the 1999 presentation.

(2) Balance Sheet Components

Accounts receivable consist of the following:

	December 31, 1999	December 31, 1998
	(amounts in thousands)	
Accounts receivable, net:		
Trade accounts receivable	$ 11,797	$ 10,963
Direct call provisioning receivable	7,268	6,190
Customer reimbursable receivable	1,161	785
Other receivables	231	547
	20,457	18,485
Less: Allowance for doubtful accounts	(3,589)	(1,996)
	$ 16,868	$ 16,489

Bad debt expense was $4,981,000, $4,930,000, and $3,785,000 for the years ended December 31, 1999, 1998 and 1997, respectively.

Property and equipment consist of the following:

	December 31, 1999	December 31, 1998
	(amounts in thousands)	
Property and equipment, net:		
Telecommunications equipment	$ 55,487	$ 52,075
Construction in progress	7,341	5,011
Office equipment	9,169	7,326
	71,997	64,412
Less: Accumulated depreciation and amortization	(38,139)	(32,914)
	$ 33,858	$ 31,498

Intangible and other assets consist of the following:

	December 31, 1999	December 31, 1998
	(amounts in thousands)	
Intangible and other assets, net:		
Patent license rights	$ 3,325	$ 3,325
Purchased technology assets	2,487	—
Capitalized software development costs	651	1,821
Acquired software technologies	1,783	1,726
Patent defense and application costs	2,583	2,525
Deposits and long-term prepayments	1,183	505
Other	1,649	1,793
	13,661	11,695
Less: Accumulated amortization	(4,409)	(2,959)
	$ 9,252	$ 8,736

(2) Balance Sheet Components — (continued)

Accrued liabilities consist of the following:

	December 31, 1999	December 31, 1998
	(amounts in thousands)	
Accrued liabilities:		
Deferred revenue and customer advances	$ 2,114	$ 1,228
Compensation related	1,175	1,292
Other	4,317	3,157
	$ 7,606	$ 5,677

(3) Mergers and Acquisitions

Gateway

On June 14, 1999, the Company completed a merger with Gateway, by exchanging 3,672,234 shares of its common stock for all of the common stock of Gateway. Each share of Gateway was exchanged for 5.0375 shares of T-NETIX common stock. Outstanding Gateway stock options were also converted at the same exchange factor into options to purchase approximately 379,000 shares of T-NETIX common stock.

In addition, in connection with the merger transaction, T-NETIX issued 375,341 shares of common stock to certain shareholders of Gateway in exchange for terminating a royalty agreement. The royalty agreement related to automated call processing technology and intellectual property rights that were assigned to Gateway by the royalty owners in exchange for royalty payments. The termination of the royalty owners' interests resulted in the acquisition of an intangible asset. The asset has been recorded at fair value, or $2,487,000. The fair value is based on the value of T-NETIX common stock at February 10, 1999 (date of the Merger Agreement), or $6.625, times the number of shares issued in exchange for termination of the royalty owners' interests. The intangible asset has been recorded in patent license rights and has an estimated useful life of 10 years, the remaining term of the underlying patent.

Selected financial data of T-NETIX and Gateway, prior to the merger were as follows:

	Three Months Ended March 31, 1999	Years Ended December 31, 1998	Years Ended December 31, 1997
	(amounts in thousands)		
Revenue:			
T-NETIX	$ 8,669	$ 38,008	$ 36,292
Gateway	9,115	30,233	26,013
Combined	$ 17,784	$ 68,241	$ 62,305
Net earnings (loss):			
T-NETIX	$ (1,077)	$ 394	$ 591
Gateway	245	(124)	1,154
Combined	$ (832)	$ 270	$ 1,745

Transactions between T-NETIX and Gateway prior to the merger consisted of revenue from a cross-licensing agreement. All such amounts have been eliminated in the restated consolidated financial statements. There were no material adjustments required to conform the accounting policies of the two companies.

(3) Mergers and Acquisitions — (continued)

Certain reclassifications were made to the Gateway financial statements to conform to T-NETIX's presentations.

In connection with the merger, the Company incurred merger transaction expenses of $1,017,000 for the year ended December 31, 1999. Merger transaction expenses consisted primarily of fees for investment bankers, attorneys, accountants, financial printing and other related charges.

Evans and Ricker Acquisition

Effective October 28, 1999, the Company completed the acquisition of substantially all of the assets of Evans and Ricker ("E&R"), of Portland, Oregon. E&R specialize in software used to control and manage information for correctional facilities. E&R's product, Lock and Track Corrections Information System ("Lock & Track™") is a comprehensive relational database designed to handle the operational control and reporting needs of municipal, state, federal, and/or private correctional facilities. The purchase price was approximately $1.4 million including acquisition costs. The acquisition has been accounted for using the purchase method of accounting. The results of operations associated with the assets acquired are included in the Company's financial statements beginning November 1, 1999. Assets acquired and liabilities assumed have been recorded at their fair values. The assets acquired were cash, accounts receivable and intangibles. The estimated excess of cost over the estimated fair value of the net assets acquired of approximately $1.3 million was allocated principally to goodwill, which will be amortized on a straight line basis over 7 years. The remaining net assets acquired were primarily current assets (cash and accounts receivable) net of current liabilities (accounts payable and accrued liabilities). The acquisition was funded by borrowings under the Company's line of credit. Pro forma information giving effect to this acquisition has been omitted as the pro forma results do not vary materially from the Company's recorded results, as E&R's operations were not significant in 1998 or 1997.

(4) SpeakEZ Operations

In December 1998, the Company began an evaluation of the SpeakEZ Division and determined that the best course of action was to combine its research and development operations previously located in New Jersey with its corporate operations in Englewood, Colorado. This change coincided with the resignation of the Company's former chief executive officer on December 9, 1998. This individual spent a majority of his time in the SpeakEZ Division. For the five months ended December 31, 1998, the Company charged the cost of the severance agreement or approximately $240,000 to SpeakEZ selling, general and administrative expense.

The Company completed the reorganization of SpeakEZ operations in February 1999. The reorganization also included a change in the marketing strategy from a direct customer sales strategy to a technology licensing strategy. A direct customer sales strategy markets a specifically developed software product to a specific, end user customer. The strategy is then to find other specific customers who have similar operating systems and market this product to them. In contrast, a technology licensing strategy focuses on a larger scale customer who can integrate the SpeakEZ software product into its existing product line. This larger customer, such as a computer manufacturer, is then responsible for the product integration and ultimate delivery to the end user customer.

The change in marketing approach noted above required the Company to evaluate future marketability of all products in the SpeakEZ Division. As a result of this evaluation, management determined that the capitalized cost for SpeakEZ products, some of which would no longer be marketed, exceeded their estimated realizable value. For the five months ended December 31, 1998, the Company incurred a charge of $490,000 for a reduction in the carrying value of such capitalized costs to their estimated net realizable value.

(4) SpeakEZ Operations (continued)

The Company also recognized a loss in the SpeakEZ Division on a note receivable made to a venture partner for $300,000. In December 1998, the venture partner notified the Company that its plans to raise capital prior to January 1999 were not progressing according to plan and as a result it would not be able to meet its obligations as they became due.

(5) Debt

Debt at December 31, 1999 and 1998 is summarized as follows:

	December 31, 1999	December 31, 1998
	(amounts in thousands)	
Debt:		
Bank lines of credit	$ 28,461	$ 16,972
Advances on direct call processing	—	2,531
Notes payable to stockholders	—	4,800
Notes payable to banks	—	625
Other	460	582
	28,921	25,510
Less current portion	7,366	21,353
Non current portion	$ 21,555	$ 4,157

In September 1999, the Company entered into a Senior Secured Revolving Credit Facility (the "Credit Facility") with its commercial bank. The Credit Facility provides for maximum credit of $40,000,000 subject to limitations based on financial covenant calculations. The Credit Facility is comprised of a one year LIBOR component of $15,000,000 at an interest rate of LIBOR plus 2.75% at December 31, 1999; a three month LIBOR component of $10,000,000 at an interest rate of LIBOR plus 2.75% at December 31, 1999; and $3,461,000 at the Bank's prime rate, 8.5% at December 31, 1999. As of December 31, 1999, the interest rate on borrowings under the line of credit ranged from 8.50% to 8.87%. The Company also pays a fee of 0.30% per annum on the unused portion of the line of credit.

The Credit Facility is collateralized by substantially all of the assets of the Company. Under the terms of the Credit Facility, the Company is required to maintain certain financial ratios and other financial covenants. These ratios include a debt to a four quarter rolling earnings before interest, taxes and depreciation and amortization (EBITDA) ratio, a ratio of fixed charges (interest and debt payments) to EBITDA, and minimum quarterly EBITDA. The Agreement also prohibits the Company from incurring additional indebtedness.

At December 31, 1999 the Company was in violation of certain covenants and the Company has received a waiver from its lenders relating to various covenant violations. In connection with the waiver, the lenders agreed to revise the existing covenant requirements if the Company can raise $7 million of additional financing on or before April 14, 2000. The funds raised are required to be used to reduce the outstanding balance on the Credit Facility. The terms of the bank dictate that $7 million of the Credit Facility is due April 14, 2000 with the remaining balance of the facility due April 30, 2001. The amount of credit under the Credit facility available to the Company is dependent upon our financial performance and may be less than $40 million.

(6) Stockholders' Equity

Stock Option Plans

The Company has reserved 3,850,000 shares of common stock for employees and non-employee directors under various stock option plans (collectively the "Plans"): the 1991 Incentive Stock Option Plan ("the 1991 ISO Plan"); the 1991 Non-Qualified Stock Option Plan ("the 1991 NSO Plan"); and the 1993 Incentive Stock Option Plan ("the 1993 ISO Plan"). The Plans provide for issuing both incentive stock options, and non-qualified stock options, which must be granted at not less than 100% of the fair market value of the stock on the date of grant. All options to date have been granted at the fair market value of the stock as determined by the Board of Directors. Options issued prior to 1994 had vesting terms of one to three years from the date of grant. Substantially all of the Incentive Stock Options issued after 1993 vest over four years from the date of grant. The options expire ten years from the date of grant.

A summary of the Company's stock option activity, and related information through December 31, 1999 is as follows:

		Options Outstanding	
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price
Balance at January 1, 1997	476,163	2,513,957	$ 4.55
Granted	(111,500)	111,500	$ 8.61
Exercised	—	(281,200)	$ 2.67
Canceled	96,875	(96,875)	$ 6.83
Balance at December 31, 1997	461,538	2,247,382	$ 4.88
Granted	(246,619)	246,619	$ 5.24
Exercised	—	(77,477)	$ 2.86
Canceled	166,000	(166,000)	$ 6.45
Balance at December 31, 1998	380,919	2,250,524	$ 4.88
Granted	(223,800)	223,800	$ 5.34
Exercised	—	(98,425)	$ 2.61
Canceled	456,769	(456,769)	$ 6.92
Balance at December 31, 1999	613,888	1,919,130	$ 4.56

The range of exercise prices for common stock options outstanding and options exercisable at December 31, 1999 is as follows:

Options Outstanding				Options Exercisable	
Range of Exercise Price	Number of Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
$ 0.20	281,475	1.3 years	$ 0.20	281,475	$ 0.20
$ 1.61	307,490	6.7 years	$ 1.61	307,490	$ 1.61
$ 3.00-$4.11	154,090	4.4 years	$ 3.32	136,590	$ 3.25
$ 4.12-$5.48	222,800	9.2 years	$ 5.08	30,000	$ 5.04
$ 5.49-$7.24	455,525	6.2 years	$ 5.58	369,025	$ 5.50
$ 7.25	394,750	6.1 years	$ 7.25	359,875	$ 7.25
$ 7.26-$10.99	53,000	7.9 years	$ 9.07	36,750	$ 9.12
$11.00-$13.71	50,000	6.0 years	$13.44	46,250	$13.64
$ 0.20-$13.71	1,919,130	5.8 years	$ 4.56	1,567,455	$ 4.31

(6) Stockholders' Equity (continued)

The Company has not recorded compensation expense for stock options granted. The Company has computed the pro forma disclosures required under SFAS 123 for stock options granted using the Black-Scholes option-pricing model. The assumptions are as follows:

	Year Ended December 31,		
	1999	1998	1997
Risk free interest rate	5.43%	5.24%	5.24%
Expected dividend yield	—	—	—
Expected lives (in years)	5.2 years	5.0 years	4.9 years
Expected volatility	70.0%	70.0%	70.0%
Weighted average remaining contractual life of options outstanding	5.8 years	4.9 years	5.2 years
Weighted average fair value at grant date	$3.24	$2.35	$4.11

The pro forma effects of applying SFAS 123 are as follows for the years ended December 31, 1999, 1998, and 1997:

	Year Ended December 31,		
	1999	1998	1997
	(amount in thousands)		
Net earnings (loss):			
As reported	$(10,247)	$ 270	$1,745
Pro forma	(11,118)	(847)	620
Net earnings (loss) per common share:			
As reported:			
Basic	$ (0.82)	$ 0.02	$ 0.15
Diluted	(0.82)	0.02	0.13
Pro forma:			
Basic	$ (0.89)	$(0.07)	$ 0.05
Diluted	(0.89)	(0.07)	0.05

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option-pricing models require the input of highly subjective assumptions, including expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models to not necessarily provide a reliable single measure of the fair value of its employee stock options.

In July, 1997, the Board of Directors amended the 1993 ISO Plan and the 1991 NSO Plan to provide that the Compensation Committee may amend certain outstanding options with an exercise price in excess of the current market price in order to modify the exercise price to the current market price or greater. On August 11, 1997, the Compensation Committee re-priced the exercise price to $7.25 per share for certain outstanding options under the 1993 ISO Plan and the 1991 NSO Plan having an exercise price equal to or greater than $7.50 prior to such re-pricing. This re-pricing affected 773,500 options granted under these Plans.

(7) Segment Information

Statement of Financial Accounting Standards No. 131, Disclosures About Segments of an Enterprise and Related Information, ("SFAS 131") establishes standards for the way public enterprises report information about operating segments in annual financial statements. SFAS 131 also establishes standards for disclosures about products and services, geographic areas and major customers.

The Company has three reportable segments; the Corrections Divisions, the SpeakEZ Division, and Internet Services Division. The Company evaluates performance based on earnings (loss) before income taxes. Additional measures include operating income, depreciation and amortization, and interest expense. There are no intersegment sales. The Company's reportable segments are specific business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Segment information is as follows:

	Years Ended December 31,		
	1999	1998	1997
	(amounts in thousands)		
Revenue from external customers:			
Corrections Division	$ 71,596	$ 67,609	$ 61,629
SpeakEZ Division	93	632	676
Internet Services Division	1,546	—	—
Operating income (loss):			
Corrections Division	$ (5,796)	$ 6,816	$ 7,031
SpeakEZ Division	(2,518)	(3,996)	(2,664)
Internet Services Division	104	—	—
Depreciation and amortization			
Corrections Division	$ 10,651	$ 9,250	$ 8,841
SpeakEZ Division	969	924	705
Internet Services Division	—	—	—
Interest and other income (expense)			
Corrections Division	$ (1,217)	$ (1,762)	$ (1,216)
SpeakEZ Division	(920)	(592)	(367)
Internet Services Division	—	—	—
Segment earnings (loss) before tax:			
Corrections Division	$ (8,029)	$ 5,054	$ 5,815
SpeakEZ Division	(3,439)	(4,588)	(3,031)
Internet Services Division	104	—	—
Segment earnings (loss) before tax:			
Revenue from external customers	$ 73,235	$ 68,241	$ 62,305
Operating income (loss)	(8,210)	2,820	4,367
Depreciation and amortization	11,620	10,174	9,546
Interest and other (income) expense, net	2,137	2,354	1,583
Segment earnings (loss) before tax	(11,364)	466	2,784

(7) Segment Information — (continued)

	December 31, 1999	December 31, 1998
	(amounts in thousands)	
Segment assets:		
Corrections Division	$ 66,943	$ 60,880
SpeakEZ Division	3,599	4,599
Internet Services Division	—	—

Substantially all of the Company's reportable segment revenue is derived within the United States. Revenue as a percentage of total revenue attributable to significant customers for the years ended December 31, 1999, 1998 and 1997 is as follows:

	1999	1998	1997
AT&T	13%	16%	19%
Bell Atlantic	10	12	12
SBC Communications	10	12	13

There was no intersegment revenue for the years ended December 31, 1999, 1998 and 1997. Unallocated amounts to arrive at net earnings (loss) included income tax expense (benefit) of $(1,117,000), $196,000, and $1,039,000 for the years ended December 31, 1999, 1998 and 1997, respectively. Consolidated total assets included eliminations of approximately $12,976,000 and $11,084,000 as of December 31, 1999 and 1998, respectively. Eliminations consist of intercompany receivables in the Corrections Division and intercompany payables in the SpeakEZ Division related solely to intercompany borrowing of the SpeakEZ Division.

(8) Income Taxes

Income tax expense for the years ended December 31, 1999, 1998 and 1997 is as follows (amounts in thousands):

	1999	1998	1997
Current:			
Federal	$ (1,007)	$ 186	$ 439
State	(191)	25	30
Total	(1,198)	211	469
Deferred:			
Federal	72	(55)	516
State	9	40	54
Total	81	(15)	570
Total income tax expense (benefit)	$ (1,117)	$ 196	$ 1,039

(8) Income Taxes (continued)

Income taxes differ from the expected statutory income tax benefit, by applying the US federal income tax rate of 34% to pretax earnings for the years ended December 31, 1999, 1998 and 1997 due to the following:

	1999	1998	1997
Expected statutory income tax (benefit) expense	$ (3,864)	$ 273	$ 947
Amounts not deductible for income tax	699	107	97
State taxes, net of federal benefit	(377)	43	55
Change in valuation allowance	2,263	(113)	—
Other	162	(114)	(60)
Total income tax expense (benefit)	$ (1,117)	$ 196	$ 1,039

The tax effects of temporary differences that give rise to significant portions of the deferred income tax assets and deferred income tax liabilities as of December 31, 1999 and 1998 are presented below:

	1999	1998
	(amounts in thousands)	
Deferred income tax assets:		
Net operating loss carryforwards	$ 6,556	$ 5,406
Allowance for doubtful accounts	1,488	716
Other	680	458
Total gross deferred income tax assets	8,724	6,580
Less valuation allowance	(3,727)	(1,464)
	4,997	5,116
Deferred income tax liabilities:		
Intangible assets, due to difference in book/tax basis	(474)	(1,068)
Property and equipment, principally due to differences in depreciation	(1,867)	(2,523)
Other assets, due to differences in book/tax basis	(359)	(563)
Total gross deferred tax liabilities	(2,700)	(4,154)
	$ 2,297	$ 962

At December 31, 1999, the Company had net operating loss carryforwards for tax purposes aggregating approximately $17.4 million which, if not utilized to reduce taxable income in future periods, expire at various dates through the year 2010. Approximately $1.3 million of the net operating loss carryforwards are subject to certain rules limiting their annual usage. The Company believes these annual limitations will not ultimately affect the Company's ability to use substantially all of its net operating loss carryforwards for income tax purposes.

A valuation allowance is provided when it is more likely than not that some portion or the entire net deferred tax asset will not be realized. The Company has offset a portion of its deferred tax assets with a valuation allowance. The valuation allowance will be adjusted in the future based on the Company's projected taxable income.

The exercise of stock options, which have been granted under the Company's 1991 NSO stock option plan gives rise to compensation which is included in the taxable income of the applicable option holder and is deductible by the Company for federal and state income tax purposes. The income tax benefit associated with the exercise of the NSO options is recorded as an adjustment to additional paid-in capital when realized.

(9) Commitments and contingencies

The Company leases office space under operating lease agreements. Rent expense under operating lease agreements for the years ended December 31, 1999, 1998 and 1997 was approximately $1,034,000, $930,000, and $629,000, respectively. Future minimum lease payments under these lease agreements for each of the next five years are summarized as follows (amounts in thousands):

Year ending December 31:	
2000	$ 976
2001	721
2002	229
2003	5
Total minimum lease payments	$1,931

The Company is involved in various legal proceedings of a nature considered normal to its business. It is the Company's policy to accrue amounts related to these legal matters if it is probable that a liability has been incurred an amount that is reasonable estimable. In the opinion of management, all matters are of such a nature as would not have a material affect on the Company's financial position, results of operations and cash flows of the Company if resolved unfavorably.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-Q

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

OR

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

For the Quarter Ended June 30, 2000

Commission File Number 0-25016

T-NETIX, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Colorado (State or Other Jurisdiction of Incorporation)	**84-1037352** (I.R.S. Employer Identification No.)
67 Inverness Drive East **Englewood, Colorado** (Address of principal executive offices)	**80112** (Zip Code)

Registrant's Telephone Number, Including Area Code: **(303) 790-9111**

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

Class	Outstanding at August 10, 2000
Common Stock, $.01 stated value	12,733,084

FORM 10-Q CROSS REFERENCE INDEX

PART I

Item 1. ***Financial Statements***

INDEX TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

T-NETIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2000	December 31, 1999
	(Amounts in Thousands)	
ASSETS		
Cash and cash equivalents	$ 298	$ 118
Accounts receivable, net	18,009	16,459
Prepaid expenses	1,569	1,038
Inventories	525	710
Total current assets	20,401	18,325
Property and equipment, net	37,454	33,858
Goodwill, net	6,035	6,401
Deferred tax asset	2,243	2,297
Intangible and other assets, net	8,497	9,252
Total assets	$ 74,630	$ 70,133
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accounts payable	$ 15,810	$ 13,187
Accrued liabilities	4,715	5,924
Current portion of long term debt	30,659	7,366
Total current liabilities	51,184	26,477
Long-term debt	77	21,555
Total liabilities	51,261	48,032
Series A redeemable convertible preferred stock, $1,000 per share, stated value, 3,750 shares authorized; issued and outstanding at June 30, 2000; liquidation preference of $3,811,000 at June 30, 2000	1,842	—
Stockholders' equity:		
Common stock, $.01 stated value, 70,000,000 shares authorized; 12,733,084 and 12,699,400 shares issued and outstanding at June 30, 2000 and December 31, 1999, respectively	127	127
Additional paid-in capital	37,566	35,791
Accumulated deficit	(16,166)	(13,817)
Total stockholders' equity	21,527	22,101
Commitments and contingencies		
Total liabilities, redeemable convertible preferred stock and stockholders' equity	$ 74,630	$ 70,133

See accompanying notes to condensed consolidated financial statements.

T-NETIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30, 2000	Three Months Ended June 30, 1999	Six Months Ended June 30, 2000	Six Months Ended June 30, 1999
	(Amounts in Thousands, Except Per Share Amounts)			
Revenue:				
Telecommunications services	$11,953	$10,065	$22,077	$19,879
Direct call provisioning	7,247	7,021	14,492	13,523
Internet services	6,743	—	12,561	—
Equipment sales and other	826	660	1,208	2,128
Total revenue	26,769	17,746	50,338	35,530
Expenses:				
Operating costs:				
Telecommunications services	5,360	4,263	9,861	8,506
Direct call provisioning	6,751	6,468	13,268	12,548
Internet services	5,550	—	10,648	—
Cost of equipment sold and other	332	214	549	879
Total operating costs	17,993	10,945	34,326	21,933
Selling, general and administrative	4,583	3,259	8,321	6,619
Research and development	1,569	1,253	2,744	2,613
Depreciation and amortization	3,117	2,848	6,166	5,670
Total expenses	27,262	18,305	51,557	36,835
Operating loss	(493)	(559)	(1,219)	(1,305)
Merger transaction expenses	—	(827)	—	(1,017)
Interest and other expense, net	(673)	(633)	(1,027)	(1,117)
Loss before income taxes	(1,166)	(2,019)	(2,246)	(3,439)
Income tax benefit (expense)	(103)	810	(103)	1,398
Net loss	(1,269)	(1,209)	(2,349)	(2,041)
Accretion of discount on redeemable convertible preferred stock	(430)	—	(430)	—
Net loss applicable to common stock	$(1,699)	$(1,209)	$(2,779)	$(2,041)
Basic and diluted loss per common share	$ (0.13)	$ (0.10)	$ (0.22)	$ (0.17)
Shares used in computing basic and diluted net loss per common share	12,701	12,372	12,756	12,318

See accompanying notes to condensed consolidated financial statements.

T-NETIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30, 2000	Six Months Ended June 30, 1999
	(Amounts in Thousands)	
Cash flows from operating activities:		
Net loss	$(2,349)	$(2,041)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	6,166	5,670
Deferred income tax benefit	54	(1,398)
Gain on sale of property and equipment	(265)	—
Accretion of discount on subordinated note payable	(17)	—
Changes in operating assets and liabilities:		
Accounts receivable, net	(1,550)	1,905
Prepaid expenses	(531)	(199)
Inventories	185	(1,015)
Intangibles and other assets	(24)	(294)
Accounts payable	2,623	3,235
Accrued liabilities	(1,209)	(521)
Cash provided by operating activities	3,083	5,342
Cash used in investing activities:		
Purchase of property and equipment	(8,537)	(6,295)
Proceeds from disposal of property and equipment	285	—
Other investing activities	—	(894)
Cash used in investing activities	(8,252)	(7,189)
Cash flows from financing activities:		
Net proceeds from (payments on) line of credit	(807)	3,390
Proceeds from debt	3,750	1,716
Payments of debt	(1,128)	(2,271)
Proceeds from issuance of redeemable convertible preferred stock, net	3,459	—
Common stock issued for cash under option plans	75	256
Cash provided by financing activities	5,349	3,091
Net increase in cash and cash equivalents	180	1,244
Cash and cash equivalents at beginning of period	118	678
Cash and cash equivalents at end of period	$ 298	$ 1,922
Cash paid for interest	$ 617	$ 1,088
Cash paid for income taxes	$ 103	$ 113

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Summary of Significant Accounting Policies

Unaudited Financial Statements

The accompanying unaudited consolidated financial statements reflect all adjustments which, in the opinion of management, are necessary to reflect a fair presentation of the financial position and results of operations of T-NETIX, Inc. and subsidiaries (the Company) for the interim periods presented. All adjustments, in the opinion of management, are of a normal and recurring nature. Some adjustments involve estimates, which may require revision in subsequent interim periods or at year-end. The financial statements have been presented in accordance with generally accepted accounting principles. Refer to notes to consolidated financial statements, which appear in the 1999 Annual Report on Form 10-K for the Company's accounting policies, which are pertinent to these statements.

Basis of Presentation

On June 14, 1999, the Company completed a merger with Gateway Technologies, Inc. ("Gateway"), a privately held provider of inmate calling services. As a result of the merger, Gateway became a wholly owned subsidiary of the Company. Prior to the merger, the Company changed its year-end from July 31 to December 31. Gateway's year-end was December 31.

The merger was accounted for as a pooling of interests. As a result, the Company's financial statements have been restated to combine Gateway's financial statements as if the merger had occurred at the beginning of the earliest period presented. Information concerning common stock and per share data has been restated on an equivalent share basis.

Liquidity

The Company incurred losses from continuing operations in the three and six months ended June 30, 2000 of $1.3 million and $2.3 million, respectively and had a working capital deficit of $30.8 million at June 30, 2000. In July 2000, the Company and its lenders amended the Company's credit agreement to revise certain financial covenants and extended the maturity date until April 30, 2001, and as a result the debt with the bank has been classified as a current liability. The Company raised $7.5 million of additional financing in April 2000. The financing consisted of preferred stock and subordinated debt. The net proceeds of approximately $7.2 million were used to reduce the outstanding balance on the credit facility.

The Company is taking steps to increase cash flow from operations, including renegotiating contract pricing and cost control measures, in order to carry out the remainder of its fiscal 2000 business plan. However, there can be no assurance that the Company will be successful in increasing its cash flow from operations and the Company may require additional financing to fund operations. In the event additional financing is required, the Company may not be able to obtain financing on terms acceptable to the Company and it may have to curtain operations.

Earnings (Loss) Per Common Share

Earnings (loss) per common share is presented in accordance with the provisions of Statement of Financial Accounting Standards No. 128, Earnings Per Share (SFAS 128). Basic earnings per share excludes the impact of potentially dilutive securities and is computed by dividing income or loss available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. There is no difference between basic and diluted net loss per share since potentially dilutive securities from the conversion of redeemable convertible preferred stock and the exercises of options and warrants are anti-dilutive for all periods presented. The calculations of diluted net loss per common share for the three and six months ended June 30, 2000 and 1999, do not include 991,000 and 748,000 and

(1) Summary of Significant Accounting Policies — (Continued)

385,000 and 424,000, respectively, of potentially dilutive securities, including common stock options and warrants and redeemable convertible preferred stock.

Recent Accounting Pronouncements

In March 2000, the Financial Accounting Standards Board ("FASB") issued interpretation No. 44 "Accounting for Certain Transactions involving Stock Compensation — an interpretation of APB Opinion No. 25 ("FIN 44"). This interpretation provides guidance on the accounting for certain stock option transactions and subsequent amendments to stock option transactions. FIN 44 is effective July 1, 2000, but certain provisions cover specific events that occur after either December 15, 1998 or January 12, 2000. The Company does not expect that the application of FIN 44 will have a material effect on its financial position or results of operations.

In December 1999, the SEC released Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements", which provides guidance on the recognition, presentation, and disclosure of revenue in financial statements filed with the SEC. Subsequently, the SEC released SAB 101A, which delayed the implementation date of SAB 101 for the Company until the quarter ended December 31, 2000. The Company does not expect the application of SAB 101 to have a material impact on its financial position or results of operations.

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 137. SFAS 137 defers the effective date of SFAS 133 to all fiscal quarters of all fiscal years beginning after June 15, 2000. SFAS 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. SFAS 133 requires companies to recognize all derivatives as either assets or liabilities, with the instruments measured at fair value. The accounting for changes in fair value, gains or losses, depends on the intended use of the derivative and its resulting designation. The Company does not expect the adoption of SFAS 133 to have a material impact on its financial position or results of operations.

Reclassification

Certain amounts in the 1999 financial statements have been reclassified to conform to the 2000 presentation.

(2) Balance Sheet Components

Accounts receivable consist of the following:

	June 30, 2000	December 31, 1999
	(Amounts in Thousands)	
Accounts receivable, net:		
Trade accounts receivable	$13,684	$11,797
Direct call provisioning receivable	5,343	7,268
Customer reimbursable receivable	377	752
Other receivables	213	231
	19,617	20,048
Less: Allowance for doubtful accounts	(1,608)	(3,589)
	$18,009	$16,459

(2) Balance Sheet Components — (Continued)

Bad debt expense was $1.5 million and $1.6 million for the three months ended June 30, 2000 and 1999, respectively, and $2.8 million and $2.9 million for the six months ended June 30, 2000 and 1999, respectively.

Property and equipment consists of the following:

	June 30, 2000	December 31, 1999
	(Amounts in Thousands)	
Property and equipment, net:		
Telecommunications equipment	$ 60,160	$ 55,487
Construction in progress	8,129	7,341
Office equipment	10,696	9,169
	78,985	71,997
Less: Accumulated depreciation and amortization	(41,531)	(38,139)
	$ 37,454	$ 33,858

Intangible and other assets consist of the following:

	June 30, 2000	December 31, 1999
	(Amounts in Thousands)	
Intangible and other assets, net:		
Patent license rights	$ 3,325	$ 3,325
Purchased technology assets	2,487	2,487
Capitalized software development costs	663	651
Acquired software technologies	1,791	1,783
Patent defense and application costs	2,579	2,583
Deposits and long-term prepayments	1,512	1,183
Other	1,386	1,649
	13,743	13,661
Less: Accumulated amortization	(5,246)	(4,409)
	$ 8,497	$ 9,252

Accrued liabilities consist of the following:

	June 30, 2000	December 31, 1999
	(Amounts in Thousands)	
Accrued liabilities:		
Deferred revenue and customer advances	$1,667	$2,114
Compensation related	875	1,175
Other	2,173	2,635
	$4,715	$5,924

(3) Debt

Debt consists of the following:

	June 30, 2000	December 31, 1999
	(Amounts in Thousands)	
Debt:		
Bank lines of credit	$26,704	$28,461
Subordinated note payable	3,750	—
Other	282	460
	30,736	28,921
Less current portion	30,659	7,366
Non current portion	$ 77	$21,555

Bank Line of Credit

In September 1999, the Company entered into a Senior Secured Revolving Credit Facility (the "Credit Facility") with its commercial bank. The Credit Facility provides for maximum credit of $40 million subject to limitations based on financial covenant calculations. The Credit Facility is comprised of a one year LIBOR component of $15 million at an interest rate of LIBOR plus 4.0% at June 30, 2000; a one month LIBOR component of $7 million at an interest rate of LIBOR plus 4.0% at June 30, 2000; and $4.7 million at the Bank's prime rate, 9.5% at June 30, plus 1.25%. As of June 30, 2000, the total interest rates on borrowings under the bank Credit Facility ranged from 8.8% to 10.75%. The Company also pays a fee of 0.40% per annum on the unused portion of the line of credit.

The Credit Facility is collateralized by substantially all of the assets of the Company. Under the terms of the Credit Facility, the Company is required to maintain certain financial ratios and other financial covenants. These ratios include a debt to a four quarter rolling earnings before interest, taxes and depreciation and amortization (EBITDA) ratio, a ratio of fixed charges (interest and debt payments) to EBITDA, and minimum quarterly EBITDA. The agreement also prohibits the Company from incurring additional indebtedness.

In July 2000, the Company and its lenders amended its credit agreement to provide for revised financial covenants and extended the maturity date until April 30, 2001 and as a result the debt with the bank has been classified as a current liability. The Company raised $7.5 million of additional financing in April 2000. The net proceeds were used to reduce the outstanding balance on the credit facility. As of June 30, 2000, the Company is in compliance with all terms of the agreement with the lenders. The maximum amount of credit under the credit facility available to the Company is dependent upon the Company's financial performance. Based on the financial covenants, the Company's maximum borrowings at June 30, 2000 are less than $40 million.

Subordinated Note Payable

The Company issued a subordinated note payable of $3.75 million, due April 30, 2001, to a director and significant shareholder of the Company. The note bears interest at prime rate plus one percent per annum (10.5% at June 30, 2000) which is payable every six months beginning in October 2000. The lender also received warrants to purchase 25,000 shares of common stock at an exercise price of $6.05 per share for a period of five years. The estimated fair value of the stock purchase warrants, using the Black-Scholes model, has been recorded as deferred financing fees and is being amortized over the term of the debt.

(4) Stockholders Equity

Preferred Stock Offering

In April 2000, the Company issued 3,750 shares of our Series A Convertible Redeemable Preferred Stock and a five-year stock purchase warrant exercisable for 340,909 shares at $6.60 per share of the Company's common stock to RGC International Investors, LLC, a fund managed by Rose Glen Capital Management LP. The Company allocated the fair value of the warrants ($1.1 million) to additional paid-in capital and recognized a discount on the preferred shares issued. The net proceeds from the issuance were $3.5 million, net of offering costs. The Company also issued warrants to purchase 50,000 shares of common stock to the broker on the sale of the preferred stock at an exercise price of $6.60 per share. The stock purchase warrants were valued at fair value ($163,000) using the Black-Scholes model and are being amortized as accretion of discount on preferred stock over the term of the preferred stock.

The preferred stock is convertible into common stock at a variable conversion price based on the closing market price of the common stock during a pricing period of 5 consecutive trading days during the 22 consecutive trading days preceding conversion, up to a "fixed" conversion price. The fixed conversion price is the lower of $6.05 per share or 110% of the market price of the Company's common stock for 10 days ending on August 17, 2000 if it is below $6.05. With limited exceptions relating to a change in control of the Company, during the six month period after the issuance of the preferred stock, the preferred stock is not convertible into the common stock unless the market price of the common stock equals or exceeds the fixed conversion price. After the six-month period, the Company has the right repurchase the preferred stock upon receipt of notice to convert the preferred shares into common stock, if the market price of the common stock is less that the fixed conversion price.

The preferred stock is redeemable at the option of the Company, subject to certain restrictions, if the market price of the Company's common stock is less than or equal to $4.00 for 10 consecutive days. The redemption is subject to notice requirements. The cash redemption price is the greater of 120% of the liquidation preference, or a value based on the number of shares of common stock issuable upon conversion of the preferred stock multiplied by the highest closing price of the common stock during a period from notice of redemption until the redemption date. Redemption of the preferred stock is mandatory at its maturity date, April 17, 2003; upon assignment of all assets of the Company; bankruptcy; failure to maintain a Nasdaq listing; or failure to meet certain other terms set forth in the preferred stock agreements.

The preferred stock is non-voting and pays no dividends. In the event of liquidation, dissolution or winding up of the Company, or major transaction, including merger or sale or disposal of 50% of the company, the holders of the preferred stock are entitled to a liquidation preference of 8% per annum.

The Company accounted for these transactions in accordance with ETIF 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios." The company recognized an increase in additional paid in capital in the amount of $771,000 for the value of the beneficial conversion. The Company will accrete the resulting discount in the preferred stock to loss applicable to common stockholders over the six-month period beginning April 17, 2000.

(5) Segment Information

The Company has three reportable segments; the Corrections Divisions, the SpeakEZ Division, and the Internet Services Division. The Company evaluates performance based on earnings (loss) before income taxes. Additional measures include operating income, depreciation and amortization, and interest expense. There are no intersegment sales. The Company's reportable segments are specific business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. The accounting policies of the reportable segments are the same as those described in the summary of

(5) Segment Information — (Continued)

significant accounting policies. Segment information for the three and six months ended June 30, 2000 and 1999 is as follows (amounts in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2000	1999	2000	1999
REVENUE FROM EXTERNAL CUSTOMERS:				
Corrections Division	$20,006	$17,712	$37,677	$35,471
SpeakEZ Division	20	34	100	59
Internet Services Division	6,743	—	12,561	—
	$26,769	$17,746	$50,338	$35,530
OPERATING INCOME (LOSS):				
Corrections Division	$(1,149)	$ 15	$(2,203)	$ 64
SpeakEZ Division	(538)	(574)	(928)	(1,369)
Internet Services Division	1,194	—	1,912	—
	$ (493)	$ (559)	$(1,219)	$(1,305)
DEPRECIATION AND AMORTIZATION:				
Corrections Division	$ 2,887	$ 2,611	$ 5,699	$ 5,173
SpeakEZ Division	230	237	467	497
Internet Services Division	—	—	—	—
	$ 3,117	$ 2,848	$ 6,166	$ 5,670
INTEREST AND OTHER EXPENSE, NET:				
Corrections Division	$ (367)	$ (426)	$ (442)	$ (703)
SpeakEZ Division	(306)	(207)	(585)	(414)
Internet Services Division	—	—	—	—
	$ (673)	$ (633)	$(1,027)	$(1,117)
SEGMENT EARNINGS (LOSS) BEFORE INCOME TAXES:				
Corrections Division	$(1,516)	$(1,238)	$(2,645)	$(1,656)
SpeakEZ Division	(844)	(781)	(1,513)	(1,783)
Internet Services Division	1,194	—	1,912	—
	$(1,166)	$(2,019)	$(2,246)	$(3,439)

	June 30, 2000	December 31, 1999
SEGMENT ASSETS:		
Corrections Division	$72,382	$66,534
SpeakEZ Division	2,248	3,599
Internet Services Division	—	—
	$74,630	$70,133

There was no intersegment revenue for the three months ended June 30, 2000 and 1999. Unallocated amounts to arrive at net earnings (loss) included an income tax (expense) benefit of $(103,000) and $1,398,000 for the six months ended June 30, 2000 and 1999, respectively. Consolidated total assets included eliminations of approximately $12.7 million and $13.0 million as of June 30, 2000 and December 31, 1999, respectively. Eliminations consist of intercompany receivables in the Corrections Division and intercompany payables in the SpeakEZ Division related solely to intercompany borrowing of the SpeakEZ Division.

ITEM 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

For a comprehensive understanding of our financial condition and performance, this discussion should be considered in the context of the condensed consolidated financial statements and accompanying notes and other information contained herein.

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Certain information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Form 10-Q includes forward-looking statements. Important factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to, those listed under the caption "Risk Factors" in the Company's Form 10-K for the year ended December 31, 1999, which may affect the potential technological obsolescence of existing systems, the renewal of existing site specific Corrections and Internet Service Division customer contracts, the ability to retain the base of current site specific customer contracts, the ability to perform under contractual performance requirements, the continued relationship with existing customers, the ability to win new contracts for our products and services, including Lock & Track™, Contain® and our Internet Services Division, the ability of our existing customers, including AT&T, to maintain their market share of the inmate calling market, the successful integration of Gateway Technologies, Inc. into our business, our ability to penetrate the market for jail management systems, the ability to reduce expenditures in the SpeakEZ Division and to successfully license voice verification and fraud prevention technology, the effect of economic conditions, the effect of regulation, including the Telecommunications Act of 1996 that could affect our sales or pricing, the impact of competitive products and pricing particularly in the our Corrections Division, our continuing ability to develop hardware and software products, commercialization and technological difficulties, manufacturing capacity and product supply constraints or difficulties, actual purchases by current and prospective customers under existing and expected agreements, and the results of financing efforts, along with the other risks detailed therein.

Overview

Acquisition of Gateway Technologies, Inc.

On June 14, 1999, we completed our merger with Gateway Technologies, Inc. or "Gateway" by exchanging 3,672,234 shares of our common stock for all of the common stock of Gateway. Each share of Gateway was exchanged for 5.0375 shares of our common stock. In addition, outstanding Gateway stock options were converted at the same exchange rate into options to purchase approximately 379,000 shares of our common stock.

The merger constituted a tax-free reorganization and has been accounted for as a pooling of interests under Accounting Principles Board Opinion No. 16. Accordingly, all prior period information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations has been restated to include the combined results of operations, financial position and cash flows of T-NETIX and Gateway as though Gateway had always been a part of T-NETIX.

In addition, in connection with the merger transaction, T-NETIX issued 375,341 shares of common stock to certain shareholders of Gateway in exchange for their terminating a royalty agreement with Gateway. The royalty agreement related to automated call processing technology and intellectual property rights that were assigned to Gateway by the royalty owners in exchange for royalty payments. The termination of the royalty owners' interests resulted in the acquisition of an intangible asset. The asset has been recorded at its estimated fair value, or $2,487,000. The fair value is based on the value of T-NETIX common stock at February 10, 1999 (date of the Merger Agreement), or $6.625, multiplied by the number of shares issued in exchange for termination of the royalty owners' interests. The intangible asset has an estimated useful life of 10 years, the remaining term of the underlying patent.

Corrections Division

In the Corrections Division we derive revenue from three main sources: telecommunications services, direct call provisioning and equipment sales. Each form of revenue has specific and varying operating costs associated with such revenue. Selling, general and administrative expenses, along with research and development and depreciation and amortization are common expenses regardless of the revenue generated.

Telecommunications services revenue is generated under long-term contracts. Pricing historically provided for transaction fees paid on a per-call basis. We are paid a prescribed fee for each call completed and additional fees for validating phone numbers dialed by inmates. The per-call charge is primarily for the provisioning of specialized call processing services to telecommunications service providers for their customers, the correctional facilities. However, recently we entered into a contract amendment with a significant customer to record revenue as a percentage of gross revenue earned by the customer, subject to certain adjustments. This new pricing was an effort by us to have our pricing remain flexible and not be effected by factors that affected call volumes. Pursuant to the amendment, we also recognized certain telecommunications expenses that were previously reimbursable charges to this customer. These charges were previously reimbursable costs to the customer. Our telecommunications service provider customers include AT&T, Bell Atlantic, Qwest (formerly US WEST), SBC Communications (including Ameritech), BellSouth, Sprint and GTE.

As a direct inmate call provider, we buy "wholesale" call services to be re-sold as collect calls. We use the services of third parties to bill the collect calls. We then enter into direct contracts with the correctional facilities and generally pay to the correctional facilities commissions on the gross billed revenue. The rates charged by us are consistent with the collect call rates charged by the incumbent local exchange carrier or "ILEC" in the same service area and the predominant interexchange carrier or "IXC". Since all calls originating from the inmate phones are collect calls, each phone generates higher-than-industry-average revenues. The uncertainty of the creditworthiness of the billed parties results however in a higher-than-industry-average uncollectible cost.

Equipment sales and other revenue includes the sales of our inmate calling system and the DRS system. The sales of the inmate calling system are generally made to only one customer. We then charge monthly maintenance fees to keep the system operational. Sales to this customer can vary depending upon the success of the customer in winning contracts with correctional facilities.

Internet Services Division

In December 1999, we entered into a master service agreement with US WEST INTERPRISE America, Inc. to provide interLATA Internet services to US WEST customers. The contract, which commenced December 1, 1999, calls for us to buy, resell and process billing of Internet bandwidth to this customer. The contract with US WEST is for a minimum of sixteen months.

We recognized significant Internet Services revenue and related costs for the three and six months ended June 30, 2000 under this agreement. Our gross margin on these services was 18% and 15% for the three and six months ended June 30, 2000, respectively. The gross margin is effected by the negotiated base management fee and contract incentive payments. The costs associated with this contract are primarily the costs for Internet bandwidth. There were no capital outlays required to begin provisioning these services. The Company anticipates adding personnel to expand the service offerings of the Internet Services Division beyond the scope of the current contract.

Extension of the contract beyond the minimum sixteen-month period is dependent upon the regulatory approval process in various states. In the event that US WEST receives regulatory approval to provide inter-LATA telecommunications services during or after the initial sixteen month period, our Internet Services revenue could be reduced significantly or eliminated.

Speaker Verification Division

We completed consolidation of our SpeakEZ operations to our Englewood facility in February 1999. The reorganization included a change in marketing strategy from a direct customer sales strategy to a technology licensing strategy. A direct customer sales strategy markets a specifically developed software product to a specific, end user customer. The strategy is then to find other specific customers who have similar operating systems and market this product to these customers. In contrast, a technology licensing strategy focuses on a larger scale customer who can integrate the SpeakEZ software product into its existing product line. This larger customer, such as a computer manufacturer, would then be responsible for the product integration and ultimate delivery to the end user customer.

Even with the changes in marketing strategy, there can be no assurance that the products based on the SpeakEZ technology will achieve the necessary market acceptance or become widely adopted. The market for speaker verification software has only recently begun to develop. As is typical in the case of a new and rapidly evolving market, demand and market acceptance for recently introduced products and services are subject to a high level of uncertainty. Our voice print revenue has been minimal to date.

Results of Operations for the Three Months Ended June 30, 2000 Compared to June 30, 1999

The following table sets forth certain statement of operations data as a percentage of total revenue for the three months ended June 30, 2000 and 1999.

	2000	1999
Revenue:		
Telecommunications services	45%	57%
Direct call provisioning	27	39
Internet services	25	—
Equipment sales and other	3	4
Total revenue	100	100
Expenses:		
Operating costs	67	62
Selling, general and administrative	17	18
Research and development	6	7
Depreciation and amortization	12	16
Operating loss	(2)	(3)
Merger transaction expenses	—	(5)
Interest and other expense	(2)	(3)
Loss before income taxes	(4)	(11)
Income tax (expense) benefit	(1)	4
Net loss	(5)	(7)
Accretion of discount on redeemable convertible preferred stock	(2)	—
Net loss applicable to common stock	(7)%	(7)%

Total Revenue. Total revenue for the three months ended June 30, 2000 was $26.8 million, an increase of 51% over $17.8 million for the corresponding prior period. This increase was primarily attributable to the commencement of Internet services, as well as increases in telecommunications services revenue and equipment sales and other offset, in part by decreases in direct call provisioning revenue.

The 19% increase in telecommunications services revenue to $12.0 million in the three months ended June 30, 2000, from $10.1 million for the corresponding prior period, was due primarily to an increase in contract prices. We changed our pricing to a significant customer whereby revenue is calculated as a percentage of our customer's gross revenue versus a transaction fee per call. In addition we experienced an increase in revenue due to call volume increases, primarily due to the addition of new sites.

Direct call provisioning revenue increased to $7.2 million for the three months ended June 30, 2000, from $7.0 million in the corresponding prior period. This increase was due to the addition of sites for which we were provisioning the long distance service. The addition of sites is primarily a result of our being successful in competitive bidding arrangements for contracts directly with correctional institutions.

The Internet Services contract commenced in December 1999. Future revenue is dependent upon the base of subscribers and contract incentive payments. Internet gross margin for the three months ended June 30, 2000 was 18%.

Equipment sales and other revenue increased 25% to $826,000 for the three months ended June 30, 2000 from $660,000 in the corresponding prior period. Such sales are primarily associated with one telecommunications service provider customer and are dependent upon the timing of installations for this customer and the customer's success rate in its territory. In the three months ended June 30, 2000 we had sales of approximately $676,000 to this telecommunications service provider customer. We do not expect significant equipment sales in the near future.

Operating costs. Total operating costs were $18.0 million in the three months ended June 30, 2000, an increase of 64% from $10.9 million in the corresponding prior period. The increases were primarily due to the commencement of Internet services as well as increases in telecommunication services and the cost of equipment sold and other expenses offset by a reduction in direct call provisioning expenses.

Operating costs of telecommunications services primarily consist of service administration costs for correctional facilities, including salaries and related personnel expenses, communication costs and inmate calling systems repair and maintenance expense. Operating costs of telecommunications services also include costs associated with call verification procedures, primarily network expenses and database access charges. Operating costs associated with direct call provisioning include the costs associated with telephone line access, long distance charges, commissions paid to correctional facilities, costs associated with uncollectible accounts and billing charges. Internet Services expense consists of Internet bandwidth costs. Cost of equipment sold and other includes primarily the purchase price of equipment which is resold. Other equipment cost components was minimal. Voice print operating costs include royalty charges, the cost of hardware and the cost of services which amounts are reflected as other operating costs.

The following table sets forth the operating costs and expenses for each type of revenue as a percentage of corresponding revenue for the three months ended June 30, 2000 and 1999.

	2000	1999
Operating costs:		
Telecommunications services	45%	42%
Direct call provisioning	93	92
Internet services	82	—
Cost of equipment sold and other	40	32

Operating costs associated with providing telecommunications services as a percentage of corresponding revenue was 45% for the three months ended June 30, 2000, an increase from 42% for the corresponding prior period. The increase was due primarily to cost increases. Total telecommunications services operating expenses were $5.4 million for the three months ended June 30, 2000 and $4.3 million for the corresponding prior period. The increase in 2000 is due to new services being provisioned for a significant customer as part of a contract amendment and due to increases in personnel costs. The increase included bonus costs associated with our line installation bonus program. The bonus program ended as of June 30, 2000. Also, the addition of new personnel in the National Service Center and other operational support functions contributed to cost increases. To a lesser extent, increases in travel and contract labor contributed to the overall cost increase. With the addition of personnel at our National Service Center and based on contract negotiations we believe we can reduce field operations personnel in the near future.

Direct call provisioning costs as a percentage of applicable revenue increased slightly to 93% of revenue for the three months ended June 30, 2000 an increase from 92% for the corresponding prior period. These costs include increases due to site commissions and transmissions costs offset by a reduction in bad debt expense because of improved collections.

The contract for Internet services commenced in December 1999. Future revenue increases are dependent upon the base of subscribers and additional contract incentive payments. Cost of equipment sold and other increased in the three months ended June 30, 2000 and also increased as a percentage of corresponding revenue from the corresponding prior primarily due to the change in the revenue mix for equipment sales.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $4.6 million for the three months ended June 30, 2000 compared to $3.3 million for the corresponding prior period. Selling, general and administrative expenses associated with the Corrections Division were $4.5 million for the three months ended June 30, 2000 compared to $3.1 million in the corresponding prior period. The increase in the three months ended June 30, 2000 was primarily due to increases in salary and benefits for additional personnel, from raises for existing personnel and the installation bonus program. Other expenses, including travel and professional fees, increased due to the integration of Gateway's operations. We anticipate selling, general and administrative expenses to remain consistent with current levels in the near future.

Research and Development Expenses. Research and development expenses were $1.6 million in the three months ended June 30, 2000 compared to $1.3 million for the corresponding prior period. Research and development expenses for the Corrections Division were $1.3 million in the three months ended June 30, 2000 and $1.1 million in the corresponding prior period. The increase was primarily due to increased personnel expenses. We anticipate research and development expenses to remain consistent for the remainder of the year.

Depreciation and Amortization Expenses. Depreciation and amortization expense was $3.1 million in the three months ended June 30, 2000, an increase from $2.8 million for the corresponding prior period. The increase was due primarily to the depreciation associated with new site installations.

Merger Transaction Expenses. These expenses were directly related to the merger with Gateway and amounted to approximately $827,000 for the three months ended June 30, 1999. Merger transaction expenses consisted primarily of fees for investment bankers, attorneys, accountants, financial printing and other related charges.

Interest and Other Expense, Net. Interest and other expense, net was $673,000 for the three months ended June 30, 2000, an increase from $633,000 for the corresponding prior period. Included in other income in the three months ended June 30, 2000 is a gain of approximately $46,000 on the sale of used telecommunications equipment. Interest expense was $719,000 for the three months ended June 30, 2000, and $633,000 for the corresponding prior period. The increase in 2000 was attributable to an increase in the average amount of indebtedness outstanding and an increase in interest rates. The average debt balance increased primarily due to the increase in capital expenditures.

Results of Operations for the Six Months Ended June 30, 2000 Compared to June 30, 1999

The following table sets forth certain statement of operations data as a percentage of total revenue for the six months ended June 30, 2000 and 1999.

	2000	1999
Revenue:		
Telecommunications services	44%	56%
Direct call provisioning	29	38
Internet services	25	—
Equipment sales and other	2	6
Total revenue	100	100
Expenses:		
Operating costs	68	62
Selling, general and administrative	17	19
Research and development	5	7
Depreciation and amortization	12	16
Operating loss	(2)	(4)
Merger transaction expenses	—	(3)
Interest and other expense	(2)	(3)
Loss before income taxes	(4)	(10)
Income tax (expense) benefit	—	4
Net loss	(4)	(6)
Accretion of discount on redeemable convertible preferred stock	(1)	—
Net loss applicable to common stock	(5)%	(6)%

Total Revenue. Total revenue for the six months ended June 30, 2000 was $50.3 million, an increase of 42% over $35.5 million for the corresponding prior period. This increase was primarily attributable to the commencement of Internet services, as well as increases in telecommunications services revenue and direct call provisioning revenue offset in part by decreases in equipment sales and other.

The 11% increase in telecommunications services revenue to $22.1 million in the six months ended June 30, 2000, from $19.9 million for the corresponding prior period, was due primarily to an increase in contract prices. We changed our pricing to a significant customer whereby revenue is calculated as a percentage of our customer's gross revenue versus a transaction fee per call. In addition we experienced an increase in revenue due to call volume increases, primarily due to the addition of new sites.

Direct call provisioning revenue increased 7% to $14.5 million for the six months ended June 30, 2000, from $13.5 million in the corresponding prior period. This increase was due to the addition of new sites primarily for which we are provisioning the long distance service. The addition of sites is primarily a result of our being successful in competitive bidding arrangements for contracts directly with correctional institutions.

The Internet Services contract commenced in December 1999. Future revenue increases are dependent upon the base of subscribers and additional contract incentive payments.

Equipment sales and other revenue decreased 43% to $1.2 million for the six months ended June 30, 2000 from $2.1 million in the corresponding prior period. Such sales are primarily associated with one telecommunications service provider customer and are dependent upon the timing of installations for this customer and the customer's success rate in its territory. In the six months ended June 30, 2000 we had sales of approximately $1.1 million to this telecommunications service provider customer. The reduction for the six months ended June 30, 2000 from the corresponding prior period is due primarily to the timing of purchases by this customer.

Operating costs. Total operating costs were $34.3 million in the six months ended June 30, 2000, an increase of 57% from $21.9 million in the corresponding prior period. The increases were primarily due to the commencement of Internet services as well as increases in telecommunication services and direct call provisioning expenses offset by a reduction in the cost of equipment sold and other expenses.

Operating costs of telecommunications services primarily consist of service administration costs for correctional facilities, including salaries and related personnel expenses, communication costs and inmate calling systems repair and maintenance expense. Operating costs of telecommunications services also include costs associated with call verification procedures, primarily network expenses and database access charges. Operating costs associated with direct call provisioning include the costs associated with telephone line access, long distance charges, commissions paid to correctional facilities, costs associated with uncollectible accounts and billing charges. Internet Services expense consists of Internet bandwidth costs. Cost of equipment sold and other includes primarily the purchase price of equipment which is resold. Other equipment cost components was minimal. Voice print operating costs include royalty charges, the cost of hardware and the cost of services which amounts are reflected as other operating costs.

The following table sets forth the operating costs and expenses for each type of revenue as a percentage of corresponding revenue for the six months ended June 30, 2000 and 1999.

	2000	1999
Operating costs:		
Telecommunications services	45%	43%
Direct call provisioning	92	93
Internet services	85	—
Cost of equipment sold and other	45	41

Operating costs associated with providing telecommunications services as a percentage of corresponding revenue was 45% for the six months ended June 30, 2000, an increase from 43% for the corresponding prior period. The increase was due to cost increases. Total telecommunications services operating expenses were $9.9 million for the six months ended June 30, 2000 and $8.5 million for the corresponding prior period. The increase in 2000 is due to new services being provisioned for a significant customer as part of a contract amendment and due to increases in personnel costs. The increase included bonus costs associated with our line installation bonus program. The bonus program ended as of June 30, 2000. Also, the addition of new personnel in the National Service Center and other operational support functions contributed to cost increases. To a lesser extent, increases in travel, consulting services, repairs and maintenance contributed to the overall cost increase.

Direct call provisioning costs as a percentage of applicable revenue decreased to 92% of revenue for the six months ended June 30, 2000 from 93% in for the corresponding prior period. This decrease was primarily due to a reduction in bad debt expense because of improved collections.

The contract for Internet services commenced in December 1999. Cost of equipment sold and other decreased in the six months ended June 30, 2000 but increased as a percentage of corresponding revenue from the corresponding prior primarily due to the change in the revenue mix for equipment sales and voice print sales.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $8.3 million for the six months ended June 30, 2000 compared to $6.6 million for the corresponding prior period. Selling, general and administrative expenses associated with the Corrections Division were $8.1 million for the six months ended June 30, 2000 compared to $6.2 million in the corresponding prior period. The increase in the six months ended June 30, 2000 was primarily due to increases in salary and benefits for additional personnel, from raises for existing personnel and the installation bonus program. Other expenses increased due to travel, communications and professional fees due to the integration of Gateway operations.

Research and Development Expenses. Research and development expenses were $2.7 million in the six months ended June 30, 2000 compared to $2.6 million for the corresponding prior period. Research and development expenses for the Corrections Division were $2.4 million in the six months ended June 30, 2000 and $2.2 million in the corresponding prior period. The increase was primarily due to higher travel and consulting costs.

Depreciation and Amortization Expenses. Depreciation and amortization expense was $6.2 million in the six months ended June 30, 2000, an increase from $5.7 million for the corresponding prior period. The increase was due primarily to the depreciation associated with new site installations.

Merger Transaction Expenses. These expenses were directly related to the merger with Gateway and amounted to approximately $1.0 million for the six months ended June 30, 1999. Merger transaction expenses consisted primarily of fees for investment bankers, attorneys, accountants, financial printing and other related charges.

Interest and Other Expense, Net. Interest and other expense, net was $1.0 million for the six months ended June 30, 2000, a decrease from $1.1 million for the corresponding prior period. Included in other income in the six months ended June 30, 2000 is a gain of approximately $334,000 on the sale of used telecommunications equipment. There was $59,000 of miscellaneous other income in the six months ended June 30, 1999. Interest expense was $1.4 million for the six months ended June 30, 2000, and $1.0 million for the corresponding prior period. The increase in 2000 was attributable to an increase in the average amount of indebtedness outstanding and an increase in interest rates. The average debt balance increased primarily due to the increase in capital expenditures and business acquisitions.

Liquidity and Capital Resources

Cash Flows

We incurred losses from continuing operations for the six months ended June 30, 2000 of $2.3 million and had a working capital deficit of $30.8 million at June 30, 2000. In July 2000 our lenders amended our credit agreement to provide for revised financial covenants. Additionally, we raised $7.5 million of debt and equity financing in April 2000. The net proceeds were used to reduce the outstanding balance on our credit facility. We are taking steps to improve our cash flow from operations, including renegotiating contract pricing and cost control measures in order to carry out the remainder of our fiscal 2000 business plan. However, there can be no assurance that we will be successful in increasing our cash flow from operations and we may require additional financing to fund our operations. In the event additional financing is required, we may not be able to obtain financing on terms acceptable to us and we may have to curtain operations.

We present the following information for the six months ended June 30, 2000 and 1999 and as of June 30, 2000 and December 31, 1999:

	2000	1999
	(Amounts in Thousands)	
Cash provided by operating activities	$ 3,083	$ 5,342
Working capital deficit	$(30,783)	$(8,152)

We have historically relied upon commercial borrowings, operating cash flow and the sale of equity securities to fund our operations and capital needs. Cash provided by operations decreased 42% to $3.1 million for the six months ended June 30, 2000 from $5.3 million in the corresponding prior period primarily due to an increase in the net loss, reductions in accounts payable, and increases in accounts receivable. The increase in the working capital deficit is primarily due to the classification of the bank credit facility. The current maturity of the facility is April 30, 2001.

Purchases of property and equipment were $8.5 million in the six months ended June 30, 2000 compared to $6.3 million for the corresponding prior period. The 36% increase in purchases of property and equipment was primarily due to additional inmate calling system installations and upgrades to existing systems.

Debt and Equity

We have been funding our operations primarily from available borrowings under a line of credit and by using cash provided by operations. Due to our capital requirements for new installations and the merger with Gateway, in September 1999, we entered into a Senior Secured Revolving Credit Facility ("Credit Facility") with a commercial bank. The maximum amount of credit under the credit facility available to the Company is dependent upon the Company's financial performance. Based on the financial covenants, the Company's maximum borrowings at June 30, 2000 were less than $40 million. In July 2000 our lenders amended our credit agreement to revise certain financial covenants. In addition, we raised $7.5 million of debt and equity financing in April 2000. The net proceeds of approximately $7.2 million were used to reduce the outstanding balance on the Credit Facility.

We anticipate that our capital expenditures in 2000 will be consistent with 1999 based on our anticipated growth in installed systems at correctional facilities. We believe our Credit Facility and cash flows from operations will be sufficient in order for us to meet our anticipated cash needs for anticipated new installations of inmate call processing systems and upgrades of existing systems and to finance our operations for at least the next 12 months. However, there can be no assurance that we will be successful in increasing our cash flow from operations and we may require additional financing to fund operations. In the event additional financing is required, we may not be able to obtain financing on terms acceptable to us and we may have to curtain operations.

Item 3. ***Quantitative and Qualitative Disclosure About Market Risk***

We are exposed to interest rate risk as discussed below.

Interest Rate Risk

We have current debt outstanding under the credit facility of $26.7 million at June 30, 2000. The credit facility bears interest at differing rates including, $22 million at LIBOR plus 4.0% and the remaining balance at the prime rate, 9.5% at June 30, 2000, plus 1.25%. Interest on LIBOR rate loans is payable at the end of the interest period applicable to the loan but not longer than every six months. Interest on prime rate loans is payable every six months. Since the interest rates on the loans outstanding are variable and are reset periodically, we are exposed to interest rate risk. An increase in interest rates of 1% would increase estimated annual interest expense by approximately $280,000 based on the amount of borrowings outstanding under the line of credit at June 30, 2000.

PART II OTHER INFORMATION

Item 1. *Legal Proceedings*

From time to time we have been, and expect to continue to be subject to various legal and administrative proceedings or various claims in the normal course of our business. We believe the ultimate disposition of these matters will not have a material affect on our financial condition, liquidity, or results of operations.

In a case brought in the First Judicial District Court of the State of New Mexico, styled *Valdez v. State of New Mexico, et. al.*, the complaint joins as defendants the State of New Mexico, several political subdivisions of the State of New Mexico and several inmate telecommunications service providers, including T-NETIX and Gateway. The complaint includes a request for certification by the court of a plaintiffs' class action consisting of all persons who have been billed for and paid for telephone calls initiated by an inmate confined in a jail, prison, detention center or other New Mexico correctional facility. The complaint alleges violations of New Mexico Unfair Practices Act, the New Mexico Antitrust Act and the New Mexico Constitution, and also alleges unjust enrichment, constructive trust, economic compulsion, constructive fraud and illegality of contracts, all in connection with the provision of "collect only" inmate telecommunications services. Although management believes the likelihood of an unfavorable outcome is low, there can be no assurance that a judgment against a class of defendant providers will not ultimately be entered.

In a case brought in the Superior Court of Washington for King County, styled *Sandy Judd, et al. v. American Telephone and Telegraph Company, et. al.*, the complaint joins as several inmate telecommunications service providers, including T-NETIX. The complaint includes a request for certification by the court of a plaintiffs' class action consisting of all persons who have been billed for and paid for telephone calls initiated by an inmate confined in a jail, prison, detention center or other Washington correctional facility. The complaint alleges violations of the Washington Consumer Protection Act and requests an injunction under the Washington Consumer Protection Act and common law to enjoin further violations. Although management believes the likelihood of an unfavorable outcome is low, there can be no assurance that a judgment against a class of defendant providers will not ultimately be entered.

Gateway is a defendant in a case brought in United States District Court Western District of Kentucky at Louisville, styled *Gus "Skip" Daleure, Jr., et al vs. Commonwealth of Kentucky, et al.* The complaint in this case joined as defendants several states, political subdivisions of states, and inmate service telecommunications providers and was filed contemporaneously with a request for certification by the court of a nationwide plaintiffs' class action consisting of all persons who have received and paid for telephone calls initiated by an inmate at a prison, jail or other correctional institution for the provision of "collect only" inmate telecommunications services. The complaint sought declaratory and injunctive relief and money damages in an unstated amount for alleged violations of the Sherman Antitrust Act, the Robinson-Patman Act and the U.S. Constitution. The district court held, on motions to dismiss; Kentucky did not have personal jurisdiction over defendants not located in or doing business in the state of Kentucky; that telephone calls are not goods or commodities and thus are not subject to the antitrust provisions of the Robinson-Patman Act; that Plaintiffs did not state a claim for relief under the Equal Protection Clause of the Fourteenth Amendment; and that Plaintiffs had not shown any harm in support of its antitrust claim under Section 1 of the Sherman Act. The trial judge did not, however, dismiss plaintiff's prayer for injunctive relief, despite these findings. The case is currently subject to appeal and cross appeal in the Second Circuit Court of Appeals. Although Gateway believes the District Court holding will not be overturned it is possible the in may be and there can be no assurance that a judgment against a class of the providers will not ultimately be entered.

Item 2. *Changes in Securities and Use of Proceeds*

None

Item 3. *Defaults Upon Senior Securities*

None.

Item 4. *Submission of Matters to a Vote of Security Holders*

On May 12, 2000 the Company held its Annual Meeting of Shareholders to elect four directors of the Company to hold office until the 2003 Annual Meeting of Stockholders or until their respective successors are duly elected and qualified and to ratify the selection of KPMG LLP; independent auditors, as auditors of the Company for the year ending December 31, 2000. The directors were elected and KPMG was ratified as independent auditors with the following voting results; 10,712,465 FOR; 113,281 AGAINST; and 400 WITHHOLD.

Item 5. *Other Information*

None.

Item 6. *Exhibits and Reports on Form 8-K*

(a) Exhibits

10.12	— First Amendment to Loan Agreement $40,000,000 Revolving Line of Credit from Bank One, Colorado, NA, COBANK, ACB, and INTRUST Bank, NA dated July 11, 2000.
27	— Financial Data Schedule.

(b) The Company filed a Form 8-K dated April 19, 2000 reporting the following:

Item 5 on Form 8-K regarding additional equity financing.

SIGNATURES

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

T-NETIX, INC.
(Registrant)

By: /s/ ALVYN A. SCHOPP
Alvyn A. Schopp
Chief Executive Officer

Date August 14, 2000

EXHIBIT E - PROPOSED TARIFF

TITLE SHEET

SOUTH DAKOTA TELECOMMUNICATIONS TARIFF

This tariff contains the descriptions, regulations, and rates applicable to the furnishing of service or facilities for Telecommunications Services furnished by T-NETIX Internet Services, Inc. ("T-NETIX"), with principal offices at 67 Inverness Drive East, Englewood, Colorado 80112. This tariff applies for services furnished within the State of South Dakota. This tariff is on file with the South Dakota Public Utilities Commission, and copies may be inspected, during normal business hours, at the company's principal place of business.

RESERVED FOR FUTURE USE

CHECK SHEET

The Sheets of this tariff are effective as of the date shown at the bottom of the respective sheet(s). Original and revised sheets as named below comprise all changes from the original tariff and are currently in effect as of the date on the bottom of this sheet.

SHEET	REVISION
1	Original
2	Original
3	Original
4	Original
5	Original
6	Original
7	Original
8	Original
9	Original
10	Original
11	Original
12	Original
13	Original
14	Original
15	Original
16	Original
17	Original
18	Original
19	Original
20	Original
21	Original
22	Original
23	Original
24	Original
25	Original
26	Original
27	Original
28	Original
29	Original
30	Original
31	Original
32	Original

* New or Revised Sheet

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TARIFF FORMAT

A. Sheet Numbering: Sheet numbers appear in the upper right corner of the page. Sheets are numbered sequentially. However, new sheets are occasionally added to the tariff. When a new sheet is added between sheets already in effect, a decimal is added. For example, a new sheet added between pages 11 and 12 would be page 11.1.

B. Sheet Revision Numbers: Revision numbers also appear in the upper right corner of each sheet where applicable. These numbers are used to indicate the most current page version on file with the Commission. For example, 4th Revised Sheet 13 cancels 3rd Revised Sheet 13. Consult the Check Sheet for the sheets currently in effect.

C. Paragraph Numbering Sequence: There are nine levels of paragraph coding. Each level of coding is subservient to its next higher level:

2.
2.1
2.1.1
2.1.1.A
2.1.1.A.1
2.1.1.A.1.(a)
2.1.1.A.1.(a).I
2.1.1.A.1.(a).I.(i)
2.1.1.A.1.(a).I.(i).(1)

D. Check Sheets: When a tariff filing is made with the Commission, an updated Check Sheet accompanies the tariff filing. The Check Sheet lists the sheets contained in the tariff, with a cross reference to the current Revision Number. When new sheets are added, the Check Sheet is changed to reflect the revision. All revisions made in a given filing are designated by an asterisk (*). There will be no other symbols used on this sheet if these are the only changes made to it (i.e., the format, etc. remains the same, just revised revision levels on some sheets). The tariff user should refer to the latest Check Sheet to find out if a particular sheet is the most current filed with the Commission.

SYMBOLS

The following are the only symbols used for the purposes indicated below:

(C) to signify change in regulation
(D) to signify a deletion
(I) to signify a rate increase
(L) to signify material relocated in the tariff
(N) to signify a new rate or regulation
(R) to signify a rate reduction
(T) to signify a change in text, but no change in rate or regulation

SECTION 1 - TECHNICAL TERMS AND ABBREVIATIONS

Access Line - An arrangement from a local exchange telephone company or other common carrier, using either dedicated or switched access, which connects a Customer's location to the Company's location or switching center.

Authorization Code - A numerical code, one or more of which may be assigned to a Customer, to enable the Company to identify the origin of the Customer so it may rate and bill the call. Automatic number identification (ANI) is used as the authorization code wherever possible.

Commission - Used throughout this tariff to mean the South Dakota Public Utilities Commission.

Customer - The person, firm, corporation or other legal entity which orders the services of the Company and is responsible for the payment of charges and for compliance with the Company's tariff regulations.

Company or T-NETIX - Used throughout this tariff to mean T-NETIX Internet Services, Inc., a Colorado Corporation.

Dedicated Access - The Customer gains entry to the Company's services by a direct path from the Customer's location to the Company's point of presence.

Holiday - New Year's Day, Independence Day, Labor Day, Thanksgiving Day and Christmas Day. Holidays shall be billed at the evening rate from 8 a.m. to 11 p.m. After 11 p.m., the lower night rate shall go into effect.

Resp. Org - Responsible Organization or entity identified by an 800 service Customer that manages and administers records in the 800 database and management system.

Switched Access - The Customer gains entry to the Company's services by a transmission line that is switched through the local exchange carrier to reach the Company's point of presence.

Telecommunications - The transmission of voice communications or, subject to the transmission capabilities of the services, the transmission of data, facsimile, signaling, metering, or other similar communications.

Underlying Carrier - The telecommunications carrier whose network facilities provide the technical capability and capacity necessary for the transmission and reception of Customer telecommunications traffic.

SECTION 2 - RULES AND REGULATIONS

2.1 Undertaking of the Company

This tariff contains the regulations and rates applicable to intrastate interexchange telecommunications services provided by the Company for telecommunications between points within the State of South Dakota. Services are furnished subject to the availability of facilities and subject to the terms and conditions of this tariff in compliance with limitations set forth in the Commission's rules. The Company's services are provided on a statewide basis and are not intended to be limited geographically. The Company offers service to all those who desire to purchase service from the Company consistent with all of the provisions of this tariff. Customers interested in the Company's services shall file a service application with the Company which fully identifies the Customer, the services requested and other information requested by the Company. The Company reserves the right to examine the credit record and check the references of all applicants and Customers. The Company may examine the credit profile/record of any applicant prior to accepting the service order. The service application shall not in itself obligate the Company to provide services or to continue to provide service if a later check of applicant's credit record is, in the opinion of the Company, contrary to the best interest of the Company. The Company may act as the Customer's agent for ordering access connection facilities provided by other carriers or entities when authorized by the Customer, to allow connection of a Customer's location to a service provided by the Company. The Customer shall be responsible for all charges due for such service arrangement.

2.1.1 The services provided by the Company are not part of a joint undertaking with any other entity providing telecommunications channels, facilities, or services, but may involve the resale of the Message Toll Services (MTS) and Wide Area Telecommunications Services (WATS) of underlying common carriers which may be subject to the jurisdiction of this Commission.

2.1.2 The rates and regulations contained in this tariff apply only to the services furnished by the Company and do not apply, unless otherwise specified, to the lines, facilities, or services provided by a local exchange telephone company or other common carriers for use in accessing the services of the Company.

2.1.3 The Company reserves the right to limit the length of communications, to discontinue furnishing services, or limit the use of service necessitated by conditions beyond its control, including, without limitation: lack of satellite or other transmission medium capacity; the revision, alteration or repricing of the Underlying Carrier's tariffed offerings; or when the use of service becomes or is in violation of the law or the provisions of this tariff.

2.2 Use of Services

2.2.1 The Company's services may be used for any lawful purpose consistent with the transmission and switching parameters of the telecommunications facilities utilized in the provision of services, subject to any limitations set forth in this Section 2.2.

2.2.2 The use of the Company's services to make calls which might reasonably be expected to frighten, abuse, torment, or harass another or in such a way as to unreasonably interfere with use by others is prohibited.

2.2.3 The use of the Company's services without payment for service or attempting to avoid payment for service by fraudulent means or devices, schemes, false or invalid numbers, or false calling or credit cards is prohibited.

2.2.4 The Company's services are available for use twenty-four hours per day, seven days per week.

2.2.5 The Company does not transmit messages, but the services may be used for that purpose.

2.2.6 The Company's services may be denied for nonpayment of charges or for other violations of this tariff.

2.2.7 Customers shall not use the service provided under this tariff for any unlawful purpose.

2.2.8 The Customer is responsible for notifying the Company immediately of any unauthorized use of services.

2.3 Liability of the Company

2.3.1 The Company shall not be liable for any claim, loss, expense or damage for any interruption, delay, error, omission, or defect in any service, facility or transmission provided under this tariff, if caused by the Underlying Carrier, an act of God, fire, war, civil disturbance, act of government, or due to any other causes beyond the Company's control.

2.3.2 The Company shall not be liable for, and shall be fully indemnified and held harmless by the Customer against any claim, loss, expense, or damage for defamation, libel, slander, invasion, infringement of copyright or patent, unauthorized use of any trademark, trade name or service mark, proprietary or creative right, or any other injury to any person, property or entity arising out of the material, data or information transmitted.

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

2.3.4 Reserved for Future Use

2.3.5 Reserved for Future Use

2.3.6 Reserved for Future Use

2.3.7 The remedies set forth herein are exclusive and in lieu of all other warranties and remedies, whether express, implied, or statutory, INCLUDING WITHOUT LIMITATION IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE.

2.4 Responsibilities of the Customer

2.4.1 The Customer is responsible for placing any necessary orders and complying with tariff regulations. The Customer is also responsible for the payment of charges for services provided under this tariff.

2.4.2 The Customer is responsible for charges incurred for special construction and/or special facilities which the Customer requests and which are ordered by the Company on the Customer's behalf.

2.4.3 If required for the provision of the Company's services, the Customer must provide any equipment space, supporting structure, conduit and electrical power without charge to the Company.

2.4.4 The Customer is responsible for arranging access to its premises at times mutually agreeable to the Company and the Customer when required for Company personnel to install, repair, maintain, program, inspect or remove equipment associated with the provision of the Company's services.

2.4.5 The Customer shall cause the temperature and relative humidity in the equipment space provided by Customer for the installation of the Company's equipment to be maintained within the range normally provided for the operation of microcomputers.

2.4.6 The Customer shall ensure that the equipment and/or system is properly interfaced with the Company's facilities or services, that the signals emitted into the Company's network are of the proper mode, bandwidth, power and signal level for the intended use of the subscriber and in compliance with criteria set forth in this tariff, and that the signals do not damage equipment, injure personnel, or degrade service to other Customers. If the Federal Communications Commission or some other appropriate certifying body certifies terminal equipment as being technically acceptable for direct electrical connection with interstate communications service, the Company will permit such equipment to be connected with its channels without the use of protective interface devices. If the Customer fails to maintain the equipment and/or the system properly, with resulting imminent harm to Company equipment, personnel or the quality of service to other Customers, the Company may, upon written notice, require the use of protective equipment at the Customer's expense. If this fails to produce satisfactory quality and safety, the Company may, upon written notice, terminate the Customer's service.

2.4.7 The Customer must pay the Company for replacement or repair of damage to the equipment or facilities of the Company caused by negligence or willful act of the Customer or others, by improper use of the services, or by use of equipment provided by Customer or others.

2.4.8 The Customer must pay for the loss through theft of any Company equipment installed at Customer's premises.

2.4.9 If the Company installs equipment at Customer's premises, the Customer shall be responsible for payment of any applicable installation charge.

2.4.10 The Customer must use the services offered in this tariff in a manner consistent with the terms of this tariff and the policies and regulations of all state, federal and local authorities having jurisdiction over the service.

2.5 Cancellation or Interruption of Services

2.5.1 Without incurring liability, upon five (5) working days' (defined as any day on which the company's business office is open and the U.S. Mail is delivered) written notice to the Customer, the Company may immediately discontinue services to a Customer or may withhold the provision of ordered or contracted services:

2.5.1.A For nonpayment of any sum due the Company for more than thirty (30) days after issuance of the bill for the amount due, unless the charge is in dispute;

2.5.1.B For violation of any of the provisions of this tariff,

2.5.1.C For violation of any law, rule, regulation, policy of any governing authority having jurisdiction over the Company's services, or

2.5.1.D By reason of any order or decision of a court, public service commission or federal regulatory body or other governing authority prohibiting the Company from furnishing its services.

2.5.2 Without incurring liability, the Company may interrupt the provision of services at any time in order to perform tests and inspections to assure compliance with tariff regulations and the proper installation and operation of Customer and the Company's equipment and facilities and may continue such interruption until any items of noncompliance or improper equipment operation so identified are rectified.

2.5.3 Service may be discontinued by the Company without notice to the Customer, by blocking traffic to certain countries, cities or NXX exchanges, or by blocking calls using certain Customer authorization codes, when the Company deems it necessary to take such action to prevent unlawful use of its service. The Company will restore service as soon as it can be provided without undue risk, and will, upon request by the Customer affected, assign a new authorization code to replace the one that has been deactivated.

2.5.4 The Customer may terminate service upon thirty (30) days written notice for the Company's standard month to month contract. Customer will be liable for all usage on any of the Company's service offerings until the Customer actually leaves the service. Customers will continue to have Company usage until the Customer notifies its local exchange carrier and changes its long distance carrier. Until the Customer so notifies its local exchange carrier, it shall continue to generate and be responsible for long distance usage.

2.6 Credit Allowance

2.6.1 Credit may be given for disputed calls, on a per call basis.

2.7 Restoration of Service

The use and restoration of service shall be in accordance with the priority system specified in part 64, Subpart D of the Rules and Regulations of the Federal Communications Commission.

2.8 Deposit

The Company does not require deposits.

2.9 Advance Payments

The Company does not require advance payments.

2.10 Payment and Billing

2.10.1 Service is provided and billed on a billing cycle basis, beginning on the date that service becomes effective. Billing is payable upon receipt. A late fee will be assessed on unpaid amounts 30 days after rendition of bills.

2.10.2 The customer is responsible for payment of all charges for services furnished to the Customer, as well as to all persons using the Customer's codes, exchange lines, facilities, or equipment, with or without the knowledge or consent of the Customer. The security of the Customer's Authorization Codes, subscribed exchange lines, and direct connect facilities is the responsibility of the Customer. All calls placed using direct connect facilities, subscribed exchange lines, or Authorization Codes will be billed to and must be paid by the Customer. Charges based on actual usage during a month and any accrued interest will be billed monthly in arrears.

2.10.3 All bills are presumed accurate, and shall be binding on the customer unless objection is received by the Company in writing within 180 days after such bills are rendered. No credits, refunds, or adjustments shall be granted if demand therefore is not received by the Company in writing within such 180 day period.

2.11 Collection Costs

In the event Company is required to initiate legal proceedings to collect any amounts due to Company, or to enforce any judgment obtained against a Customer, or for the enforcement of any other provision of this tariff or applicable law, Customer shall, in addition to all amounts due, be liable to Company for all reasonable costs incurred by Company in such proceedings and enforcement actions, including reasonable attorneys' fees, collection agency fees or payments, and court costs. In any such proceeding, the amount of collection costs, including attorneys' fees, due to the Company, will be determined by a court of competent jurisdiction or by the Commission.

2.12 Taxes

All federal, state and local taxes, assessments, surcharges, or fees, including sales taxes, use taxes, gross receipts taxes, and municipal utilities taxes, are billed as separate line items and are not included in the rates quoted herein.

2.13 Late Charge

A late fee of 1.5% per month or the amount otherwise authorized by law, whichever is lower, will be charged on any past due balances.

2.14 Returned Check Charge

A fee of $20.00 will be charged whenever a check or draft presented for payment for service is not accepted by the institution on which it is written.

2.15 Reconnection Charge

A reconnection fee of $25.00 per occurrence will be charged when service is reestablished for Customers which have been disconnected due to non-payment. Payment of the reconnection fee and any other outstanding amounts will be due in full prior to reconnection of service.

SECTION 3 - DESCRIPTION OF SERVICE

3.1 Computation of Charges

3.1.1 The total charge for each completed call may be a variable measured charge dependent on the duration, distance and time of day of the call. The total charge for each completed call may also be dependent only on the duration of the call, i.e. a statewide flat rate per minute charge. The variable measured charge is specified as a rate per minute which is applied to each minute. All calls are measured in increments as set forth in the Rates Section of this tariff. All calls are rounded up to the next whole increment.

3.1.2 Where mileage bands appear in a rate table, rates for all calls are based upon the airline distance between the originating and terminating points of the call, as determined by the vertical and horizontal coordinates associated with the exchange (the area code and three digit central office code) associated with the originating and terminating telephone numbers. If the Customer obtains access to the Company's network by a dedicated access circuit, that circuit will be assigned an exchange for rating purposes based upon the Customer's main telephone number at the location where the dedicated access circuit terminates. The vertical and horizontal (V & H) coordinates for each exchange and the airline distance between them will be determined according to industry standards.

3.1.3 Timing begins when the called station is answered and two way communication is possible, as determined by standard industry methods generally in use for ascertaining answer, including hardware answer supervision in which the local telephone company sends a signal to the switch or the software utilizing audio tone detection. Recognition of answer supervision is the responsibility of the Underlying Carrier. Timing for each call ends when either party hangs up. The Company will not bill for uncompleted calls.

3.2 Customer Complaints and/or Billing Disputes

Customer inquiries or complaints regarding service or accounting may be made in writing or by telephone to the Company at:

67 Inverness Drive East
Englewood, Colorado 80112
(800) 531-4245

An objection to billed charges should be reported promptly to the Company. Adjustments to Customers' bills shall be made to the extent that records are available and/or circumstances exist which reasonably indicate that such charges are not in accordance with approved rates or that an adjustment may otherwise be appropriate.

The Company will respond within seventy two (72) hours of receipt of an inquiry. If the Customer is dissatisfied with the Company's response to a complaint or inquiry, the Customer may file a complaint with the Commission for resolution of the conflict. The South Dakota Public Utilities Commission can be reached at:

500 East Capitol
Pierre, SD 57501-5070
(605) 773-3201
(800) 332-1782
TTY through Relay Service South Dakota-
(800) 877-1113

If a Customer accumulates more than One Dollar of undisputed delinquent Company 800 Service charges, the Company Resp. Org. reserves the right not to honor that Customer's request for a Resp. Org. change until such undisputed charges are paid in full.

3.3 <u>Level of Service</u>

A Customer can expect end to end network availability of not less than 99% at all times for all services.

3.4 <u>Billing Entity Conditions</u>

When billing functions on behalf of the Company or its intermediary are performed by local exchange telephone companies or others, the payment of charge conditions and regulations of such companies and any regulations imposed upon these companies by regulatory bodies having jurisdiction apply. The Company's name and toll-free telephone number will appear on the Customer's bill.

3.5 Service Offerings

3.5.1 1+ Dialing

This service permits Customers to originate calls via switched or dedicated access lines, and to terminate intrastate calls. The customer dials "1+" followed by "ten digits" or dials "101XXXX" followed by "1+ ten digits".

3.5.2 Travel Cards

The Customer utilizes an 11 digit "toll-free" access number established by the Company to access a terminal. Upon receiving a voice prompt, the Customer uses push button dialing to enter an identification code assigned by the Company, and the ten digit number of the called party.

3.5.3 800 Service (Toll-Free)

This service is inbound calling only where an 800, 888 or other toll-free prefix number rings into a Customer's premise routed to a specific telephone number or terminated over a dedicated facility.

3.5.4 Reserved for Future Use

Reserved for Future Use

3.5.5 Directory Assistance.

Access to long distance directory assistance is obtained by dialing 1 + 555-1212 for listings within the originating area code and 1 + (area code) + 555-1212 for other listings. When more than one number is requested in a single call, a charge will apply for each number requested. A charge will be applicable for each number requested, whether or not the number is listed or published.

3.5.6 Specialized Pricing Arrangements.

Customized service packages and competitive pricing packages at negotiated rates may be furnished on a case-by-case basis in response to requests by Customers to the Company for proposals or for competitive bids. Service offered under this tariff provision will be filed with the Commission. Specialized rates or charges will be made available to similarly situated Customers on a non-discriminatory basis. The Company will notify the Commission of such arrangements as required by Commission rules and regulations.

3.5.7 Emergency Call Handling Procedures

Emergency "911" calls are not routed to company, but are completed through the local network at no charge.

3.5.8 Promotional Offerings

The Company may, from time to time, make promotional offerings to enhance the marketing of its services. These offerings may be limited to certain dates, times and locations. The Company will notify the Commission of such offerings as required by Commission rules and regulations.

SECTION 4 - RATES

4.1 1+ Dialing

$0.22 per minute

A $4.95 per month service charge applies.
Billed in one minute increments.

4.2 Travel Cards

$.35 per minute

A $.25 per call service charge applies.
Billed in one minute increments.

4.3 Toll Free

$0.22 per minute

A $10 per month per number service charge applies.
Billed in one minute increments.

4.4 Reserved for Future Use

4.5 Directory Assistance

$.95

4.6 Returned Check Charge

$20.00

4.7 Rate Periods

	Monday - Friday	Sat.	Sun.
8 a.m. to 5 p.m.*	Daytime Rate Period		
5 p.m. to 11 p.m.*	Evening Rate Period		Evening Rate Period
11 p.m. to 8 a.m.*	Night/Weekend Rate Period		

* To, but not including

When a message spans more than one rate period, total charges for the minutes in each rate period are calculated and the results for each rate period are totaled to obtain the total message charge. If the calculation results in a fractional charge, the amount will be rounded down to the lower cent.

4.8 Payphone Dial Around Surcharge

A dial around surcharge of $.35 per call will be added to any completed INTRAstate toll access code and subscriber 800/888 type calls placed from a public or semi-public payphone.

4.9 Universal Service Fund Assessment & Presubscribed Interexchange Carrier Charge

The Customer will be assessed a monthly Universal Service Fund Contribution charge on all telecommunications services, which in no event shall be less than the prevailing contribution percentage rate charged the Company on intrastate traffic by any state agency or its administrator. A Presubscribed Interexchange Carrier Charge ("PICC") applies on a monthly basis to all Customer monthly bills at the prevailing rate.

T-NETIX, INC.
67 INVERNESS DRIVE EAST
ENGLEWOOD, CO 80112
(303) 790-9111

Check No. - 63945
Check Date - 09/18/00

DETACH STATEMENT BEFORE DEPOSITING

Stub 1 of 1

INVOICE NUMBER	DATE	DESCRIPTION	GROSS AMOUNT	DEDUCTIONS	AMOUNT
LD FILING	091800	Interent filing fee	250.00		
			250.00		

TC00-138

THIS CHECK IS VOID WITHOUT A COLORED BACKGROUND AND HAS MICROPRINTING

T-NETIX, INC.
67 INVERNESS DRIVE EAST
ENGLEWOOD, CO 80112
(303) 790-9111

BANK ONE, N.A.
CIRCLEVILLE, OH OFFICE
1-800-310-1111
56-1544/441

CHECK NO. 63945

DATE	AMOUNT
09/18/00	*********250.00

3004

PAY

TWO HUNDRED FIFTY AND 00/100 **

TO THE ORDER OF:

State of South Dakota
Public Utilities Commission
500 E. Capitol
Pierre, SD 57501-5070

John Gaine

⑈063945⑈ ⑆044115443⑆ 6271201579⑈

South Dakota Public Utilities Commission
WEEKLY FILINGS
For the Period of September 21, 2000 through September 27, 2000

If you need a complete copy of a filing faxed, overnight expressed, or mailed to you, please contact Delaine Kolbo within five business days of this filing.
Phone: 605-773-3705 Fax: 605-773-3809

CONSUMER COMPLAINTS

CT00-104 **In the Matter of the Complaint filed by Joan Clark, Yankton, South Dakota, against AT&T Communications of the Midwest, Inc. Regarding Unauthorized Switching of Long Distance Carrier.**

The complainant alleges that when she established new telephone services she was switched to AT&T without her authorization. She had selected another long distance carrier. The complainant requests compensation for the unauthorized switching and for her AT&T charges to be rerated to the rate her selected carrier would have charged.

Staff Analyst: Charlene Lund
Staff Attorney: Karen E. Cremer
Date Docketed: 09/25/00
Intervention Deadline: NA

ELECTRIC

EL00-027 **In the Matter of the Petition filed by Northern States Power Company d/b/a Xcel Energy, Inc. for Approval of Modifications to the Small General Time of Day Service.**

On September 21 2000, Northern States Power Company d/b/a Xcel Energy, Inc. filed a petition for modifications to its Small General Time of Day Service. The main purpose of the modifications is to provide for an additional type of service under this rate for customers with numerous, low wattage devices.

Staff Analyst: Heather Forney
Staff Attorney: Karen Cremer
Date Docketed: 09/21/00

TELECOMMUNICATIONS

TC00-137 **In the Matter of the Application of Americatel Corporation d/b/a 10 123 Americatel and 1010 123 Americatel to Amend its Certificate of Authority to Offer Prepaid Calling Cards.**

Americatel Corporation, d/b/a 10 123 Americatel and 1010 123 Americatel (Americatel) was granted a certificate of authority to provide telecommunications services in South Dakota on March 28, 1998, subject to the condition that it not offer prepaid calling card service without prior approval from the Commission. On September 21, 2000, Americatel submitted an application to revise its tariff to provide for prepaid calling card service.

Staff Analyst: Heather Forney
Date Docketed: 09/21/00
Intervention Deadline: 10/13/00

TC00-138 **In the Matter of the Application of T-NETIX Internet Services, Inc. for a Certificate of Authority to Provide Telecommunications Services in South Dakota.**

T-NETIX Internet Services, Inc. is seeking a Certificate of Authority to provide interexchange telecommunication services in South Dakota. The applicant is a reseller that intends to offer interexchange services including 1+ and 101XXXX outbound dialing, toll free inbound dialing, directory assistance, data services and travel card services.

Staff Analyst: Keith Senger
Date Docketed: 09/22/00
Intervention Deadline: 10/13/00

TC00-139 **In the Matter of the Filing for Approval of a Boundary Change between Valley Telecommunications Cooperative Association, Inc. and West River Telecommunications Cooperative.**

Valley Telecommunications Cooperative Association, Inc. and West River Telecommunications Cooperative filed a joint application for approval of a boundary change between the Mobridge and Glenham Exchanges. The proposed change moves the staggered and inconsistent boundary lines to section lines or county roads.

Staff Analyst: Keith Senger
Staff Attorney: Karen Cremer
Date Docketed: 09/25/00
Intervention Deadline: 10/13/00

TC00-140 **In the Matter of the Application of Telicor, Inc. for a Certificate of Authority to Provide Telecommunications Services, Including Local Exchange Services, in South Dakota.**

Telicor Inc. has filed for a Certificate of Authority to provide resold and facilities-based local exchange and interexchange service within the State of South Dakota. Telicor intends to provide 1+ and 101XXXX outbound dialing, 800/888 toll-free inbound dialing, calling cards and data services, as well as switched local exchange service, non-switched local service (e.g. private line), Centrex and/or Centrex-like services, DSL, ISDN, and other high capacity line services.

Staff Analyst: Michele Farris
Date Docketed: 09/27/00
Intervention Deadline: 10/13/00

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE APPLICATION OF T-NETIX INTERNET SERVICES, INC. FOR A CERTIFICATE OF AUTHORITY TO PROVIDE TELECOMMUNICATIONS SERVICES IN SOUTH DAKOTA	)))))	**ORDER GRANTING CERTIFICATE OF AUTHORITY** **TC00-138**

On September 22, 2000, the Public Utilities Commission (Commission), in accordance with SDCL 49-31-3 and ARSD 20:10:24:02, received an application for a certificate of authority from T-NETIX Internet Services, Inc. (T-NETIX).

T-NETIX proposes to offer interexchange services, including 1+ and 101XXXX outbound dialing, 800/888 toll-free inbound dialing, directory assistance, data services and travel card services. A proposed tariff was filed by T-NETIX. The Commission has classified long distance service as fully competitive.

On September 28, 2000, the Commission electronically transmitted notice of the filing and the intervention deadline of October 13, 2000, to interested individuals and entities. No petitions to intervene or comments were filed and at its October 17, 2000 meeting, the Commission considered T-NETIX's request for a certificate of authority. Commission Staff recommended granting a certificate of authority, subject to the condition that T-NETIX not offer a prepaid calling card or require deposits or advance payments without prior approval of the Commission. Commission Staff further recommended a waiver of ARSD 20:10:24:02(8).

The Commission finds that it has jurisdiction over this matter pursuant to SDCL Chapter 49-31, specifically 49-31-3 and ARSD 20:10:24:02 and 20:10:24:03. The Commission finds that T-NETIX has met the legal requirements established for the granting of a certificate of authority. T-NETIX has, in accordance with SDCL 49-31-3, demonstrated sufficient technical, financial and managerial capabilities to offer telecommunications services in South Dakota. Further, the Commission finds that there is good cause to waive ARSD 20:10:24:02(8). The Commission approves T-NETIX's application for a certificate of authority, subject to the condition that T-NETIX not offer a prepaid calling card or require deposits or advance payments without prior approval of the Commission. As the Commission's final decision in this matter, it is therefore

ORDERED, that T-NETIX's application for a certificate of authority is hereby granted, effective November 22, 2000, subject to the condition that T-NETIX not offer a prepaid calling card or require deposits or advance payments without prior approval of the Commission. It is

FURTHER ORDERED, that the Commission finds good cause to waive ARSD 20:10:24:02(8). It is

FURTHER ORDERED, that T-NETIX shall file informational copies of tariff changes with the Commission as the changes occur.

Dated at Pierre, South Dakota, this 20th day of October, 2000.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that this document has been served today upon all parties of record in this docket, as listed on the docket service list, by first class mail, in properly addressed envelopes, with charges prepaid thereon.

By: Delaine Kolbo

Date: 10/23/00

(OFFICIAL SEAL)

BY ORDER OF THE COMMISSION:

James A. Burg
JAMES A. BURG, Chairman

Pam Nelson
PAM NELSON, Commissioner

Laska Schoenfelder
LASKA SCHOENFELDER, Commissioner

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

CERTIFICATE OF AUTHORITY

To Conduct Business As A Telecommunications Company
Within The State Of South Dakota

Authority was Granted October 17, 2000, effective November 22, 2000
Docket No. TC00-138

This is to certify that

T-NETIX INTERNET SERVICES, INC.

is authorized to provide telecommunications services in South Dakota.

This certificate is issued in accordance with SDCL 49-31-3 and ARSD 20:10:24:02, and is subject to all of the conditions and limitations contained in the rules and statutes governing its conduct of offering telecommunications services.

Dated at Pierre, South Dakota, this 20th day of October, 2000.

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION:

JAMES A. BURG, Chairman

PAM NELSON, Commissioner

LASKA SCHOENFELDER, Commissioner