TC02-120

TC02-120

DOCKET NO.

In the Matter of — IN THE MATTER OF THE APPLICATION OF INTER-TEL NETSOLUTIONS, INC. FOR A CERTIFICATE OF AUTHORITY TO PROVIDE INTEREXCHANGE TELECOMMUNICATIONS SERVICES IN SOUTH DAKOTA

Public Utilities Commission of the State of South Dakota

DATE		MEMORANDA
9/4	02	Filed and Docketed;
9/5	02	Weekly Filing;
9/27	02	Supplement to Application;
3/7	03	Order Granting COA;
3/7	03	Docket Closed.

STATE PUBLISHING CO., PIERRE, SOUTH DAKOTA—SMEAD 104 SP14130

TC02-120

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September 3, 2002

RECEIVED
SEP - 4 2002
SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

<u>Via Federal Express</u>
(605) 773-3201

Ms. Debra Elofson
Executive Director
South Dakota Public Utilities Commission
Capitol Building, 1st Floor
500 East Capitol Avenue
Pierre, South Dakota 57501-5070

Dear Ms. Elofson:

I am enclosing an original and 10 copies of Inter-Tel NetSolutions, Inc.'s Petition for a Certificate of Authority to provide interexchange telecommunications services in South Dakota. I am enclosing an extra copy of this letter and the Petition to be file-stamped and returned to me in the enclosed postage-paid envelope.

Sincerely yours,

Bradford W. Bayliff

Enclosures

TC02-120

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE APPLICATION OF INTER-TEL NETSOLUTIONS, INC. FOR A CERTIFICATE OF AUTHORITY TO PROVIDE INTEREXCHANGE TELECOMMUNICATIONS SERVICES IN SOUTH DAKOTA)	**CASE NO.**____

RECEIVED
SEP - 4 2002
SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

PETITION FOR A CERTIFICATE OF AUTHORITY

Comes now, Inter-Tel NetSolutions, Inc. (NetSolutions), by its undersigned counsel, and hereby applies pursuant to SDCL 49-31-1, ARSD 20:10:24:02, and the Federal Telecommunications Act of 1996, for authority to provide interexchange telecommunications service within the state of South Dakota. In support of this application, NetSolutions states as follows:

1. Name, address, and telephone number of the Applicant

NetSolutions' corporate address is 3550 North Central Avenue, Suite 800, Phoenix, Arizona 85012.

2. The name under which the Applicant will provide its services

The Applicant will provide services as Inter-Tel NetSolutions, Inc.

3. The Applicant is a corporation.

a. The state in which the Applicant is incorporated, its date of incorporation, and its Certificate of Authority to transact business in South Dakota

The Applicant is a corporation duly organized and existing under and by the virtue of the laws of the State of Texas on June 19, 1990. The Applicant's Certificate of Authority of a Foreign Corporation is attached as Exhibit A to this application.

b. The location of the Applicant's principal office, if any in South Dakota, and the name and address of its current registered agent

The Applicant does not have any offices in South Dakota at this time. Its registered agent in South Dakota is:

Corporation Service Company
503 South Pierre Street
Pierre, South Dakota 57501

c. The name and address of each corporation, association, partnership, cooperative, or individual holding a 20 percent or greater ownership or management interest in the applicant corporation and the amount and character of the ownership or management interest.

NetSolutions is a wholly owned subsidiary of Inter-Tel. Inter-Tel is a well-established and reputable company that has for more than 30 years researched, engineered, produced, distributed, installed, and serviced advanced business telephone systems and related products and systems that are among the most technologically advanced in the industry. Inter-Tel is a leading provider of business key telephone systems and related call processing software, voice processing software and call accounting software. Inter-Tel's products include the AXXESS business telephone system, AXXESSORY Talk voice mail system, Executone computer telephony products, the InterPrise voice and data routers, and ClearConnect e-commerce software. Inter-Tel also provides maintenance, leasing and support services for its products. Inter-Tel's Common Stock is quoted on the Nasdaq National Market System under the symbol INTL.

The Applicant's principal corporate officers and directors are: Jon Brinton, President; Steven G. Mihaylo, Vice President and Director; Kurt R. Kneip, Vice President, Secretary, and Director; John C. Abbott, Treasurer, and Ross E. McAlpine, Director. Each of the corporate officers may be contacted at the Applicant's corporate offices.

4. Representation in this cause

NetSolutions is represented in this cause by Bradford W. Bayliff, Casey & Gentz, LLP, Suite 1060, 919 Congress Avenue, Austin, Texas, (512) 225-0027. All inquires, correspondence, communications, pleadings, notices, orders and decisions relating to this case should be addressed to:

Attorney: Bradford W. Bayliff
Casey & Gentz, L.L.P.
919 Congress Avenue, Suite 1060
Austin, Texas 78701
(512) 225-0027 (Telephone)
(512) 480-9200 (Fax)
bbayliff@phonelaw.com

5. Description of the Telecommunications Services the Applicant Proposes to Provide.

NetSolutions provides a variety of long distance calling services, including domestic and international calling services, 800 calling services, dedicated services, voice and video conferencing, customized billing, and a variety of other telecommunication services. NetSolutions resells long distance services only to business customers of its affiliates and its parent, Inter-Tel, Inc. (Inter-Tel). Examples of the customers provided service by NetSolutions include call centers using T-1 access for incoming toll-free traffic, sales offices using NetSolutions' long distance, and companies linking multiple offices throughout the country on a frame relay network.

6. A detailed statement of the means by which the applicant will provide its services.

NetSolutions does not request authority to provide interexchange services in South Dakota using its own equipment. The Applicant will resell the services of carriers that have facilities in South Dakota.

7. The geographic areas in which the services will be offered or a map describing the service area.

NetSolutions proposes to offer telecommunications services to small businesses throughout the state of South Dakota.

8. Information demonstrating the Applicant's Financial Capacity to Provide Service and a copy of the Applicant's tariff with the terms and conditions of service.

NetSolutions has the financial capability to provide interexchange service for the benefit of the public. The Applicant has been a viable and profitable company since it began providing service in 1991 and has grown in each year of its existence. NetSolutions intends to meet its working capital needs through the generation of operating revenues.

If economic circumstances force NetSolutions to turn to outside sources of funding, it will make use of its relationship with, and the assets of, its parent company, Inter-Tel. Inter-Tel formed NetSolutions to better serve Inter-Tel's equipment customers by offering long distance services that Inter-Tel's customers may use in conjunction with its telephone systems. NetSolutions is uniquely capable of fulfilling Inter-Tel's customers' telecommunications needs because some of Inter-Tel's customers desire the convenience of acquiring long distance calling services through the same vendor that the customer uses to purchase its telephony equipment and other services. Inter-Tel is committed to the success of NetSolutions and will provide capital as necessary for NetSolutions' operations. As evidence of the Applicant's soundness and ability to provide intrastate toll services within South Dakota, Inter-Tel's audited financial statements for 1999, 2000, and 2001 are provided as Exhibit B. The Applicant's proposed tariff is attached as Exhibit C.

9. The names, addresses, telephone number, fax number, e-mail address, and toll-free number of the applicant's representatives to whom all inquiries must be made regarding complaints and regulatory matters and a description of how the applicant handles customer billings and customer service matters

Corporate
Representative: Jon Brinton
President
3550 North Central Avenue, Suite 800

Phoenix, Arizona 85012-2190
(602) 253-6004 telephone
(800) 894-7026 toll-free telephone

Customer Service:

Allison Andrews
Manager of Provisioning and Customer Service
Inter-Tel NetSolutions, Inc.
885 Trademark Drive
Reno, Nevada 89511
(800) 821-1661 Telephone
(800) 814-5860 FAX
Allison_Andrews@inter-tel.com

Regulatory Matters:

Dave Read
Director of Operations
Inter-Tel NetSolutions, Inc.
885 Trademark Drive
Reno, Nevada 89511
(866) 897-3283 Telephone
(800) 814-5860 FAX
Dave_Read@inter-tel.com

NetSolutions resells long distance services only to business customers of its affiliates and Inter-Tel and residential services to its employees and employees of its customers, affiliates, and Inter-Tel. NetSolutions is uniquely capable of fulfilling Inter-Tel's customers' telecommunications needs because some of Inter-Tel's customers desire the convenience of acquiring long distance calling services through the same vendor that the customer uses to purchase its telephony equipment and other services. NetSolutions is authorized to provide service in over thirty states and is engaged in the process of applying for certification in all 50 states. The same management team responsible for the Applicant's operations in those jurisdictions will oversee all operations in Rhode Island.

The Applicant's Customer Service Division follows sound practices and procedures to ensure that slamming and cramming do not occur and that it responds promptly to customer inquiries and complaints. Customers may contact the Applicant's Customer Service Division concerning repairs and maintenance, complaints, billing questions, refunds, and any other customer service-related inquiries at:

Customer Service
Inter-Tel NetSolutions, Inc.
885 Trademark Drive
Reno, Nevada 89511

If a customer prefers to discuss a matter with a Customer Service Representative, he may call (800) 821-1661. Customer Service Representatives are available to assist with customer service and billing inquiries Monday through Friday between 5:00 a.m. and 6:00 p.m., Pacific Time. Emergency service is available at the same number twenty-four hours a day, seven days a week using a voice mailbox for messages or a pager option to request a call from an on-call Customer Service Representative or Supervisor.

10. A list of the states in which the applicant is registered or certified to provide telecommunications services, whether the applicant has ever been denied registration or certification in any state and the reasons for such denial, as statement as to whether the applicant is in good standing with the appropriate regulatory agency in the states where it is registered or certified, and a detailed explanation of why the applicant is not in good standing in a given state, if applicable.

The Applicant is currently authorized to provide and is providing interexchange services in 33 other jurisdictions: Alabama, Arizona, California, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Minnesota, Missouri, Montana, Nebraska, Nevada, New Jersey, New Mexico, New York, North Carolina, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin, and West Virginia. The Applicant also is authorized to provide local exchange services in Texas and Illinois. The same management team responsible for the Applicant's operations in those jurisdictions will oversee all operations in Arkansas.

NetSolutions was authorized to provide local exchange services in Florida on November 25, 1997, in Docket No. 971196-TX, Order No. PSC-97-1494-FOF-TX. NetSolutions never began providing local exchange service in Florida. NetSolutions' Florida local service authorization was revoked on April 13, 2000, in Docket No. 000228-TX, Order No. PSC-00-0694-SC-TX. The authorization was revoked for failure to provide information necessary for inclusion in the Florida Public Service Commission's local competition report as required by Section 364.386, Florida Statutes. NetSolutions failed to respond to a Show Cause Order in a timely manner and ALEC certificate number 5285 was cancelled. NetSolutions has not requested reauthorization to provide local service because it intends to focus on the provision of interexchange services.

NetSolutions has provided intrastate toll service in Oklahoma since it was granted its interexchange resale Certificate of Convenience and Necessity (CCN) on August 6, 1997, in Cause No. PUD 96-366, Order No. 414843. The Oklahoma Corporation Commission revoked the Applicant's CCN on December 13, 2001, in Cause No. PUD 2001-533, Order No. 458964, for failure to report intrastate billed revenues and failure to contribute to the Oklahoma Universal Service Fund (OUSF).

NetSolutions corrected its compliance status with the Oklahoma Corporation Commission. NetSolutions provided all past-due reports to the Oklahoma Corporation Commission and the National Exchange Carrier Association, the Commission's contractor for OUSF collections. The Applicant's payments associated with the OUSF reports are current. NetSolutions reapplied for authorization to provide service in Oklahoma. Temporary authority to continue providing service to NetSolutions' five current customers in Oklahoma was granted and NetSolutions expects that its application will be approved.

The Applicant's failure to comply with the Commission's regulations and respond to Commission requests for information did not affect the service of customers in a negative manner. The NetSolutions management team understands the serious nature of the Applicant's failure to respond to the Commission in a timely manner and is taking proactive steps to increase its oversight and review of the Applicant's policies, procedures, and practices. The Applicant is designing and implementing new systems to prevent failures in its ability to respond to inquiries from Commission staff and to file its required reports in a timely manner.

NetSolutions is standardizing its procedures to utilize the same corporation services company to receive service of process notices in each state in which it provides service. The Applicant is listing members of its management team are listed as its corporate and regulatory contacts with each Secretary of State and regulatory commission. These steps are intended to ensure that service of process and regulatory notices are served upon persons with the responsibility and authority to respond to them.

11. <u>A description of how the applicant intends to market its services, its target market, whether the applicant engages in any multilevel marketing, and copies of any company brochures used to assist in the sale of services.</u>

The Applicant does not market its services to the general public and limits its customer base to existing and potential customers of its affiliates and Inter-Tel, Inc. (Inter-Tel). Inter-Tel formed NetSolutions to better serve Inter-Tel's equipment customers by offering long distance services that Inter-Tel's customers may use in conjunction with its telephone systems. NetSolutions is uniquely capable of fulfilling Inter-Tel's customers' telecommunications needs because some of Inter-Tel's customers desire the convenience of acquiring long distance calling services through the same vendor that the customer uses to purchase its telephony equipment and other services. NetSolutions does not engage in any multilevel marketing.

12. Cost support for rates shown in the company's tariff for all noncompetitive or emerging competitive services.

The Applicant resells interexchange services at or above its cost.

13. The applicant's federal tax identification number.

The Applicant's federal tax identification number is 51-000-9810.

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.

NetSolutions utilizes specially trained Customer Service Representatives to respond to customer complaints regarding NetSolutions' service. Every complaint is recorded and Customer Service Representatives attempt to resolve the complaint on the initial call. If the complaint is not resolved on the initial call, the Customer Service Representative who takes the original call retains responsibility for resolving the complaint. Each step of the Applicant's troubleshooting activity is documented and the customer is given follow-up reports as appropriate. The average complaint is resolved within one business day.

If there is still disagreement about a service problem, the matter will be reviewed by a Customer Service Manager. If the matter is still not resolved, NetSolutions will inform the customer of the customer's right to contact the Oklahoma Corporation Commission. Since NetSolutions began reselling long distance in 1991, it has never had a customer complaint escalate to the Commission level.

15. A written request for waiver of those rules the applicant believes to be inapplicable

The Applicant requests waiver of ARSD 20:10:06:05 and 20:10:06:09 of the Rules. Those sections require the Applicant to retain customer records for a period of six years. No other state requires the Applicant to retain its records for a period of six years. The Federal Communications

Commission requires the Applicant to retain its records for a period of two years and the Applicant complies with that requirement. Additional requirements for South Dakota would be burdensome and impose excessive expense upon the Applicant.

16. Information demonstrating the Applicant's Technical Abilities and Managerial Resources to Provide Service

NetSolutions possesses the managerial and technical capabilities to provide interexchange service to its customers. The Applicant is currently authorized to provide and is providing interexchange services in 33 other jurisdictions: Alabama, Arizona, California, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Minnesota, Missouri, Montana, Nebraska, Nevada, New Jersey, New Mexico, New York, North Carolina, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin, and West Virginia. The Applicant also is authorized to provide local exchange services in Texas and Illinois. The same management team responsible for the Applicant's operations in those jurisdictions will oversee all operations in South Dakota. The management and telecommunications experience of the Applicant's corporate officers and directors and of its management team is provided as Exhibit D.

17. Other Information Relevant to the Application

NetSolutions agrees to comply with all applicable statutes and Commission rules and to meet all relevant service standards related, but not limited to, billing, quality of service and tariff filing and maintenance.

NetSolutions submits that the public interest will be served by Commission approval of this application because NetSolutions' proposed services will create and enhance competition and expand customer service options consistent with the legislative goals set forth in the Federal

Telecommunications Act of 1996. Prompt approval of this application also will expand the availability of innovative, high quality and reliable telecommunications services within the state of South Dakota. The grant of a certificate of service authority to NetSolutions to provide interexchange telecommunications services within South Dakota will benefit the public because it will increase competition and customer choice for users of exchange access and local exchange services. By increasing competition, NetSolutions' provision of service is expected to improve the price and quality of telephone service in South Dakota. Moreover, NetSolutions' entry into the market will neither prejudice nor disadvantage any class of telephone customers or providers. To the contrary, the presence of another authorized carrier will provide additional consumer choice, promote competition, lower prices and stimulate development of additional telecommunications services.

WHEREFORE, Inter-Tel NetSolutions, Inc. respectfully requests that the Commission grant it a certificate of public convenience and necessity to provide interexchange telecommunications services as herein requested, and such other relief as the Commission deems reasonable.

Respectfully submitted,

CASEY & GENTZ, L.L.P.
919 Congress Avenue, Suite 1060
Austin, Texas 78701
(512) 225-0027 [Telephone]
(512) 480-9200 [Fax]

By: ______________________

Bradford W. Bayliff

ATTORNEYS FOR APPLICANT INTER-TEL NETSOLUTIONS, INC.

EXHIBIT A

CERTIFICATE OF AUTHORITY TO OPERATE AS A FOREIGN CORPORATION

State of South Dakota

OFFICE OF THE SECRETARY OF STATE

Certificate of Authority

ORGANIZATIONAL ID #: FB026299

I, JOYCE HAZELTINE, Secretary of State of the State of South Dakota, hereby certify that the Application for a Certificate of Authority of **INTER-TEL NETSOLUTIONS, INC. (TX)** 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 29, 2002.

Joyce Hazeltine

Joyce Hazeltine
Secretary of State

Cert of Authority Merge.doc

EXHIBIT B

2001 SEC FORM 10-K OF INTER-TEL, INC.

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

FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2001	**Commission File Number: 0-10211**

INTER-TEL, INCORPORATED

Incorporated in the State of Arizona	**I.R.S. No. 86-0220994**

1615 S. 52nd Street
Tempe, Arizona 85281
(480) 449-8900

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

Common Stock
(24,190,130 shares outstanding as of March 8, 2002)

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant, based upon the last reported sales price of Inter-Tel's Common Stock reported on the Nasdaq National Market System on March 8, 2002 was approximately $351.8 million. Shares of Common Stock held by each executive officer and director have been excluded in that such persons may be deemed to be affiliates.

Items 10 (as to Directors), 11 and 12 of Part III incorporate by reference information from the Registrant's Proxy Statement relating to its 2002 Annual Meeting of Shareholders.

INTER-TEL, INCORPORATED
2001 FORM 10-K ANNUAL REPORT

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PART I

ITEM 1. BUSINESS

The Company

This Annual Report to Shareholders on Form 10-K ("10-K") contains forward-looking statements that involve risks and uncertainties. The statements contained in this 10-K that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including without limitation statements regarding the Company's expectations, beliefs, intentions or strategies regarding the future. All forward-looking statements included in this document are based on information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statements. The cautionary statements made in this 10-K should be read as being applicable to all related forward-looking statements wherever they appear in this document. The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under "Factors That May Affect Future Operating Results" below and elsewhere in this document. In evaluating the Company's business, shareholders and prospective investors should consider carefully the following factors in addition to the other information set forth in this document.

Inter-Tel, incorporated in 1969, is a single point of contact, full service provider of business communications systems, voice mail systems and networking applications. We market and sell voice processing and unified messaging software, call accounting software, Internet Protocol (IP) telephony software, computer-telephone integration (CTI) applications, long distance calling services, and other communications services. Our products and services include the *Axxess* by Inter-Tel and *Eclipse²* by Inter-Tel business communication systems, with integrated voice processing and unified messaging systems, IP telephony voice and data routers, and ClearConnect Talk-to-Agent e-commerce software. We also provide maintenance, leasing and support services for our products. Our customers include business enterprises, government agencies and non-profit organizations. Our common stock is quoted on the Nasdaq National Market System under the symbol "INTL."

We have developed a distribution network of direct sales offices, dealers and value added resellers (VARs), which sell our products to organizations throughout the United States and internationally, including to divisions of Fortune 500 companies, large service organizations and governmental agencies. As of December 31, 2001, we had 49 direct sales offices in the United States and one in Japan, and a network of hundreds of dealers and VARs around the world that purchase directly from us. We also maintain a wholesale distribution office in the United Kingdom that supplies Inter-Tel's dealers and distributors throughout the UK and parts of Europe. In January 2002, we acquired selected assets and assumed certain selected liabilities of McLeod USA, Inc. (McLeod). As a result, we added 5 new direct sales offices and we added personnel to 3 other existing sales offices.

Industry Background

Since the mid-1980s, the global telecommunications industry has been characterized by rapid structural change caused by technological innovation, economic factors and changes in government policies that encourage competition and increase consumer choice. These changes are evidenced by the growing impact of the Internet, deregulation, optical networking technology, broadband connectivity, wireless and mobile communications and demand by enterprises for cost-effective, multi-functional networks and applications.

As a result of the changes in the telecommunications industry, it is expected that customers will demand more complex networks over the next several years. In addition, network platforms are expected to become increasingly multifunctional, supporting the convergence of voice, data and video communications services, thus reducing the operating costs associated with separate networks and facilitating the development of advanced, converged applications.

Businesses increasingly recognize data networks such as the Internet as a valuable and cost-efficient medium for internal and public communications. In order to reduce their telecommunications costs, businesses are moving their voice communications to packet-switched networks, such as corporate intranets and the Internet. Although packet-switched networks can offer more efficiency and value to businesses, the traditional telephone network remains the standard for voice communications today. As a result, businesses that wish to take advantage of packet-switched networks for voice communications must still be able to place and receive calls over the traditional telephone network with customers, suppliers and others who rely solely on the traditional circuit-switched telephone network for voice communications.

In addition, businesses typically make substantial investment in traditional voice systems and networks and do not wish to abandon that investment in order to implement entirely new converged voice and data platforms. Rather than discarding an entire legacy system, many businesses choose to supplement existing systems with new software and applications, including remote telecommunications network management, enhanced voicemail and packet-switched voice applications. For example, businesses may wish to route external calls over their existing voice network and route internal calls between offices over data networks, such as an intranet or the Internet, all using the same telecommunications system. Consequently, there is a need for a communication system that can interface with both packet-switched networks and the traditional circuit-switched telephone network utilizing a business' existing telecommunications infrastructure.

A new generation of telecommunications systems has emerged over the last several years to address the challenges and inadequacies associated with traditional circuit-switched private telephone systems. Many existing telecommunications systems do not address the needs of businesses that wish to transmit voice communications over both the traditional circuit-switched telephone network and packet-switched data networks. We believe a significant opportunity exists to provide businesses with an integrated solution that delivers the benefits of integrated, multifunction communications systems using both intranets and the Internet, as well as the traditional circuit-switched telephone network and allows those businesses to migrate to a fully converged voice, video and data network at their own pace.

Strategy

Inter-Tel's objective is to continue to strengthen its position as a leading single-source provider of business communications equipment, software applications and network services. Our strategy incorporates the following key elements:

Offer Total Communications Solution

Inter-Tel offers a broad range of products and services that incorporate advanced technologies and provide customers with a single source to cost-effectively fulfill their business communications needs. We couple this solution-oriented approach with a high level of customer service and support and a commitment to quality throughout our operations. Our business communications systems are integrated with our fully-integrated computer-telephone applications and include voice mail, auto attendant, unified messaging, call center applications, Interactive Voice Response (IVR), wireless applications, Automatic Call Distribution (ACD), long distance and networking services, together with a variety of other communications applications. Because of the modular design of our systems and the high level of software content in our products, customers can readily increase the size and functionality of their systems as their needs change by adding new services, software and hardware applications, or by upgrading to new systems or advanced versions of their existing systems. We believe that our customers prefer to purchase business communications equipment and services from a single source because of the convenience, consistency of service, ease of upgrade, availability of financing alternatives and confidence in the performance of integrated systems and services all incorporated into a total solution package.

Facilitate the Convergence of Voice, Video and Data Networks

Inter-Tel's business communications systems allow our customers to migrate their business communications systems to enable real-time voice communications to be transmitted on digital packet-switched networks as well as traditional circuit-switched telephone networks. In this regard, Inter-Tel's *Axxess* and *Eclipse²* systems, Versions 5.x and 6.x software, IP phones and Softphones for work at home and remote office locations, IP telephony voice and data routers, voice and data convergence applications, voice disaster recovery software applications, Internet and wireless application protocol (WAP) software applications and e-commerce voice enabled call center applications, allow customers to incorporate the benefits of Internet protocol communication (or communication over packet-switched networks) without replacing their existing Inter-Tel business communications system infrastructure. Moreover, Inter-Tel's Version 6.0 software released in the first quarter of 2002 uses Internet Protocol and Asynchronous Transfer Mode, or ATM, to address larger system configurations.

Leverage Customer Base

We will continue to leverage our relationships with our approximately 500,000 business customers, to promote increased usage and deployment of our products and services as they expand or change their organizations. In particular, we intend to use our network of 54 (including the five new offices from the purchase of certain selected McLeod assets and liabilities) direct sales and service facilities, and our dealer and reseller channels to drive recurring revenue from our customers. Existing customers accounted for a significant portion of our 2001 net sales from maintenance services, software additions and/or upgrades, support, training and hardware products such as video conferencing, headsets (wired and wireless) and speaker-phones. Because our business communications platform allows for system migration without the complete change out of hardware, existing customers are sold enhancements and new solutions through software-only upgrades. We believe that we can provide our customers with the ability to enhance their business communications systems on a cost-effective basis as voice, video and data communications convergence applications evolve.

Continue to Develop Advanced Communications Products and Expand Capacity

Inter-Tel commits substantial research and development resources to provide its customers with advanced telecommunications technologies on a cost-effective basis. We have developed an extensive C++ and JAVA software library and we have significant voice and data communications expertise. In many cases, we develop new technologies as software and hardware upgrades or add-ons to existing products. For example, our Version 6.0 software, which was released commercially during the first quarter of 2002, will double the capacity of a single node to 1,024 ports as well as double the capacity of networked systems to 40,000 ports. Our ongoing research and development efforts are directed towards the development and creation of new products, applications and services for sale to our existing customer base and to new customers. Through computer-telephony applications and advanced network services, Inter-Tel provides technology that is designed to enable its customers to improve their efficiency and enhance their competitiveness.

Expand Distribution Channels

Inter-Tel continues to expand its distribution channels by growing our network of direct dealers and direct sales offices, hiring additional direct sales personnel and expanding into new international markets. We have established sales relationships with hundreds of direct dealers in the United States, United Kingdom, parts of Europe, Mexico and Asia. Inter-Tel has increased its direct sales activity in recent periods through strategic acquisitions of resellers of telephony products, data products and services. These acquisitions, which we consider on an ongoing basis, increase the geographic coverage of our direct sales force, support our dealer and distributor channels and augment direct sales in areas that we have existing direct sales offices. To increase sales within the dealer distribution channel we provide dealers with support, on-site training, and we share best practices. In addition, we provide access to Inter-Tel's demonstration rooms, located in our direct sales office, as well as sales, technical and marketing support from regional sales managers and sales engineers.

Products and Services

Inter-Tel offers voice and data communications products and related services for business enterprises, government agencies and non-profit organizations. Our core products are business communications systems supporting scalable networked installations, IP telephony products and services, computer-telephony applications, unified messaging and voice processing software. We also offer long distance calling services, network design and implementation services, maintenance services, leasing and support services, and we resell peripheral data and telecommunications products.

Business Communications Systems

Inter-Tel has developed as its core product offering a business communications system that consists of a hardware platform and a suite of software applications that enables specific functionality. Inter-Tel sells its business communications system to mid- and large-sized organizations under its *Axxess* by Inter-Tel (*Axxess*) and *Eclipse*^{2} by Inter-Tel (*Eclipse*^{2}) brand names. The *Axxess* and *Eclipse*^{2} systems differ in terms of their appearance and some functionality but are based upon the same software and architecture, which incorporate open interfaces, employ the standard programming languages C++ and JAVA, and are built on a computer-telephony interface that allows outside computer applications to integrate with and monitor and control the operation of the Inter-Tel communications system. The platforms support industry standard computer-telephony interfaces, such as TAPI, TCP/IP, CSTA, and CT-Connect, as well as robust proprietary interfaces that provide capabilities beyond those available through the standard interfaces. Our software architecture enables customers to choose from a variety of server-level or desktop applications.

***Axxess* and *Eclipse*^{2}.** The *Axxess* and the *Eclipse*^{2} systems are designed to enable businesses to customize their communications applications to enhance their operations and increase productivity. These systems deliver integrated voice processing, IP telephony and advanced call center applications, and incorporate networking solutions that allow these applications to operate transparently across multiple systems and locations. Our commercially-available systems support up to 40,000 ports and include advanced capabilities such as primary and basic rate ISDN, integrated call recording, voice prompts in different languages, and a Microsoft Windows-based, touch screen sensitive, attendant's console. Version 6.0 of the *Axxess* and *Eclipse*^{2} systems, released in the first quarter of 2002, doubles the size of a single node to 1024 ports and commercially supports up to 40,000 ports in a transparent network environment. Our systems can be networked together using a combination of point-to-point telephony circuits, voice-over-IP interfaces, or frame-relay circuits depending on the customer's data and voice infrastructure.

The *Axxess* and *Eclipse²* systems' industry standard computer-telephony interfaces permit integration with desktop computers and network servers. Examples of applications that are enabled by these computer-telephony interfaces include:

- Database Look-up: uses caller identification to retrieve customer information from a computer database and present it on a call center agent's screen automatically;
- Advanced ACD Routing: uses caller identification, corporate database information and current ACD queue status to determine where to route customer calls for the highest possible level of customer service;
- Automated Outbound Calling: uses numbers pulled from a computer database to initiate outbound calls for telemarketing agents; and
- Personal Call Routing: uses caller identification and customer identification to screen and re-route calls to improve workplace productivity.

The *Axxess* and *Eclipse²* systems' telephones feature user-friendly, liquid crystal displays, or LCDs, of up to 6-by-16 characters, with menu keys that permit users to select from multiple menu choices or access additional menu screens. These *Axxess* and *Eclipse²* telephones also incorporate integrated voice processing, which permits key selection and push-button selection of voice processing commands, such as playback and record, to appear on the telephone's LCD, as well as voice-prompted selections through the telephone keypad. Our systems currently offer American English, British English, Japanese and Spanish voice prompts and LCDs, and allow users to switch from one language to another on a phone-by-phone basis. The software is also designed to support the addition of other languages.

The *Axxess* and *Eclipse²* systems' advanced software configures and uses real-time digital signal processor semiconductor components, known as DSPs. We employ DSPs and related software in our systems to decrease system costs, permit higher functionality and increase system flexibility. The system's DSP resources can be configured for different combinations of speakerphones, conference capabilities, caller ID receivers and other DSP-based applications, depending on the needs of an individual customer.

Inter-Tel has also developed and incorporated a Windows 2000-based Central Processing Unit, or Server CPU into the *Axxess* and *Eclipse²* systems. This server-based CPU is designed to handle call processing with increased speed and efficiency and provides enhanced computer-telephony interfaces. By combining server-based technology with the core telephony functionality of the *Axxess* and *Eclipse²* systems, Inter-Tel's customers can benefit from the speed, efficiency and enhanced functionality of a standards-based server while enjoying the benefits of a traditional PBX, such as equipment maintenance during system operation and cost-effective telephony interfaces. Because the Server CPU integrates with existing Inter-Tel systems, customers can benefit from new functionality and call handling capacity, while retaining most of their current system investment.

Integrated with the *Axxess* and *Eclipse²* systems, our Voice Processing Unit provides an automated call attendant to guide callers to the person or information they need. An "electronic employee" answers incoming calls, transfers calls, records messages, screens calls and returns calls using caller identification software. The Voice Processing Unit also provides enhanced voice mail and call routing announcements. Voice mail messages can be retrieved using the Voice Processing Unit from any location in the world using a touch-tone phone.

IP Telephony Products

The emergence of high-performance, low-cost computers and the growth of the Internet and other digital IP networks have enabled real-time voice communications to be transmitted on digital packet-switched networks in addition to traditional circuit-switched telephone networks. Because IP network telephony converts all transmissions to the same type of packets, both voice and data can use the same data circuits, thereby increasing efficiency and maximizing the use of available bandwidth. Using IP telephony, bandwidth can be maximized to such an extent that users may be able to reduce the overall number of circuits and bandwidth they require.

With Inter-Tel's *Axxess* and *Eclipse²* systems, users are able to enhance their existing telephone systems with specific IP telephony functionality or, alternatively, base their entire communications systems on IP telephony. Our systems are designed to enable our customers to preserve traditional communications capabilities while delivering the benefits offered by new technologies, such as packet-switched voice-over-IP.

IP Phones and IP SoftPhones. By using the Internet as part of a communications solution, our phone systems can be accessed by our customers from anywhere. Inter-Tel's IP phones, such as our IP PhonePlus and the IP Softphone, are fully integrated with our *Axxess* and *Eclipse*² systems, enabling users anywhere—whether in a home office, in a satellite office, a hotel room, or at a warehouse—to have access to the full functionality of the phone system, including call transferring, conferencing, voice mail access, record-a-call and computer-telephony integration.

IP Telephony Voice and Data Routers. We market and sell a line of voice and data routers. Voice and data routers are transition points between the public circuit-switched telephone network and a packet-switched IP network, such as the Internet. Our IP router products convert regular circuit-switched voice and facsimile transmissions to or from the compressed data packets that travel over packetized networks. The Inter-Tel voice and data routers enable phone-to-phone and PC-to-phone calling over packet-switched IP networks.

IP Networking Module. Our IP Networking Module product enables the transparent networking capabilities of the *Axxess* and *Eclipse*² systems over Internet Protocol and frame-relay data networks, rather than using traditional point-to-point lines. Whether our customers have 1 site or 63 sites, all of their locations can interact seamlessly and transparently over IP networks: practically anything that can be done using our systems in one location can be done between geographically-dispersed locations. All the advanced features of our systems remain in place when networking over IP, such as ACD hunt groups, call center applications, paging zones, centralized attendants and tightly integrated voice mail. By employing refined voice compression, jitter buffer and echo cancellation technologies, calls consume minimal bandwidth on data networks and provide clear connections.

Computer-Telephony Products

Computer-Telephony Applications and Enabling Technologies. Through computer telephony (CT), Inter-Tel provides seamless integration between computers and telephones. CT automates repetitive tasks, which can improve performance and enhance customer service. Examples of typical CT applications with the *Axxess* and *Eclipse*² systems include: viewing caller name, information and history through a "pop-up" screen by interfacing with a company's database, performing call handling tasks from a PC, and automatic call answering and routing.

The open architecture interfaces of our business communications systems enable straight-forward integration with "off-the-shelf," shrink-wrapped applications or custom software packages. Our architecture also enables our systems' capabilities to be expanded because of the support available for industry standard protocols. CT applications developed by Inter-Tel are based on this open architecture at both the desktop and system levels. Through the use of Microsoft's TAPI, Intel/Dialogic's CT-Connect and CSTA protocols, Inter-Tel's software applications work with other off-the-shelf desktop and server applications such as personal information managers, customer relationship management (CRM) applications, help-desk applications, call routing or call management.

If off-the-shelf applications do not fully address the needs of a particular customer, Inter-Tel can develop custom CT applications or provide professional consulting services for that customer to meet their needs. Alternatively, the simple-to-use open architecture interfaces of our software enable independent application developers and end-user management information services departments to write custom CT applications to meet the customer's specific needs.

Call Center Suite. The Call Center Suite is a collection of computer-telephony software applications that maximize the effectiveness and productivity of call centers. The specific modules of the Call Center Suite include server software, reporting functionality, desktop statistical reporting, intelligent call routing and agent task information. Each module interfaces with Inter-Tel's business communications systems to add cost-reducing functionality to call centers. The applications in Inter-Tel's Call Center Suite can manage automatic call distribution at peak efficiency or route incoming telephone calls to a specific person based on various parameters. The Suite can also be used to collect, analyze and report real-time call processing information.

ClearConnect Talk-to-Agent. ClearConnect Talk-to-Agent is a voice-over-IP product that enables customers to conduct voice conversations with sales agents over the Internet, while connected to the business' Web site. Within seconds, the voice-over-IP call is routed to an Automatic Call Distribution queue where it can be routed to a customer service agent. With live conversations over the Internet, customers are able to obtain answers to their questions quickly, and our customer service agents can push Web pages directly to the customers for increased agent productivity and enhanced revenue opportunities.

Unified Messaging. Inter-Tel's Unified Messaging software works in conjunction with a variety of messaging platforms, including Microsoft's Exchange messaging application, Lotus' Notes, Lotus' cc:Mail, Novell's GroupWise and other Internet mail applications such as AOL, Yahoo Mail, and Hotmail. Designed to run on a Windows NT server, Inter-Tel's Unified Messaging Software combines e-mail, voice mail and faxes into a single, centralized mail management program. Messages are converted to standard file formats for access and processing through a variety of devices for improved workplace productivity.

Encore by Inter-Tel. Our Encore product is a business communications system that addresses the small business market. Encore provides small organizations with features and benefits associated with more expensive PBX systems. Encore can be configured from two trunks and six stations up to eight trunks and 18 stations, with or without an optional integrated voice mail and automated attendant. In addition, Encore can be programmed and maintained remotely, minimizing the costs associated with on-site technician visits.

Computer Telephony Products Under Development

Applications Platform. Our Applications Platform product, planned for commercial release in the first quarter or early in the second quarter of 2002, is a highly flexible and robust computer-telephony and voice application development product for enterprises. The Applications Platform enables creative customization for Interactive Voice Response, or IVR, applications and is comprised principally of two components: a run-time engine and an easy-to-use graphical application development environment. The full-featured, turn-key Applications Platform is being designed to include high-performance hardware, state-of-the-art enabling technology, integrated IVR capabilities and an application starter pack with two IVR applications for general business use. These starter applications will provide end users with a sample of the type of functionality the platform can support. Based on specific end user requirements, customized IVR applications can also be created for the Applications Platform. Customers can further enhance the functionality of their IVR applications by deploying the optional automatic speech recognition and text-to-speech modules.

Unified Communicator. Our Inter-Tel Unified Communicator product, also scheduled for commercial release in the first quarter or early in the second quarter of 2002, is a Web-based user interface for the *Axxess* and *Eclipse²* systems. Unified Communicator is being designed to offer features to end users through a standard Web browser, or through a WAP Web client using a cellular phone or wireless PDA. Using Unified Communicator, customers will be able to perform call handling, message management and a number of related tasks on their desktop phones from virtually anywhere. Unified Communicator will also enable users to directly manage and control their personal features and the specific features of the users' desktop *Axxess* and *Eclipse²* systems' telephones. To complement the Internet and WAP interfaces of Unified Communicator, a telephone interface and a speech recognition engine will be available as separate modules. By adding the appropriate module, users can call into the system and manage their messages and call routing through either a touch-tone or speech interface.

Other Services and Products

Network and Long Distance Services. Through our subsidiary, Inter-Tel NetSolutions, we resell a variety of telecommunications services, including domestic and international calling services, calling card services, 800 calling services, switched and dedicated services, Internet, frame-relay and voice and video conferencing, disaster recovery solutions and customized billing. We also provide long distance calling services through NetSolutions. Because many of our customers desire the convenience of acquiring long distance calling services through the same vendor that they use to purchase other telephony equipment and services, we also resell long distance services to our customers through contracts we have established with major U.S. long distance carriers.

We also support telecommunications applications such as T-1 access for incoming toll-free traffic at call centers, switched long distance used at sales offices and frame relay networks linking together multiple offices of an enterprise.

Networking Technologies Integration. Inter-Tel designs, installs and supports an integrated, comprehensive solution for our customers' complex data and telecommunications networks, from local area networks, or LANs, to geographically dispersed wide area networks, or WANs.

By forming relationships with major manufacturers of hardware and software technologies, Inter-Tel provides the routers, ATM, LAN and WAN switches, wire-less WAN connections, file servers, intelligent hubs and other devices required for the customer's intranet or for access to the Internet. We offer pre-sale design support, project coordination for implementation, and installation support on our full line of server-based telephony products and IP telephony products and services.

Peripheral Products. Inter-Tel also distributes leading telecommunications peripheral products, applications and services developed by third parties, through our CommSource Division to our direct sales offices, dealers and VARs. We offer a selection of third-party peripheral products including audio and video conferencing, computer-telephony applications, battery backup, headsets, surge protection, paging equipment, wireless communications, cabling solutions and data multiplexers and routers. Our CommSource Division sells and distributes products that we have endorsed as leading communications peripherals widely deployed within organizations worldwide. Many of these products and services interface with our telephone systems.

Inter-Tel.NET. Through July 23, 2001, we provided communications services over data networks using IP with points of presence (POPs) in various cities in the United States, Mexico and Hong Kong through our subsidiary, Inter-Tel.NET, Inc.. Inter-Tel.NET developed an IP network of high capacity switches/gateways and privately managed bandwidth, which could accommodate large volumes of traffic. The managed network, routing structure and bandwidth capacity were designed to create a cost-effective solution compared to traditional long distance calling services. Through international alliances, Inter-Tel.NET also participated with businesses in Asia, Europe, Mexico and South America to provide international IP telephony service. Inter-Tel.NET's core customer base includes telecommunication service providers, such as long distance carriers, resellers, Competitive Local Exchange Carriers, or CLECs, and data network providers that offer their end users access to voice, fax and other enhanced services. Inter-Tel.NET utilizes other IP networks or traditional Long Distance Carriers to complete the call where Inter-Tel.NET or one of its network partners does not have a POP.

On July 24, 2001, Inter-Tel sold 83% of Inter-Tel.NET to Comm-Services Corporation (Comm-Services) for a note in the principal amount of $4.95 million, secured in part by stock and other marketable securities and 100% of the net assets of Inter-Tel.NET. On December 30, 2001, Comm-Services entered into a merger agreement with Vianet Technologies, Inc. (Vianet). Pursuant to the merger, our 17% interest in Inter-Tel.NET was converted to 5.95 million shares, or approximately 10% of Vianet, plus the full amount of the note. For more information associated with the Inter-Tel.NET transactions, see "Notes to Consolidated Financial Statements." For risks associated with our Inter-Tel.NET business, see "Factors That May Affect Future Operating Results." See Note N to the financial statements for more information about our segments.

Sales and Distribution

We have developed a distribution network of direct sales offices, dealers and VARs that have traditionally marketed to small- to medium-size organizations our products, which can support networked installations of up to 1,024 ports in a single cabinet and 40,000 ports in a network configuration. With the advent of Inter-Tel's new product releases, including Version 6.0 of the *Axxess* and *Eclipse*² systems released in the first quarter of 2002, our distribution network now markets to large organizations our products, which can support networked installations of up to 40,000 ports. As of December 31, 2001, Inter-Tel had 49 direct sales offices in the United States and one in Japan, and a network of hundreds of dealers that purchase systems directly from us. We also maintain a wholesale distribution office in the United Kingdom that supplies and supports Inter-Tel's dealers and distributors throughout the United Kingdom and in parts of Europe, and we have several dealers in Japan and in Mexico. In January 2002, we acquired selected assets and assumed certain selected liabilities of McLeod's key system, PBX and DataNet Operations. As a result of the McLeod acquisition, we added five more direct sales offices in the United States. The DataNet operation located in Sioux Falls, South Dakota is a LAN, WAN and network sales and service provider. We believe that the DataNet operation will expand our product offerings to our larger customers and provide us with increased revenue opportunities.

Distribution Channels

Our success depends in part upon the strength of our distribution channels and our ability to maintain close access to our end user customers through our distribution channels. In recent periods, we have sought to improve our access to end users through strategic acquisitions of resellers of telephony products and services located in markets in which we have existing direct sales offices and in other markets. As of December 31, 2001, Inter-Tel's direct sales office personnel and national and government accounts personnel consisted of 1,009 and 60 persons, respectively. Our sales through our direct sales offices and government and national accounts group, as a percentage of total sales, have increased from 52.9% of net sales in 2000 to 58.2% of net sales in 2001. Sales to distributors, dealers, and VARs have decreased from 27.0% of net sales in 2000 to 22.8% of net sales in 2001. Sales through our long distance and network services operations have decreased from 13.5% of net sales in 2000 to 11.3% of net sales in 2001.

Direct dealers and VARs enter into exclusive or non-exclusive reseller agreements with us for a term of one or more years. These agreements often include requirements that the reseller meet or use their best efforts to meet minimum annual purchase quotas. We generally provide support and other services to our resellers under the terms of the agreements. We face intense competition from other telephone system and voice processing system manufacturers for our dealers' attention, as many of our dealers carry products that compete with our products.

During the third quarter of 2001, we launched an exclusive business partner program. This program is designed to reward dealers who sell only Inter-Tel products to all new prospects and aggressively seek to upgrade their base. For this commitment from the dealer, we have offered our expertise to help them manage their business. This includes operational business reviews, shared human resource forms and policies, additional sales, marketing and training support, enhanced co-op benefits as well as special sales promotions and awards. In addition, we will allow our branch sales offices to help dealers close business. We believe that this program offers us an opportunity to expand our wholesale channel of distribution.

Leasing Services. Inter-Tel offers its Total Solutions program through our subsidiary, Inter-Tel Leasing, Inc. The Total Solutions program enables an end user to acquire a full range of telephony systems, applications, maintenance and support services from affiliated vendors. This program provides a total system financing package to the customer at a set monthly cost, with system expansion available for an additional fee. The typical Total Solutions contract has a term of 60 months, with the customer entitled to renew the contract at a specified price for up to an additional 36 months.

Inter-Tel also offers a line of low-cost lease purchase financing. Lease terms range from 24 to 84 months with $1.00, fixed and fair market value purchase options. Inter-Tel can also customize financing packages to suit customers with special financial needs. By offering this type of financing to acquire our products and services, our customers are able to lease directly from Inter-Tel or an authorized Inter-Tel dealer, thereby allowing us, or one of our dealers to maintain a direct relationship with our customers. This direct relationship allows Inter-Tel to provide maintenance and support services and information regarding other Inter-Tel products and services.

International Sales. We currently have dealers in the United Kingdom, parts of Europe, Japan and Latin America. International sales, which include business communications systems and IP telephony and peripheral products, accounted for approximately 2.6% of our net sales in both 2001 and 2000. In order to sell our products to customers in other countries, Inter-Tel must comply with local telecommunications standards. Our *Axxess* and *Eclipse²* systems and IP telephony products can be modified using our software to facilitate compliance with these local regulations. In addition, the *Axxess* and *Eclipse²* systems have been designed to support multi-lingual functionality, and both currently support American English, British English, Japanese and Spanish languages. We are currently working to expand our international dealer network.

Customer Service and Support

Customer service and support are critical components of customer satisfaction and the success of our business. We operate a technical support group that provides a range of support services to our distributors, dealers and end user customers through the Internet and through a toll-free telephone number. Inter-Tel provides on-site customer support and, using remote diagnostic procedures, we have the ability to detect and correct system problems from our technical support facilities. In 2000, Inter-Tel began an initiative to greatly enhance our Internet, intranet and extranet capabilities. Through this initiative, we re-designed our Web site to offer to our direct sales offices and dealer channel state-of-the-art support for sales and technical support activities. Our Web site also offers a wide array of sales and technical information, including an on-line product and service catalog, efficient order processing, portable-document-format sales brochures, competitive information, on-line technical manuals, frequently-asked-questions on important topics and convenient "touch-to-talk" live operator help employing our own ClearConnect two-way voice-over-IP technology. We intend to further develop our Web site to add additional information and services. In 2001, Inter-Tel began an initiative to enhance the technical knowledge database, the automated order system and the browser-based sales proposal platform on our intranet and extranet.

We analyze feedback from our customer service call records to provide direction for product and service enhancements. Our direct sales offices and resellers can receive service activity reports summarizing the reasons that technicians are asking for assistance and common issues that give rise to technical inquiries. This allows our direct sales offices and resellers to track trends in their service operations and to thereby provide better customer service.

We believe that we can best serve our customers by continually improving the quality of our systems, customer service and support, and other aspects of our organization. Through our continuous improvement process initiated in 1991, Inter-Tel implements quality processes throughout its business operations. We have established formal procedures to ensure responsiveness to customer requests, monitor response times and measure customer satisfaction. We have also established means by which all end users, including customers of our resellers, can request product enhancements directly from us. Inter-Tel supports its dealers and VARs through an extensive training program offered at its facilities, at dealer and third-party sites, a toll-free telephone number for sales and technical support, an extranet site offering up-to-date sales and support information, and the provision of end user marketing materials. We typically provide a one year warranty on our systems to end users through our direct offices. We offer eighteen-month warranties on our systems to the dealer channel, which in turn are responsible for providing a warranty to their end users.

Research and Development

We believe that our ability to enhance our current products, develop and introduce new products on a timely basis, maintain technological competitiveness and meet customer requirements are essential to our success. Inter-Tel's research and development efforts over the last several years have been focused primarily on the development of, and enhancements to, our *Axxess* and *Eclipse²* systems, including adding new applications, incorporating IP convergence applications and IP telephones, developing Unified Messaging Software applications, and expanding the telecommunications networking package to include networking over IP and frame relay networks. Over the last several years, our research and development efforts have also focused on the development of the ClearConnect SoftPhone and the related ClearConnect Talk-to-Agent Web communications software. Inter-Tel's current efforts are focused on developing and enhancing the IP telephony products and applications for our *Axxess* and *Eclipse²* systems, increasing single-site node capacity using an ATM backbone, enhancing our Unified Messaging Software, developing a speech-recognition and text-to-speech enabled unified communications product, developing an advanced IVR and CT application development tool, enhancing the IP digital telephones, and enhancing Inter-Tel's server-based PBX offerings. As of December 31, 2001, we had a total of 209 personnel engaged in research and development and related technical service and support functions. Research and development expenses were $17,556,000, $19,489,000, and $14,798,000 for 2001, 2000, and 1999.

Manufacturing

Inter-Tel manufactures substantially all of its systems through third party subcontractors located in the United States, the People's Republic of China and Mexico. These subcontractors use both standard and proprietary integrated circuits and other electronic devices and components to produce telephone switches, telephones and printed circuit boards to our engineering specifications and designs. Our suppliers inspect and test the equipment before delivering them to us, and in some cases our suppliers also perform systems integration, software loading, final testing and shipment. Varian Associates, a multinational electronics company, currently manufacturers a significant portion of our products, including substantially all of the printed circuit boards used in the *Axxess* and *Eclipse²* systems, at Varian's Tempe, Arizona and Poway, California facilities. We provide Varian with forecasted schedules of our manufacturing needs and revise the forecasts on a periodic basis. We continuously monitor the quality of the products produced on our behalf by our manufacturing subcontractors, and we are extending Inter-Tel's continuous improvement process to our suppliers.

Competition

The market for our products is highly competitive and has in recent periods been characterized by rapid technological change, business consolidations and decreasing prices. Our PABX and key systems products competitors include Avaya, NorTel Networks, 3Com, Cisco Systems, Comdial, Iwatsu America, Inc., Mitel Networks, NEC Corporation, Panasonic, Siemens and Toshiba. We also compete against the regional Bell System operating companies (RBOCs), which typically offer systems produced by one or more of our competitors listed above and also typically offer Centrex systems in which automatic calling facilities are provided through equipment located in the telephone company's central office. We also compete with next-generation service providers, such as DSL providers and cable companies, that offer bundled telephony and data services in an application service provider telephony model.

In the market for voice processing applications including voice mail, we compete against Captaris, Active Voice, ADC Telecommunication, InterVoice-Brite, Lucent Technologies, Avaya, Nortel, Comdial and other competitors. In the market for long distance services, we compete against AT&T, MCI WorldCom, Sprint, Qwest and others. We also expect to compete with RBOCs, cable television companies, satellite and other wireless broadband service providers for long distance business. Key competitive factors in the sale of telephone systems and related applications include price, performance, features, reliability, service and support, name recognition and distribution capability. We believe that we compete favorably in our markets with respect to the price, performance and features of our systems, as well as the level of service and support that we provide to our customers. However, certain of our competitors have significantly greater resources, name recognition and distribution capabilities than we do.

In the market for IP telephony products geared toward the enterprise markets, Inter-Tel competes with existing IP telephony providers such as Lucent, Avaya, NorTel, Cisco Systems, 3Com, ADC and Motorola. Several of these competitors have been active in developing and marketing IP telephony products and have established relationships with customers within their markets. If the market for IP telephony products becomes fully developed or develops at a rapid rate, large computer companies such as IBM and Microsoft, or large telephone companies such as AT&T, MCI WorldCom, Sprint or Qwest, could choose to develop proprietary software designed to facilitate voice communication services over an IP network.

As we compete for local telephone service, long distance service and IP network access, we face additional competition from established foreign and domestic long distance carriers, RBOCs and other providers. Many of these competitors have larger marketing and sales organizations, significantly greater financial and technical resources and a larger and more established customer base than we do. In addition, RBOCs and other providers have greater name recognition, more established positions in the market and long standing relationships with customers.

Intellectual Property Rights

We currently hold patents for 17 telecommunications and unified messaging products. The remaining life of these patents ranges from 4 to 16 years in duration. We have also applied to the U.S. Patent and Trademark Office for 6 additional patents. We also rely on copyright, trademark, trade secret law and contractual provisions to protect our intellectual property.

Employees

As of December 31, 2001, we had a total of 1,667 employees, of whom 578 were engaged in sales, marketing and customer support; 572 in quality, manufacturing and related operations; 209 in research and development and related technical service and support functions; and 308 in finance, administration and management. We believe that our relations with our employees are good.

Factors That May Affect Future Operating Results

Risks Related to Our Business

Our market is subject to rapid technological change and to compete successfully, we must continually introduce new and enhanced products and services that achieve broad market acceptance.

The market for our products and services is characterized by rapid technological change, evolving industry standards and vigorous customer demand for new products, applications and services. To compete successfully, we must continually enhance our existing telecommunications products, related software and customer services, and develop new technologies and applications in a timely and cost-effective manner. If we fail to introduce new products and services that achieve broad market acceptance, or if we do not adapt our existing products and services to customer demands or evolving industry standards, our business could be significantly harmed. In addition, current competitors or new market entrants may offer products, applications or services that are better adapted to changing technology or customer demands and that could render our products and services unmarketable or obsolete.

In addition, if the markets for computer-telephony (CT) applications, Internet Protocol (IP) network products, or related products fail to develop or continue to develop more slowly than we anticipate, or if we are unable for any reason to capitalize on any of these emerging market opportunities, our business, financial condition and operating results could be significantly harmed.

Our future success largely depends on increased commercial acceptance of our *Axxess* and *Eclipse*^{2} systems, Encore product, InterPrise products, new speech recognition and Interactive Voice Response products, and related computer-telephony products.

During the past few years, we have introduced transparent networking and unified messaging capabilities on our *Axxess* and *Eclipse*^{2} systems and introduced our Encore product and InterPrise family of voice and data convergence products. In 2000, we introduced ClearConnect, a software-based telephone that runs on a PC, ClearConnect Talk-to-Agent, an e-commerce "touch-to-talk" Web call product, a line of IP voice terminals and IP soft phones that add IP telephony to the *Axxess* and *Eclipse*^{2} systems, and several other telephony-related products. During the past 12 months, sales of our *Axxess* business communications systems and related software have comprised a substantial portion of our net sales. Our future success depends, in large part, upon increased commercial acceptance and adoption of the InterPrise and related computer-telephony products, the *Axxess* and *Eclipse*^{2} systems, Encore products, new speech recognition and Interactive Voice Response products, as well as future upgrades and enhancements to these products and networking platforms. We cannot assure you that these products or platforms will achieve commercial acceptance in the future.

Our products are complex and may contain errors or defects that are detected only after their release, which may cause us to incur significant unexpected expenses and lost sales.

Our telecommunications products and software are highly complex. Although our new products and upgrades are examined and tested prior to release, they can only be fully tested when used by a large customer base. Consequently, our customers may discover program errors, or "bugs," or other defects after new products and upgrades have been released. Some of these bugs may result from defects contained in component parts or software from our suppliers or other third parties that are intended to be compatible with our products and over which we have little or no control. Although we have test procedures and quality control standards in place designed to minimize the number of errors and defects in our products, we cannot assure you that our new products and upgrades will be free of bugs when released. If we are unable to quickly or successfully correct bugs identified after release, we could experience the following, any of which would harm our business:

- costs associated with the remediation of any problems;
- costs associated with design modifications;
- loss of or delay in revenues;
- loss of customers;
- failure to achieve market acceptance or loss of market share;
- increased service and warranty costs;
- liabilities to our customers; and
- increased insurance costs.

The complexity of our products could cause delays in the development and release of new products and services. As a result, customer demand for our products could decline, which could harm our business.

Due to the complexity of our products and software, we have in the past experienced and expect in the future to experience delays in the development and release of new products or product enhancements. If we fail to introduce new software, products or services in a timely manner, or fail to release upgrades to our existing systems or products and software on a regular and timely basis, customer demand for our products and software could decline, which would harm our business.

Business acquisitions, dispositions or joint ventures entail numerous risks and may disrupt our business, dilute shareholder value or distract management attention.

As part of our business strategy, we consider acquisitions of, or significant investments in, businesses that offer products, services and technologies complementary to ours. Such acquisitions could materially adversely affect our operating results and/or the price of our common stock. Acquisitions also entail numerous risks, including:

- unanticipated costs and liabilities;
- difficulty of assimilating the operations, products and personnel of the acquired business;
- difficulties in managing the financial and strategic position of acquired or developed products, services and technologies;
- the diversion of management's attention from the core business;
- inability to maintain uniform standards, controls, policies and procedures; and
- impairment of relationships with acquired employees and customers occurring as a result of integration of the acquired business.

In particular, in 2000 we acquired certain assets and assumed certain liabilities of Executone Information Systems, Inc. Our operating results were adversely affected by several of the factors described above relating to the Executone acquisition, including the risks related to unanticipated acquisition costs and liabilities and impairment of employee and customer relationships, as well as the erosion of gross and operating margins. For these and other reasons, we wrote-off our investment in Executone during the second quarter of 2000.

In addition to the Executone losses discussed above, for the quarter ended September 30, 2000, we also recorded a pre-tax loss of $2.0 million related to our equity share of Cirilium's net losses. As of the close of the third quarter, we wrote off our remaining investment in Cirilium of $2.0 million. Total pre-tax losses from Cirilium from all sources were $8.6 million for 2000.

In January 2001, we acquired certain assets and assumed certain liabilities of Convergent Technologies, Inc. In connection with the Convergent acquisition, we hired over 200 Convergent employees and opened eight Inter-Tel branch offices in previous Convergent locations. Among other risks and uncertainties, we have experienced and may continue to experience the following difficulties or risks associated with the Convergent acquisition:

- substantially all of Convergent's sales were of our competitor's products and services, and these competitors have made it difficult and expensive for us to service and maintain some of these products;
- a number of Convergent's customers have declined the assignment of their maintenance contracts to us;
- a number of the employees hired by Inter-Tel have not integrated successfully into the Inter-Tel business model; and
- many of the independent contractors who performed projects for Convergent have not assumed similar roles with Inter-Tel.

In July 2001, Inter-Tel agreed to sell 83% of Inter-Tel.NET to Comm-Services Corporation. In connection with this transaction, Inter-Tel assessed the fair value of the net assets of Inter-Tel.NET as of June 30, 2001 under FAS 121 to arrive at an adjustment to the remaining investment in Inter-Tel.NET. The charge recorded as of the close of the second quarter of 2001 totaled $5.4 million ($3.4 million after tax), associated with the impairment of Inter-Tel's investment in Inter-Tel.NET. The recording of this charge adversely affected our operating results for the second quarter of 2001. On December 30, 2001, Comm-Services entered into a merger agreement with Vianet Technologies, Inc. (Vianet). Inter-Tel's 17% investment in Comm-Services was converted to approximately 10% of Vianet stock. Our financial condition will be adversely affected to the extent that the Vianet business is unsuccessful.

During 1999, 2000 and 2001, Inter-Tel.NET also entered into operating lease agreements totaling approximately $6.5 million from an equipment vendor for network equipment and software. The lease agreements required Inter-Tel.NET to have vendor maintenance on their products. Inter-Tel originally guaranteed the indebtedness. In the second quarter of 2001, Inter-Tel.NET notified the vendor of network and network equipment problems encountered due to vendor equipment and software recommended, supplied and financed by this vendor. Inter-Tel.NET requested that the vendor not only solve the problems, but also compensate Inter-Tel.NET for the problems and the resulting lost customers, lost revenues and lost profits. Pursuant to Inter-Tel's sale of 83% of Inter-Tel.NET, Comm-Services assumed the vendor lease and maintenance obligations and as such Inter-Tel has not recorded any liability for these obligations. However, the vendor has not released Inter-Tel from its guarantee of these obligations and Inter-Tel has not released the vendor from Inter-Tel's claims, nor did we assign our rights to these claims to Comm-Services. Our financial condition will be adversely affected to the extent that payments made under the guarantee exceed damages realized from our claim.

In January 2002, we acquired selected assets and liabilities of McLeodUSA, Inc. (McLeod). In connection with the McLeod acquisition, we hired approximately 100 McLeod employees and opened two Inter-Tel branch offices in previous McLeod locations. We cannot predict whether we will be able to integrate the employees and business of McLeod into our operations successfully.

Finally, to the extent that shares of our stock or the rights to purchase stock are issued in connection with any future acquisitions, dilution to our existing shareholders will result and our earnings per share may suffer. Any future acquisitions may not generate additional revenue or provide any benefit to our business, and we may not achieve a satisfactory return on our investment in any acquired businesses.

We may not be able to adequately protect our proprietary technology and may be infringing upon third-party intellectual property rights.

Our success depends upon our proprietary technology. We currently hold patents for 17 telecommunication and unified messaging products and have also applied to the U.S. Patent and Trademark Office for six additional patents. We also rely on copyright and trade secret law and contractual provisions to protect our intellectual property. Despite these precautions, third parties could copy or otherwise obtain and use our technology without authorization, or develop similar technology independently.

We cannot assure you that any patent, trademark or copyright that we own or have applied to own, will not be invalidated, circumvented or challenged by a third party. Effective protection of intellectual property rights may be unavailable or limited in foreign countries. We cannot assure you that the protection of our proprietary rights will be adequate or that competitors will not independently develop similar technology, duplicate our services or design around any patents or other intellectual property rights we hold. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Litigation could be costly, absorb significant management time and harm our business.

We are also subject to third party claims that our current or future products or services infringe upon the rights of others. For example, we are subject to proceedings alleging that certain of our key products infringe upon third party intellectual property rights, including patents, trademarks, copyrights or other intellectual property rights. We have viewed presentations from one of our primary competitors, Lucent and subsequently Lucent's spin off Avaya, alleging that our *Axxess* business communications system utilizes inventions covered by certain of their patents. We are continuing the process of investigating this matter and we have made claims against Avaya and Lucent for infringement of our patents. Additionally, we recently received a letter from AT&T alleging that some of our IP products infringe upon intellectual property protected by AT&T's patents. Although we have denied AT&T's allegations and intend to defend our position vigorously, we cannot assure you that we will ultimately prevail in this dispute. When any such claims are asserted against us, among other means to resolve the dispute, we may seek to license the third party's intellectual property rights. Purchasing such licenses can be expensive, and we cannot assure you that a license will be available on prices or other terms acceptable to us, if at all. Alternatively, we could resort to litigation to challenge such a claim. Litigation could require us to expend significant sums of cash and divert our management's attention. In the event that a court renders an enforceable decision with respect to our intellectual property, we may be required to pay significant damages, develop non-infringing technology or acquire licenses to the technology subject to the alleged infringement. Any of these actions or outcomes could harm our business. If we are unable or choose not to license technology, or decide not to challenge a third party's rights, we could encounter substantial and costly delays in product introductions. These delays could result from efforts to design around asserted third party rights or our discovery that the development, manufacture or sale of products requiring these licenses could be foreclosed.

Our IP network products may be vulnerable to viruses, other system failure risks and security concerns, which may result in lost customers or slow commercial acceptance of our IP network products.

Inter-Tel's IP telephony and network products may be vulnerable to computer viruses or similar disruptive problems. Computer viruses or problems caused by third parties could lead to interruptions, delays or cessation of service that could harm our operations and revenues. In addition, we may lose customers if inappropriate use of the Internet or other IP networks by third parties jeopardize the security of confidential information, such as credit card or bank account information or the content of conversations over the IP network. In addition, user concerns about privacy and security may cause IP networks in general to grow more slowly, and impair market acceptance of our IP network products in particular, until more comprehensive security technologies are developed.

We have many competitors and expect new competitors to enter our market, which could increase price competition and spending on research and development and which may impair our ability to compete successfully.

The markets for our products and services are extremely competitive and we expect competition to increase in the future. Our current and potential competitors in our primary business segments include:

- PABX and core systems providers such as Avaya, Cisco Systems, Comdial, 3Com, Iwatsu, Mitel, NEC, Nortel, Panasonic, Siemens, and Toshiba;
- large data routing and convergence companies such as 3Com and Cisco Systems;
- voice processing applications providers such as ADC, InterVoice-Brite, Active Voice (a subsidiary of NEC America), Avaya, Captaris (formerly AVT) and Lucent;
- long distance services providers such as AT&T, MCI WorldCom, Qwest and Sprint;
- large computer and software corporations such as IBM and Microsoft; and
- regional Bell operating companies, or RBOCs, cable television companies and satellite and other wireless broadband service providers.

These and other companies may form strategic relationships with each other to compete with us. These relationships may take the form of strategic investments, joint-marketing agreements, licenses or other contractual arrangements, which could increase our competitors' ability to address customer needs with their product and service offerings.

Many of our competitors and potential competitors have substantially greater financial, customer support, technical and marketing resources, larger customer bases, longer operating histories, greater name recognition and more established relationships in the industry than we do. We cannot be sure that we will have the resources or expertise to compete successfully. Compared to us, our competitors may be able to:

- develop and expand their product and service offerings more quickly;
- adapt to new or emerging technologies and changing customer needs faster;
- take advantage of acquisitions and other opportunities more readily;
- negotiate more favorable licensing agreements with vendors;
- devote greater resources to the marketing and sale of their products; and
- address customers' service-related issues more adequately.

Some of our competitors may also be able to provide customers with additional benefits at lower overall costs or to reduce their gross margins aggressively in an effort to increase market share. We cannot be sure that we will be able to match cost reductions by our competitors. In addition, we believe that there is likely to be consolidation in our markets, which could lead to increased price competition and other forms of competition that could cause our business to suffer.

Our reliance on a limited number of suppliers for key components and our increasing dependence on contract manufacturers could impair our ability to manufacture and deliver our products and services in a timely and cost-effective manner.

We currently obtain certain key components for our digital communication platforms, including certain microprocessors, integrated circuits, power supplies, voice processing interface cards and IP telephony cards, from a limited number of suppliers and manufacturers. Our reliance on these limited suppliers and contract manufacturers involves risks and uncertainties, including the possibility of a shortage or delivery delay for some key components. We currently manufacture our products through third-party subcontractors located in the United States, the People's Republic of China, the United Kingdom and Mexico. The Encore system is manufactured by an OEM partner in the United Kingdom. Foreign manufacturing facilities are subject to changes in governmental policies, imposition of tariffs and import restrictions and other factors beyond our control. Varian currently manufactures a significant portion of our products at Varian's Tempe, Arizona and Poway, California facilities, including substantially all of the printed circuit boards used in the *Axxess* and *Eclipse*^{2} systems, as well as substantially all of the Executone computer-telephony products. We have experienced occasional delays in the supply of components and finished goods that have harmed our business. We cannot assure that we will not experience similar delays in the future.

Our reliance on third party manufacturers and OEM partners involves a number of additional risks, including reduced control over delivery schedules, quality assurance and costs. Our business may be harmed by any delay in delivery or any shortage of supply of components or finished goods from a supplier. Our business may also be harmed if we are unable to develop alternative or additional supply sources as necessary. To date, we have been able to obtain supplies of components and products in a timely manner even though we do not have long-term supply contracts with any of our contract manufacturers. However, we cannot assure you that we will be able to continue to obtain components or finished goods in sufficient quantities or quality or on favorable pricing or delivery terms in the future.

We derive a substantial portion of our net sales from our dealer network and if these dealers do not effectively promote and sell our products, our business and operating results could be harmed.

We derive a substantial portion of our net sales through our network of independent dealers. We face intense competition from other telephone, voice processing, and voice and data router system manufacturers for these dealers' business, as most of our dealers carry products that compete with our products. Our dealers may choose to promote the products of our competitors to our detriment. The loss of any significant dealer or group of dealers, or any event or condition harming our dealer network, could harm our business, financial condition and operating results.

Expanding our international sales efforts may expose us to additional business risks, which may result in reduced sales or profitability in our international markets.

We are in the process of attempting to expand our international dealer network both in the countries in which we already have a presence and in new countries and regions. International sales are subject to a number of risks, including changes in foreign government regulations and telecommunication standards, export license requirements, tariffs and taxes, other trade barriers, difficulties in protecting our intellectual property, fluctuations in currency exchange rates, difficulty in collecting receivables, difficulty in staffing and managing foreign operations, and political and economic instability. Fluctuations in currency exchange rates could cause our products to become relatively more expensive to customers in a particular country, leading to a reduction in sales or profitability in that country. In addition, the costs associated with developing international sales may not be offset by increased sales in the short term, or at all. Any of these risks could cause our products to become relatively more expensive to customers in a particular country, leading to reduced sales or profitability in that country. In addition, the costs associated with developing an international dealer network may not be offset by increased sales in the short term, if at all.

If we lose key personnel or are unable to hire additional qualified personnel as necessary, we may not be able to achieve our objectives.

We depend on the continued service of, and our ability to attract and retain, qualified technical, marketing, sales and managerial personnel, many of whom would be difficult to replace. Competition for qualified personnel is intense, and we have historically had difficulty hiring employees in the timeframe that we desire, particularly skilled engineers. The loss of any of our key personnel or our failure to effectively recruit additional key personnel could make it difficult for us to manage our business, complete timely product introductions or meet other critical business objectives. For example, our inability to retain key executives of Executone following our Executone acquisition impaired our ability to benefit from the Executone business and to grow revenues from the Executone assets. Moreover, our operating results will be impaired if we lose a substantial number of key Convergent and McLeod employees. We cannot assure you that we will be able to continue to attract and retain the qualified personnel necessary for the development of our business.

We may be unable to manage our growth effectively, which may harm our business.

The ability to operate our business in a rapidly evolving market requires an effective planning and management process. The growth in our business has placed, and is expected to continue to place, a significant strain on our personnel, management systems, infrastructure and other resources. Our ability to manage any future growth effectively will require us to successfully attract, train, motivate and manage new employees, to integrate new employees into our overall operations and to continue to improve our operational, financial and management controls and procedures. Furthermore, we expect that we will be required to manage an increasing number of relationships with suppliers, manufacturers, customers and other third parties. If we are unable to implement adequate controls or integrate new employees into our business in an efficient and timely manner, our operations could be adversely affected and our growth could be impaired which could harm our business.

The introduction of new products and services has lengthened our sales cycles, which may result in significant sales and marketing expenses.

In the past few years, we introduced the *Axxess* and *Eclipse*^{2} ATM business communications system and networking software, which are typically sold to larger customers at a higher average selling price and often represent a significant communications infrastructure capital expenditure by the prospective enterprise customer. Accordingly, the purchase of our products typically involves numerous internal approvals relating to the evaluation, testing, implementation and acceptance of new technologies. This evaluation process frequently results in a lengthy sales process, which can range from a few months to more than 12 months, thereby subjecting our sales cycle to a number of significant uncertainties concerning budgetary constraints and internal acceptance reviews. The length of our sales cycle also may vary substantially from customer to customer. While our customers are evaluating our products and before placing an order with us, we may incur substantial sales and marketing expenses and expend significant management effort. Consequently, if sales forecasted from a specific customer for a particular quarter are not realized in that quarter, our operating results could be materially adversely affected.

Our operating results have historically depended on a number of factors, and these factors may cause our operating results to fluctuate in the future.

Our quarterly operating results have historically depended on, and may fluctuate in the future as a result of, many factors including:

- volume and timing of orders received during the quarter;
- gross margin fluctuations associated with the mix of products sold;
- the mix of distribution channels;
- general economic conditions;
- patterns of capital spending by customers;
- the timing of new product announcements and releases by us and our competitors;
- pricing pressures, the cost and effect of acquisitions, in particular the Executone and Convergent acquisitions; and
- the availability and cost of products and components from our suppliers.

In addition, we have historically operated with a relatively small backlog, with sales and operating results in any quarter depending principally on orders booked and shipped in that quarter. In the past, we have recorded a substantial portion of our net sales for a given quarter in the third month of that quarter, with a concentration of such net sales in the last two weeks of the quarter. Market demand for investment in capital equipment such as business communications systems and associated call processing and voice processing software applications depends largely on general economic conditions, and can vary significantly as a result of changing conditions in the economy as a whole. We cannot assure you that historical trends for small backlog will continue in the future.

Our expense levels are based in part on expectations of future sales and, if sales levels do not meet expectations, our operating results could be harmed. In addition, because sales of business communications systems through our dealers typically produce lower gross margins than sales through our direct sales organization, operating results have varied, and will continue to vary based upon the mix of sales through direct and indirect channels. Also, the timing and profitability of lease resales from quarter to quarter could impact operating results, particularly in an environment of fluctuating interest rates. Long distance sales, which typically have lower gross margins than our core business, have grown in recent periods at a faster rate than our overall net sales. As a result, gross margins could be harmed if long distance calling services continue to increase as a percentage of net sales. In addition, we experience seasonal fluctuations in our operating results, as net sales for the first quarter is frequently less than the fourth quarter and the third quarter is frequently less than the second quarter. As a result of these and other factors, we have historically experienced, and could continue to experience in the future, fluctuations in sales and operating results on a quarterly basis.

Our stock price has been and may continue to be volatile, impairing your ability to sell your shares at or above purchase price.

The market price for our common stock has been highly volatile. The volatility of our stock could be subject to continued wide fluctuations in response to many risk factors listed in this section, and others beyond our control, including:

- announcements of developments relating to our business;
- fluctuations in our operating results;
- shortfalls in revenue or earnings relative to securities analysts' expectations;
- announcements of technological innovations or new products or enhancements by us or our competitors;
- announcements of acquisitions or planned acquisitions of other companies or businesses;
- investors' reactions to acquisition announcements or our forecasts of future results;
- general conditions in the telecommunications industry;
- the market for Internet-related products and services;
- changes in the national or worldwide economy;
- changes in legislation or regulation affecting the telecommunications industry;
- an outbreak of hostilities or terrorist acts;
- developments relating to our and third party intellectual property rights; and
- changes in our relationships with our customers and suppliers.

In addition, stock prices of technology companies in general, and for voice and data communications companies of technology stocks in particular, have experienced extreme price fluctuations in recent years which have often been unrelated to the operating performance of affected companies. We cannot assure you that the market price of our common stock will not experience significant fluctuations in the future, including fluctuations that are unrelated to our performance.

Our Chairman of the Board of Directors, CEO and President controls 21.7% of our Common Stock and is able to significantly influence matters requiring shareholder approval.

As of March 1, 2002, Steven G. Mihaylo, Inter-Tel's Chairman of the Board of Directors, Chief Executive Officer and President, beneficially owned approximately 21.7% of the outstanding shares of the common stock. As a result, he has the ability to exercise significant influence over all matters requiring shareholder approval. In addition, the concentration of ownership could have the effect of delaying or preventing a change in control of Inter-Tel.

Risks Related to Our Industry

The emerging market for IP network telephony is subject to market risks and uncertainties that could cause significant delays and expenses.

The market for IP network voice communications products has begun to develop only recently, is evolving rapidly and is characterized by an increasing number of market entrants who have introduced or developed products and services for Internet or other IP network voice communications. As is typical of a new and rapidly evolving industry, the demand for and market acceptance of, recently introduced IP network products and services are highly uncertain. We cannot assure you that packet-switched voice networks will become widespread. Even if packet-switched voice networks become widespread in the future, we cannot assure you that our products, including the Inter-Tel InterPrise product line and IP telephony features of the *Axxess* and *Eclipse*^{2} systems, will successfully compete against other market players and attain broad market acceptance. Inter-Tel sold 83% of Inter-Tel.NET, an IP telephony provider, to Comm-Services in July 2001, and our remaining 17% investment was subsequently converted to approximately 10% interest in Vianet Technologies, Inc. via a merger between Comm-Services and Vianet. Accordingly, Inter-Tel continues to maintain an investment of 10% in Inter-Tel.NET through Vianet. Accordingly, our financial condition will be adversely affected if the Inter-Tel.NET/Vianet business is unsuccessful.

Moreover, the adoption of packet-switched voice networks generally requires the acceptance of a new way of exchanging information. In particular, enterprises that have already invested substantial resources in other means of communicating information may be reluctant or slow to adopt a new approach to communications. If the market for IP network voice communications fails to develop or develops more slowly than we anticipate, our IP network telephony products could fail to achieve market acceptance, which in turn could significantly harm our business, financial condition and operating results. This growth may be inhibited by a number of factors, such as quality of infrastructure; security concerns; equipment, software or other technology failures; regulatory encroachments; inconsistent quality of service; poor voice quality over IP networks as compared to circuit-switched networks; and lack of availability of cost-effective, high-speed network capacity. Moreover, as IP-based data communications and telephony usage grow, the infrastructure used to support these IP networks, whether public or private, may not be able to support the demands placed on them and their performance or reliability may decline. The technology that allows voice and facsimile communications over the Internet and other data networks, and the delivery of other value-added services, is still in the early stages of development.

Government regulation of third party long distance and network service entities on which we rely may harm our business.

Our supply of telecommunications services and information depends on several long distance carriers, RBOCs, local exchange carriers, or LECs, and competitive local exchange carriers, or CLECs. We rely on these carriers to provide network services to our customers and to provide us with billing information. Long distance services are subject to extensive and uncertain governmental regulation on both the federal and state level. We cannot assure that the increase in regulations will not harm our business. Our current contracts for the resale of services through long distance carriers include multi-year periods during which we have minimum use requirements and/or costs. The market for long distance services is experiencing, and is expected to continue to experience significant price competition, and this may cause a decrease in end-user rates. We cannot assure you that we will meet minimum use commitments, that we will be able to negotiate lower rates with carriers if end-user rates decrease or that we will be able to extend our contracts with carriers at favorable prices. If we are unable to secure reliable long distance and network services from certain long distance carriers, RBOCs, LECs and CLECs, or if these entities are unwilling or unable to provide telecommunications services and billing information to us on favorable terms, our ability to expand our own long distance and network services will be harmed. Carriers that provide telecommunications services to us may also experience financial difficulties, up to and including bankruptcies, which could harm our ability to offer telecommunications services.

Consolidation within the telecommunications industry could increase competition and reduce our customer base.

During the past year, there has been a trend in the telecommunications industry towards consolidation and we expect this trend to continue as the industry evolves. As a result of this consolidation trend, new stronger companies may emerge that have improved financial resources, enhanced research and development capabilities and a larger and more diverse customer base. The changes within the telecommunications industry may adversely affect our business, operating results and financial condition.

Reductions in spending on enterprise communications equipment may materially and adversely affect our business.

The overall economic slowdown has had a harmful effect on the market for enterprise communications equipment. Our customers have reduced significantly their capital spending on communications equipment in an effort to reduce their own costs and bolster their revenues. The market for enterprise communications equipment may continue to grow at a modest rate and our financial performance has been and may continue to be materially and adversely affected by the reductions in spending on enterprise communications equipment.

DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth certain information regarding Inter-Tel's directors and executive officers as of March 8, 2002.

Name	Age	Position
Steven G. Mihaylo	58	Chairman of the Board of Directors, Chief Executive Officer and President
Norman Stout	44	Executive Vice President/Chief Administrative Officer
Craig W. Rauchle	46	Executive Vice President/Chief Operating Officer
Jeffrey T. Ford	40	Senior Vice President/Chief Technology Officer
Kurt R. Kneip	39	Chief Financial Officer, Vice President and Secretary
J. Robert Anderson	65	Director
Jerry W. Chapman	61	Director
Gary Edens	60	Director
C. Roland Haden	61	Director

MR. MIHAYLO, the founder of Inter-Tel, has served as Chairman of the Board of Directors of Inter-Tel since September 1983, as President since May 1998 and as Chief Executive Officer since Inter-Tel's formation in July 1969. Mr. Mihaylo served as President of Inter-Tel from 1969 to 1983 and from 1984 to December 1994, and as Chairman of the Board of Directors from July 1969 to October 1982.

MR. STOUT was elected Executive Vice President, Chief Administrative Officer and President of Inter-Tel Software and Services in June 1998. From October 1994 to June 1998, he served as one of our directors. Prior to joining Inter-Tel, Mr. Stout was Chief Operating Officer of Oldcastle Architectural Products and since 1996, Mr. Stout also had served as President of Oldcastle Architectural West. Mr. Stout was previously President of Superlite Block, a subsidiary of Oldcastle Architectural Products and a manufacturer of concrete products, since February 1993. Prior thereto he was employed by Boorhem-Fields, Inc. of Dallas, Texas, a manufacturer of crushed stone, as Chief Executive Officer from 1990 to 1993 and as Chief Financial Officer from 1986 to 1990. Prior to that, Mr. Stout was a Certified Public Accountant with Coopers & Lybrand. Mr. Stout holds a Bachelor of Science degree in Accounting from Texas A&M and an MBA from the University of Texas.

MR. RAUCHLE was elected Chief Operating Officer in August 2001 and has been our Executive Vice President since December 1994. He had been our Senior Vice President and continues as President of Inter-Tel Technologies, Inc., our wholly owned sales subsidiary. In addition, he currently is responsible for our corporate strategic planning and mergers and acquisitions. Mr. Rauchle joined Inter-Tel in 1979 as Branch General Manager of the Denver Direct Sales Office and in 1983 was appointed the Central Region Vice President and subsequently the Western Regional Vice President. From 1990 to 1992, Mr. Rauchle served as President of Inter-Tel Communications, Inc. Mr. Rauchle holds a Bachelor of Arts degree in Communications from the University of Denver.

MR. FORD was elected Senior Vice President in May 1998 and has served as our Chief Technology Officer since 1997. He was elected President of Inter-Tel Integrated Systems, Inc. ("IIS") in May 1998, after serving as Senior Vice President of IIS for one year and Vice President of Software Engineering of Inter-Tel Integrated Systems from 1993 to 1997. He joined Inter-Tel in 1983 as a software design engineer. Mr. Ford holds a Bachelor of Science degree in Computer Systems Engineering from Arizona State University and an SEP certificate from the Stanford Graduate School of Business.

MR. KNEIP has served as our Vice President and Chief Financial Officer since September 1993. He was elected Secretary and Treasurer in October 1994. In May 1996 he was elected Assistant Treasurer, as John Abbott was elected Treasurer. He joined Inter-Tel in May 1992 as Director of Corporate Tax, after seven years with the accounting firms of Ernst & Young and KPMG Peat Marwick. Mr. Kneip is a Certified Public Accountant, and holds a Bachelor of Science degree in Commercial Economics from South Dakota State University and a Masters Degree in Professional Accountancy from the University of South Dakota.

MR. ANDERSON has served as one of our directors since February 1997. Mr. Anderson held various positions at Ford Motor Company from 1963 to 1983, serving as President of the Ford Motor Land Development Corporation from 1978 to 1983. He served as Senior Vice President, Chief Financial Officer and a member of the Board of Directors of The Firestone Tire and Rubber Company from 1983 to 1989, and as Vice Chairman of Bridgestone/Firestone, Inc. from 1989 through 1991. He most recently served as Vice Chairman, Chief Financial Officer and a member of the Board of Directors of the Grumman Corporation from 1991 to 1994. Mr. Anderson is currently semi-retired, and he is an active leader in various business, civic and philanthropic organizations.

MR. CHAPMAN was elected as one of our directors in December 1999 and previously served as one of our directors in the late 1980's and early 1990's. He served with a local CPA firm from 1963 through 1969, at which time he joined Ernst & Young (then Ernst & Ernst). He became a partner of Ernst & Young in 1977 and, until retiring from the firm in 1989, served as engagement partner on a wide variety of audit, assurance and consulting engagements. Additionally, he managed Ernst & Young's practices in Arizona as well as certain offices in the adjoining southwest states from 1980 through 1989. He then operated his own consulting firm through 1992 and joined Arthur Andersen in 1993 as a partner specializing in providing business consulting services. He retired from Arthur Andersen in 1999 and currently provides services for a small number of clients requiring strategic and market-driven services.

MR. EDENS has served as one of our directors since October 1994. He was a broadcasting media executive from 1970 to 1994, serving as Chairman and Chief Executive Officer of Edens Broadcasting, Inc. from 1984 to 1994, when that corporation's nine radio stations were sold. He is currently President of The Hanover Companies, Inc., an investment firm. He is an active leader in various business, civic and philanthropic organizations.

DR. HADEN has served as one of our directors since 1983. Dr. Haden has been Vice Chancellor and Dean of Engineering of Texas A&M University since 1993. Previously, he was Vice Chancellor of Louisiana State University, Dean of the College of Engineering and Applied Sciences at Arizona State University, and Vice President for Academic Affairs at Arizona State University. He earlier served as department head at the University of Oklahoma. Dr. Haden has served on a number of corporate boards, such as Square D Company and E-Systems, Inc., both then Fortune 500 companies. His Ph.D. is in Electrical Engineering from the University of Texas.

The Audit Committee of our Board of Directors consisted of Messrs. Chapman, Anderson and Haden, through December 31, 2001. Pursuant to the Audit Committee charter, the Audit Committee reviews, acts and reports to our Board of Directors on various auditing and accounting matters, including the appointment of our independent accountants, the scope of our annual audits, fees to be paid to our independent accountants, the performance of our independent accountants and our accounting and financial management practices. A report of the Audit Committee is set forth below. The Audit Committee met five times during the last fiscal year. All of the members of our Audit Committee are "independent" members in accordance with the National Association of Securities Dealers.

The Compensation Committee consisted of Messrs. Anderson and Edens through December 31, 2001. The Compensation Committee reviews employee compensation and makes recommendations thereon to our Board of Directors and administers our Stock Incentive Plans. The Compensation Committee also determines, upon review of relevant information, the employees to whom options shall be granted. The Compensation Committee met two times during the last fiscal year.

ITEM 2. PROPERTIES

We recently relocated our corporate headquarters to a 22,600 square foot building located in Tempe, Arizona pursuant to a lease that expires in December 2003, and consolidated our two distribution centers from the existing Chandler, Arizona and Poway, California locations to a 68,000 square foot building also in Tempe, Arizona pursuant to a lease that expires in March 2006. The principal product development and support operations remain in a 96,000 square foot building located in Chandler, Arizona pursuant to a lease that expires in May 2008. We also own a 70,000 square foot facility located in Reno, Nevada that houses credit and lease finance facilities, business development center and sales office. We also lease sales and support offices in a total of 52 locations in the United States, including approximately 147,000 square feet of office space in Milford, Connecticut pursuant to the Executone acquisition (a portion of which has been subleased), and two locations overseas. Our aggregate monthly payments under these leases were approximately $563,000 at December 31,

2001. We believe that our facilities will be adequate to meet our current needs and that additional or alternative space will be available as necessary in the future on commercially reasonable terms.

ITEM 3. LEGAL PROCEEDINGS

We are involved from time to time in litigation incidental to our business. We believe that the outcome of current litigation will not have a material adverse effect upon our business, financial condition or results of operations and will not disrupt our normal operations.

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

None.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED SHAREHOLDER MATTERS

Inter-Tel Common Stock is traded over-the-counter (Nasdaq symbol: INTL) and since February 1983 has been included in the Nasdaq National Market System. As of March 8, 2002 there were of record approximately 1,684 shareholders of our Common Stock. The following table sets forth high and low sales prices reported by Nasdaq for each quarter in the last two years.

A dividend of $.01 per share of Common Stock has been paid to shareholders of record for each quarter since December 31, 1997. In October 2001, the Board of Directors declared an increase to the quarterly cash dividend to $.02 per share of Common Stock, effective December 31, 2001. The continuation of this dividend policy will depend on our earnings, capital requirements for growth, financial conditions and other factors.

2001	**High**	**Low**	**2000**	**High**	**Low**
First Quarter	13.125	6.8125	First Quarter	46.375	21.50
Second Quarter	14.74	7.75	Second Quarter	28.00	12.875
Third Quarter	16.95	9.90	Third Quarter	16 3125	11.00
Fourth Quarter	20.90	11.21	Fourth Quarter	13.25	6.1875

ITEM 6. SELECTED FINANCIAL DATA

Financial Summary

(In thousands, except per share amounts and ratios)	For the years ended December 31,								
	2001		2000		1999	1998		1997	
Net Sales	$ 385,655		$ 402,723		$ 314,221	$ 274,504		$ 223,569	
Cost of sales	211,161		243,685	(2)	159,463	140,946		122,363	
Research and development	17,556		19,489		14,798	11,373		7,998	
Selling, general and Administrative	131,157		127,468		98,430	86,554		69,942	
Write-off in-process research and development	--		5,433	(2)	--	22,755	(3)	--	
Other charges	5,357	(1)	45,245	(2)	--	--		--	
Operating (loss) income	20,424	(1)	(38,597)	(2)	41,530	12,876	(3)	23,266	
Equity share of Cirilium losses	--		(5,938)		--	--		--	
Write-off of Cirilium investment	--		(2,045)		--	--		--	
Interest and other income	1,081		1,474		2,391	2,913		1,556	
Gain (loss) on foreign translation adjustments	(337)		(421)		(46)	105		(173)	
Interest expense	(468)		(213)		(110)	(60)		(47)	
(Loss) income before taxes	20,700	(1)	(45,740)	(2)	43,765	15,834	(3)	24,602	
Income taxes	7,659		(16,817)		16,619	6,790		9,920	
Net (loss) income	13,041	(1)	(28,923)	(2)	$27,146	$9,044	(3)	$14,682	
Net (loss) income per share									
Basic	$ 0.53	(1)	$ (1.10)	(2)	$ 1.05	$ 0.34	(3)	$ 0.59	
Diluted	$ 0.52	(1)	$ (1.10)	(2)	$ 1.01	$ 0.32	(3)	$ 0.57	
Weighted average basic common shares	24,488		26,273		25,949	26,602		24,836	
Weighted average diluted common shares	25,240		26,273		27,004	27,846		25,983	
BALANCE SHEET DATA									
Total assets	$ 227,462		$ 243,126		$ 247,517	$ 197,030		$ 194,988	
Working capital	93,156		86,008		60,799	96,317		123,814	
Shareholders' equity	126,837		136,436		168,121	142,686		145,505	
KEY RATIOS									
Current ratio	2.41		2.05		1.93	3.17		4.69	
Dividends declared per share	$ 0.05		$ 0.04		$ 0.04	$ 0.04		$ 0.01	
Return on equity-continuing Operations	9.6	%	(17.2)	%	19.0 %	6.2	%	15.5	%
Return on equity-excluding Charges	12.0	%(1)	7.8	%(2)	19.0 %	15.6	%(3)	15.5	%

(1) 2001 operating income includes a pre-tax charge of $5.4 million, which reduced net income by $3.4 million, or $0.13 per share after tax. This pre-tax charge reflects the write-down of our investment in Inter-Tel.NET to net realizable value.

(2) 2000 operating income includes pre-tax charges of $66.8 million, which reduced net income by $42.0 million, or $1.60 per share after tax. These pre-tax charges reflect the write-off of the Executone acquisition of $50.9 million ($7.6 million of which is included in cost of sales) in the second quarter, the write-off of IPRD in connection with the Executone purchase of $5.4 million during the first quarter, the write-down to net realizable value of Inter-Tel.NET assets of $2.0 million during the second quarter, the equity share of Cirilium's losses of $5.9 million for the year, and write-off of our investment in Cirilium of $2.6 million (including reserve adjustments) during the third quarter. Without these charges, we would have reported net income of $13.1 million ($0.50 per diluted share) for the year ended December 31, 2000.

(3) 1998 operating income includes a special pre-tax charge of $22.8 million, which reduced net income by $13.7 million or $.49 per diluted share after tax. This charge reflects the write-off of in-process research and development in connection with the purchase of certain assets and liabilities of Telecom Multimedia Systems, Inc. ("TMSI"). Without this write-off, we would have reported net income of $22.7 million ($.82 per diluted share) for the year ended December 31, 1998.

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations and other parts of this Report on Form 10-K contain forward-looking statements that involve risks and uncertainties. The words "expects," "anticipates," "believes," "intends," "will" and similar expressions identify forward-looking statements which are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth in "Factors That May Affect Future Operating Results" and elsewhere in this 10-K.

General

Inter-Tel, incorporated in 1969, is a single point of contact, full service provider of business communications systems, voice mail systems and networking applications. We market and sell voice processing and unified messaging software, call accounting software, Internet Protocol (IP) telephony software, computer-telephone integration (CTI) applications, long distance calling services, and other communications services. Our products and services include the *Axxess* by Inter-Tel and *Eclipse²* by Inter-Tel business communication systems, with integrated voice processing and unified messaging systems, IP telephony voice and data routers, and ClearConnect Talk-to-Agent e-commerce software. We also provide maintenance, leasing and support services for our products. Our customers include business enterprises, government agencies and non-profit organizations. Our common stock is quoted on the Nasdaq National Market System under the symbol "INTL."

We have developed a distribution network of direct sales offices, dealers and value added resellers (VARs), which sell our products to organizations throughout the United States and internationally, including to divisions of Fortune 500 companies, large service organizations and governmental agencies. As of December 31, 2001, we had 49 direct sales offices in the United States and one in Japan, and a network of hundreds of dealers and VARs around the world that purchase directly from us. We also maintain a wholesale distribution office in the United Kingdom that supplies Inter-Tel's dealers and distributors throughout the UK and parts of Europe. In January 2002, we acquired selected assets and assumed certain selected liabilities of McLeod USA, Inc. (McLeod). As a result, we added 5 new direct sales offices and added personnel to 3 other existing offices. We integrated several of these offices into existing sales offices during 2002.

Sales of systems through our dealers and VARs typically generate lower gross margins than sales through our direct sales organization, although direct sales typically require higher levels of selling, general and administrative expenses. In addition, our long distance and network services typically generate lower gross margins than sales of software and system products. Accordingly, our margins may vary from period to period depending upon distribution channel and product mix. In the event that sales through dealers or sales of long distance services increase as a percentage of net sales, our overall gross margin could decline.

Our operating results depend upon a variety of factors, including the volume and timing of orders received during a period, the mix of products sold and the mix of distribution channels, general economic conditions, patterns of capital spending by customers, the timing of new product announcements and releases by us and our competitors, pricing pressures, the cost and effect of acquisitions and the availability and cost of products and components from our suppliers. Historically, a substantial portion of our net sales in a given quarter have been recorded in the third month of the quarter, with a concentration of such net sales in the last two weeks of the quarter. In addition, we are subject to seasonal variations in our operating results, as net sales for the first and third quarters are frequently less than those experienced during the fourth and second quarters, respectively.

The markets served by us have been characterized by rapid technological changes and increasing customer requirements. We have sought to address these requirements through the development of software enhancements and improvements to existing systems and the introduction of new products and applications. Inter-Tel's research and development efforts over the last several years have been focused primarily on the development of, and enhancements to, our *Axxess* and *Eclipse²* systems, including adding new applications, incorporating IP convergence applications and IP telephones, developing Unified Messaging Software applications, and expanding the telecommunications networking package to include networking over IP and frame relay networks. Over the last several years, our research and development efforts have also focused on the development of the ClearConnect SoftPhone and the related ClearConnect Talk-to-Agent Web communications software. Inter-Tel's current efforts are focused on developing and enhancing the IP telephony products and applications for our *Axxess* and *Eclipse²* systems, increasing single-site node capacity using an Asynchronous Transfer Mode backbone using version 6.0 *Axxess and Eclipse² software*, enhancing our Unified Messaging Software, developing a speech-recognition and text-to-speech enabled unified communications product, developing an advanced IVR and CT application development tool, enhancing the IP digital telephones, and enhancing Inter-Tel's server-based PBX offering.

We offer to our customers a package of lease financing and other services under the name Total Solution (formerly, Totalease). Total Solution provides our customers lease financing, maintenance and support services, fixed price upgrades and other benefits. We finance this program through the periodic resale of lease rental streams to financial institutions.

Net sales decreased 4.2% in 2001 compared to 2000. Net sales in 2000 and 1999 increased substantially by 28.2%, and 14.5%, respectively, over the preceding years.

Results of Operations

The following table sets forth certain statement of operations data expressed as a percentage of net sales for the periods indicated:

	Year Ended December 31		
	2001	2000	1999
Net sales	100.0 %	100.0 %	100.0 %
Cost of sales	54.8	60.5	50.7
Gross margin	45.2	39.5	49.3
Research and development	4.6	4.8	4.7
Selling, general and administrative	34.0	31.7	31.3
Other charges	1.4	12.6	--
Operating income (loss)	5.3	(9.6)	13.2
Equity share of Cirilium's net losses	--	(1.5)	--
Write-off of Cirilium investment	--	(0.5)	--
Interest and other income	0.3	0.4	0.7
Loss on foreign translation adjustments	(0.1)	(0.1)	--
Interest expense	(0.1)	(0.1)	0.0
Income taxes (benefit)	2.0	(4.2)	5.3
Net income (loss)	3.4 %	(7.2) %	8.6 %

Year Ended December 31, 2001 Versus Year Ended December 31, 2000

Net Sales. Net sales decreased 4.2% to $385.7 million in 2001 from $402.7 million in 2000, representing a decrease of $17.1 million. Sales from Inter-Tel.NET (in which Inter-Tel sold 83% in July 2001), accounted for $8.8 million of the decrease. Sales from our direct sales offices, including government and national accounts, and from wholesale distribution accounted for $9.4 million of the decrease. Sales from NetSolutions accounted for $1.0 million of the decrease from 2000 to 2001. Net sales from lease financing increased to $19.8 million in 2001 from $16.2 million in 2000. International revenues decreased approximately $300,000 from 2000 to 2001.

Since July 24, 2001, the date of the sale of 83% of Inter-Tel.NET, we have used the investment method of accounting for our remaining investment in Inter-Tel.NET/Comm-Services. Accordingly, we have not recorded revenues or expenses of Inter-Tel.NET since the date of sale. Excluding sales from Inter-Tel.NET, net sales for 2001 decreased 2.2% to $371.7 million, compared to $379.9 million in 2000. Inter-Tel.NET generated net sales of $14.0 million in 2001 compared to $22.8 million in 2000. The reduction in sales attributable to Inter-Tel.NET was due primarily to our sale of 83% of Inter-Tel.NET on July 24, 2001. Accordingly, less than seven months of activity from Inter-Tel.NET was reflected in the 2001 results as compared to the full year results of Inter-Tel.NET reported in 2000.

The 2001 decrease in net sales was also attributable to delayed customer buying decisions in 2001 related to a deterioration in macroeconomic conditions. Inter-Tel recognized lower revenues due to lower sales volumes of systems collectively through the direct sales offices, government and national accounts group, dealer channel and foreign operations, offset partially by sales increases in our lease finance operations. In some instances, prices of various telecommunications systems decreased, and discounts or other promotions that were offered to customers to generate sales resulted in lower revenues. Please refer to Note N of Notes to Consolidated Financial Statements for additional segment reporting information.

Gross Profit. Gross profit increased 9.7% to \$174.5 million, or 45.2% of net sales in 2001, from \$159.0 million, or 39.5% of net sales in 2000. Excluding the Executone restructuring charge, gross profit increased 4.7% compared to 166.7 million, or 41.4% of net sales in 2000. This increase in gross profit was primarily a result of lower sales from Inter-Tel.NET, which experienced negative gross margins, an increase in sales, as a percentage of consolidated net sales, through our direct sales channel compared to our dealer network, reduced product costs and higher relative recurring revenues. Gross profit also increased as a percentage of net sales, due in large part to items noted above. These increases were offset by greater competitive pricing pressures in 2001 and by pricing discounts on telephone system sales.

Excluding the operations of Inter-Tel.NET, gross profit for 2001 increased 1.4% to \$180.4 million, or 48.5% of net sales, compared to \$177.9 million, or 46.8% of net sales, in 2000. Inter-Tel.NET generated negative gross profit of \$5.9 million in 2001 compared to negative \$11.2 million in 2000.

Research and Development. Research and development expenses decreased to \$17.6 million, or 4.6% of net sales in 2001, from \$19.5 million, or 4.8% of net sales in 2000. The decline is attributable in large part to the closure of the Executone research and development operations in Milford, Connecticut in July 2000. Accordingly, our 2001 costs did not reflect the Executone expenses, compared to seven months of activity in 2000. In 2001, research and development expenses were directed principally toward the continued development of the digital *AXXESS* and Eclipse[2] software and systems (including version 6.0), unified messaging and voice processing software, InterPrise IP router solutions, Talk-to-Agent web e-commerce solutions, speech recognition and text-to-speech applications, and certain CTI and IVR applications. We expect that research and development expenses will increase in absolute dollars as we continue to develop and enhance existing and new technologies and products. These expenses may vary, however, as a percentage of net sales.

Selling, general and administrative. Selling, general and administrative expenses increased to \$131.2 million, or 34.0% of net sales in 2001, from \$127.5 million, or 31.7% of net sales in 2000. The increase in these expenses reflected an increase in costs associated with sales through our direct office channels compared to our dealer network, increased reserves for accounts receivable, and an increase in costs of maintaining additional facilities, including our new facilities in the Phoenix metro area and the Convergent offices acquired in January 2001. We expect that selling, general and administrative expenses will increase in absolute dollars, but may vary as a percentage of net sales.

Excluding the operations of Inter-Tel.NET, selling, general and administrative expenses increased to \$128.7 million, or 34.6% of net sales for 2001, compared to \$121.0 million, or 31.8% of net sales in 2000. Excluding charges, Inter-Tel.NET incurred selling, general and administrative expenses of \$2.5 million in 2001 compared to \$5.9 million in 2000.

Other charges. In connection with the sale of its interest in Inter-Tel.NET in July 2001, the Company recorded a pre-tax charge or \$5.4 million during 2001, which reduced net income by \$3.4 million, or \$0.13 per share after-tax. This charge was associated with the impairment of our investment in Inter-Tel.NET. The impairment was measured as the difference between the carrying value of Inter-Tel's 17% interest in Inter-Tel.NET and the estimated fair market value of the 17% interest in the net assets of Inter-Tel.NET.

We reported pre-tax charges of \$66.8 million during 2000, which reduced net income by \$42.0 million, or \$1.60 per share after tax. These pre-tax charges reflected the write-off of the Executone acquisition of \$50.9 million in the second quarter, the write-off of in process research and development in connection with the Executone purchase of \$5.4 million during the first quarter, the write-down to net realizable value of Inter-Tel.NET assets of \$2.0 million during the second quarter, the equity share of Cirilium's losses of \$5.9 million for the year, and write-off of Inter-Tel's investment in Cirilium of \$2.6 million (including reserve adjustments) during the third quarter. Without these charges, we would have reported net income of \$24.2 million (\$0.90 per diluted share) for the year ended December 31, 2000. Refer to "Restructuring Charges" below for additional information.

Charges and write-off of in process research and development. We reported a pre-tax charge of \$5.4 million during 2001, which reduced net income by \$3.4 million, or \$0.13 per share after tax. This pre-tax charge reflected the sale of 83% of our interest in Inter-Tel.NET and the write-down of our investment in Inter-Tel.NET to anticipated net realizable value. Without this charges, we would have reported net income of \$16.4 million (\$0.65 per diluted share) for the year ended December 31, 2001.

Interest and Other Income. Other income in both periods consisted primarily of interest income and foreign exchange rate gains and losses. Interest and other income decreased $393,000 in 2001 compared to the same period in 2000 principally as a result of lower levels of cash available for investment. During 2001, the Company recognized foreign exchange rate losses of $337,000 compared to losses of $421,000 in 2000. Interest expense was $468,000 in 2001 compared to $213,000 in 2000, primarily attributable to debt from assets financed for Inter-Tel.NET operations. This debt was transferred upon the sale of 83% of Inter-Tel.NET in July 2001.

Income Taxes. The 2001 income tax rate increased to 37.0% compared to 36.8% for 2000. The rate was lower in 2000 because we received no tax benefits for a component of the Cirilium losses that were capital losses during 2000 (lower tax benefits were received to apply to 2000 net losses). In 2002, we anticipate an effective tax rate comparable to or slightly higher than 2001.

Net Income. Including the charge recorded in 2001, net income increased to $13.0 million, or $.52 per diluted share, in 2001 compared to net loss of $28.9 million, or a net loss of $1.10 per diluted share, in 2000 reflecting the charges noted above associated with the Executone, Cirilium and Inter-Tel.NET operations. Excluding the charges, net income would have been $16.4 million, or $.65 per diluted share, in 2001.

Excluding the charges, all Cirilium losses and operations of Inter-Tel.NET, the Company reported net income of $21.8 million, or $0.86 per diluted share, in 2001, compared to net income of $24.2 million, or $0.90 per diluted share, in 2000.

Year Ended December 31, 2000 Versus Year Ended December 31, 1999

Net Sales. Net sales increased 28.2% to $402.7 million in 2000 from $314.2 million in 1999, representing an increase of $88.5 million. Sales from our direct sales offices, including government and national account, and from wholesale distribution accounted for $61.5 million of the increase and the network services group accounted for $21.2 million of the increase. In addition, sales from Inter-Tel.NET increased to $22.8 million in 2000 from $2.8 million in 1999.

Gross Profit. Gross profit including the Executone restructuring charge increased 2.8% to $159.0 million, or 39.5% of net sales in 2000 from $154.8 million, or 49.3% of net sales, in 1999. Excluding the Executone restructuring charge, gross profit increased 7.7% to 166.7 million, or 41.4% of net sales in 2000. This increase in gross profit was primarily a result of the large increase in consolidated sales. However, gross profit decreased as a percentage of net sales, due in large part to increases in sales of IP and long distance services, which have lower gross margins than sales of our digital systems and software. In addition, we experienced a lower proportion of sales through our direct sales offices compared to our dealer network, and were impacted by pricing discounts on telephone system sales.

Research and Development. Research and development expenses increased to $19.5 million, or 4.8% of net sales in 2000 from $14.8 million, or 4.7% of net sales, in 1999. The increase was attributable in large part to the purchase of Executone and related research and development operations in Milford, Connecticut in January 2000. Accordingly, our 2000 costs included seven months of Executone activity, compared to none in 1999. In 2000, these expenses were directed principally toward the continued development of the *AXXESS* and Eclipse^2 business communication systems, unified messaging and voice processing software, InterPrise IP router solutions, ClearConnect solutions and certain CTI applications.

Selling, general and administrative. Selling, general and administrative expenses increased to $127.5 million, or 31.7% of net sales, in 2000 from $98.4 million, or 31.3% of net sales, in 1999. The increase reflected increased costs from continued development of the Inter-Tel.net network and related expenses, increased reserves for accounts receivable, additional personnel to support the direct dealer network, and selling, incentive, training and other compensation costs at our direct sales office operations.

Other charges and IPRD write-off. We reported pre-tax charges of $66.8 million during 2000, which reduced net income by $42.0 million, or $1.60 per share after tax. These pre-tax charges reflected the write-off of the Executone acquisition of $50.9 million in the second quarter, the write-off of IPRD in connection with the Executone purchase of $5.4 million during the first quarter, the write-down to net realizable value of Inter-Tel.NET assets of $2.0 million during the second quarter, the equity share of Cirilium's losses of $5.9 million for the year, and write-off of our investment in Cirilium of $2.6 million (including reserve adjustments) during the third quarter.

Without these charges, we would have reported net income of $13.1 million ($0.50 per diluted share) for the year ended December 31, 2001. Refer to "Restructuring Charges" below for additional information.

Interest and Other Income. Other income in both periods consisted primarily of interest income and foreign exchange rate gains and losses. Other income decreased approximately $1.3 million in 2000 principally as a result of lower levels of cash available for investment.

Income Taxes. The 2000 income tax rate decreased to 36.8% compared to 38.0% for 1999. We received no tax benefit for a component of the Cirilium losses during 2000 that were capital losses.

Net Income. Including the charges recorded in 2000, net income decreased to a loss of $28.9 million, or a loss of $1.10 per diluted share, in 2000 compared to net income of $27.1 million, or $1.01 per diluted share, in 1999. Excluding the charges, net income would have been $13.1 million, or $.50 per diluted share, in 2000.

Inflation/Currency Fluctuation

Inflation and currency fluctuations have not previously had a material impact on Inter-Tel's operations. International procurement agreements have traditionally been denominated in U.S. currency. Moreover, a significant amount of contract manufacturing has been or is expected to be moved to alternative sources. The expansion of international operations in the United Kingdom and Europe and increased sales, if any, in Japan and other parts of Asia could result in higher international sales as a percentage of total revenues; however, international revenues are currently not significant.

Liquidity and Capital Resources

At December 31, 2001, cash and equivalents totaled $61.8 million, which represented an increase of approximately $34.7 million from December 31, 2000. We maintain a $25 million unsecured, revolving line of credit with BankOne Arizona, NA, that is available through June 1, 2002. Under the credit facility, we have the option to borrow at a prime rate or adjusted LIBOR interest rate. Historically, we have used the credit facility primarily to support international letters of credit to suppliers. During the year ended December 31, 2001, approximately $28.9 million of available cash was used to repurchase our common stock and an additional $6.8 million of available cash was used to fund acquisitions. During the prior year ended December 31, 2000, we used approximately $6.7 million to repurchase shares of our Common Stock and an additional $2.9 million of available cash in acquisitions and joint ventures. Also during 2000, we expended approximately $11.0 million in the restructuring of the Executone operations, including severance and related costs, the shut down and consolidation of the Milford facility and the impairment of assets associated with the restructuring. The remaining cash balances may be used for acquisitions, strategic alliances, working capital and general corporate purposes.

Net cash provided by operating activities totaled $75.0 million for the year ended December 31, 2001, compared to $17.3 million for the same period in 2000. Cash provided by operating activities in 2001 primarily resulted from income from operations after considering the non-cash portion of restructuring charges and the non-cash depreciation and amortization expenses. Cash generated by the change in operating assets and liabilities in 2001 was $16.1 million, compared to cash used by the change in operating assets and liabilities of $29.0 million in 2000. At December 31, 2001, we achieved lower accounts receivable, inventory, prepaid expenses and other current assets than at December 31, 2000, which was primarily a result of close management of receivables and inventory and working down elevated levels of working capital assets acquired in the Executone acquisition. In addition, accounts payable at December 31, 2001 were lower than prior year end consistent with the lower inventory levels achieved. We expect to expand sales through our direct sales office and dealer networks, which is expected to require the expenditure of working capital for increased accounts receivable and inventories.

Net cash used in investing activities, primarily in the form of acquisitions and capital expenditures totaled $14.6 million and $5.9 million for the years ended December 31, 2001 and 2000, respectively. Cash used in acquisitions and investments in joint ventures totaled approximately $6.8 million in 2001 compared to $2.9 million in 2000. Capital expenditures totaled approximately $8.0 million for 2001 compared to $9.6 million in 2000. Net cash used in investing activities in 2000 were partially offset by cash received of $6.6 million from the disposition of the manufacturing operations of Executone. We anticipate additional capital expenditures during 2002, principally relating to expenditures for equipment and management information systems used in operations, facilities expansion and acquisition activities.

Net cash used in financing activities totaled $25.7 million during 2001 compared to $3.5 million in 2000. We expended approximately $28.9 million and $6.7 million for stock repurchases during 2001 and 2000, respectively, funded by existing cash balances during each period. We issued long term debt, net of repayments, of $1.8 million in 2001 and $1.0 million in 2000 primarily in the form of long term capital leases to support capital additions to Inter-Tel.net prior to our divestiture of our majority ownership in July, 2001. During 2001, we reissued treasury shares through stock option exercises and issuances, with the proceeds received totaling less than the cost basis of the treasury stock reissued. Accordingly, the difference was recorded as a reduction to retained earnings. Net cash used for cash dividends totaled $1.0 million in 2001 and $1.1 million during 2000, which was offset in each period by cash provided by the exercise of stock options and stock issuances pursuant to our Employee Stock Purchase Plan.

We offer to our customers lease financing and other services, including our Total Solution (formerly Totalease) program, through our Inter-Tel Leasing, Inc. subsidiary. We fund our Total Solution program in part through the sale to financial institutions of rental income streams under the leases. Resold lease rentals totaling $202.7 and $198.4 million remain unbilled at December 31, 2001 and December 31, 2000, respectively. We are obligated to repurchase such income streams in the event of defaults by lease customers and, accordingly, maintain reserves based on loss experience and past due accounts. Although we to date have been able to resell the rental streams from leases under the Total Solution program profitably and on a substantially current basis, the timing and profitability of lease resales could impact our business and operating results, particularly in an environment of fluctuating interest rates and economic uncertainty. If we are required to repurchase rental streams and realizes losses thereon in amounts exceeding our reserves, our operating results will be adversely affected.

Inter-Tel received a gross cash award of $20 million in February 2002 in settlement of a binding arbitration claim. Income taxes, attorney's fees, expert witness costs, arbitration costs and additional costs and expenses, including $1.3 million in bonus payments to employees who assisted in the litigation and arbitration, totaled approximately $10.7 million in 2002. Accordingly, net proceeds from this arbitration totaled approximately $9.3 million. This transaction concluded in 2002; therefore no cash proceeds were included in the 2001 financial statements.

We believe that our working capital and credit facilities, together with cash generated from operations, will be sufficient to develop and expand our business operations, to finance acquisitions of additional resellers of telephony products and other strategic acquisitions or corporate alliances, and to provide adequate working capital for the next twelve months. However, to the extent that additional funds are required in the future to address working capital needs and to provide funding for capital expenditures, expansion of the business or additional acquisitions, we will seek additional financing. There can be no assurance that additional financing will be available when required or on acceptable terms.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The methods, estimates and judgments we use in applying our most critical accounting policies have a significant impact on the results we report in our consolidated financial statements. We evaluate our estimates and judgments on an on-going basis. We base our estimates on historical experience and on assumptions that we believe to be reasonable under the circumstances. Our experience and assumptions form the basis for our judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may vary from what we anticipate and different assumptions or estimates about the future could change our reported results. We believe the following accounting policies are the most critical to us, in that they are important to the portrayal of our financial statements and they require our most difficult, subjective or complex judgments in the preparation of our consolidated financial statements:

Revenue Recognition. We recognize revenue pursuant to Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements." Accordingly, revenue is recognized when all four of the following criteria are met: (i) persuasive evidence that arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is both fixed and determinable and; (iv) collectibility is reasonably probable. Revenue derived from sales of systems and services to end-user customers is recognized upon installation of the systems and performance of the services, respectively. Pre-payments for communications services are deferred and recognized as revenue as the communications services are provided.

For shipments to dealers and other distributors, our revenues are recorded as products are shipped and services are rendered, because the sales process is complete. These shipments are primarily to third-party dealers and distributors and title passes when goods are shipped (free-on-board shipping point).. Long distance services revenues are recognized as service is provided.

Sales-Leases. For our sales-type lease accounting, we follow the guidance provided by FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities – A Replacement of FASB Statement No. 125. We record the discounted present values of minimum rental payments under sales-type leases as sales, net of provisions for continuing administration and other expenses over the lease period. The costs of systems installed under these sales-leases, net of residual values at the end of the lease periods, are recorded as costs of sales. Gains or losses resulting from the sale of rental income from such leases are recorded as net sales. We maintain reserves against potential recourse following the resales based upon loss experience and past due accounts. The allowance for uncollectible minimum lease payments and recourse liability at the end of the year represent reserves against the entire lease portfolio or allowance for collectibility from customers. These reserves are either netted in the current and long-term components of "Net investments in Sales-Leases" on the balance sheet, or included in long-term liabilities on our balance sheet for off-book leases.

Goodwill and Other Identifiable Intangibles. We assess the impairment of goodwill and other identifiable intangibles whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Some factors we consider important which could trigger an impairment review include the following:

- Significant under-performance relative to historical, expected or projected future operating results;
- Significant changes in the manner of our use of the acquired assets or the strategy for our overall business;
- Our market capitalization relative to net book value, and
- Significant negative industry or economic trends.

When we determine that the carrying value of goodwill and other identified intangibles may not be recoverable, we measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," on January 1, 2002 we will cease to amortize goodwill arising from acquisitions completed prior to July 1, 2001. Inter-Tel has tested goodwill for impairment using the two-step process prescribed in SFAS 142. The first step is a screen for potential impairment, while the second step measures the amount of the impairment, if any. Inter-Tel has performed the first of the required impairment tests for goodwill as of January 1, 2002 and has determined that the carrying amount of goodwill is not impaired.

Inter-Tel has adopted SFAS 142 effective January 1, 2002. Application of the nonamortization provisions of SFAS 142 is expected to result in an increase in income from continuing operations before income taxes of approximately $1.8 million in 2002.

Allowance for Doubtful Accounts. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers or channel partners were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Additional reserves or allowances for doubtful accounts are recorded for our sales-type leases, discussed above in "Sales-Leases."

Inventories. We value our inventories at lower of cost or market. Cost is determined by the first-in, first-out (FIFO) method, including material, labor and factory overhead. Significant management judgment is required to determine the reserve for obsolete or excess inventory. Inventory on hand may exceed future demand either because the product is outdated, or obsolete, or because the amount on hand is more than can be used to meet future need, or excess. We currently consider all inventory that has no activity within one year as well as any additional specifically identified inventory to be excess. We also provide for the total value of inventories that we determine to be obsolete based on criteria such as customer demand, product life-cycles, changing technologies and market conditions. We write down our excess and obsolete inventory equal to the difference between the cost of inventory and the estimated market value. At December 31, 2001, our inventory reserves were $13.2 million of our $34.1 million gross inventories. If actual customer demand, product life-cycles, changing technologies and market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Contingencies. We are a party to various claims and litigation in the normal course of business. Management's current estimated range of liability related to various claims and pending litigation is based on claims for which our management can estimate the amount and range of loss. Because of the uncertainties related to both the amount and range of loss on the remaining pending claims and litigation, management is unable to make a reasonable estimate of the liability that could result from an unfavorable outcome. As additional information becomes available, we will assess the potential liability related to our pending litigation and revise our estimates. Such revisions in our estimates of the potential liability could materially impact our results of operation and financial position. We also received correspondence during 1999 from a major competitor and subsidiary inviting us to negotiate a license agreement regarding the competitors' patents. We have continued to negotiate with these competitors regarding their patent claims as well as make claim for our patents. We received additional correspondence in 2000 alleging intellectual property claims from another competitor. Inter-Tel responded by providing notice of consent to transfer license previously granted by this competitor. We do not anticipate that the resolution of such matters will have a material adverse effect on our consolidated financial position.

Other Charges

Inter-Tel.NET and ICA. During the second quarter of 2000, Inter-Tel recorded a pre-tax charge associated with Inter-Tel.NET operations of $2.0 million ($1.2 million after-tax), related to the write-down to net realizable value of network equipment and lease termination costs of certain redundant facilities. The reserves established at the time of the write-down have been fully utilized as of December 31, 2001. The following table summarizes the details of the write-down and activity in the reserve balances from the date of the write-down through December 31, 2001. Activity represents payments made or amounts written off.

Description	Cash/ Non-Cash	Other Charge	2000 Activity	2001 Activity	Reserve Balance At 12/31/01
			(In thousands)		
Lease termination obligations (net of anticipated recovery):					
Building leases	Cash	$ (144)	$ 87	$ 57	$ --
Impairment of Assets:					
Fixed assets	Non-Cash	(1,824)	1,824	--	--
Total		**$ (1,968)**	**$ 1,911**	**$ 57**	**$ --**

In March 2000, the Company's Inter-Tel.NET subsidiary acquired the stock of Intercomm Americas, Inc. (ICA), an international IP communications reseller for $580,000 cash and 750,000 shares of Inter-Tel.NET, with conversion rights into Inter-Tel, Incorporated Common Stock. The acquisition purchase price was valued at $1.2 million at March 2000.; The ICA shareholders did not intend to exercise conversion rights. However, due to market conditions, they decided to convert their Inter-Tel.NET shares to Inter-Tel shares in July 2001. Based on the exercise of conversion rights in July 2001, the valuation of purchase price of ICA increased to $6.2 million in accordance with the provisions of the acquisition agreement. The conversion of Inter-Tel.NET shares into Inter-Tel, Incorporated common stock was treated as an acquisition by Inter-Tel of Inter-Tel.NET shares, rather than as an adjustment to the original purchase price of ICA, as the conversion rights were part of the original purchase agreement, even though the value of the conversion rights could not be readily determined at that time. As a result, Inter-Tel made adjustments totaling $4.85 million to goodwill based on the value of the converted Inter-Tel shares as of June 30, 2001.

On July 24, 2001, Inter-Tel agreed to sell 83% of Inter-Tel.NET to Comm-Services Corporation for a note of $4.95 million, secured by Comm Services stock, other marketable securities of the shareholders of Comm Services and 100% of the net assets of Inter-Tel.NET. The marketable securities held as collateral may be exchanged for cash or other readily marketable assets as long as the fair market value of the collateral exceeds $2.5 million. The note is due and payable interest only from October 16, 2001 through July 15, 2002; then a principal payment of $250,000 due July 15, 2002, monthly principal and interest payments based on 1% of collected monthly revenues from July 16, 2002 to October 15, 2002 and based on 2% of collected monthly revenues from October 16, 2002 until paid in full. Additionally, any funds due Comm-Services for services rendered can be applied against the note. The note is due and payable on December 31, 2007, or earlier in certain circumstances.

In connection with the sale of 83% of Inter-Tel.NET, we assessed the fair value of the remaining 17% investment in Inter-Tel.NET. Pursuant to SFAS 121, we recorded a charge as of the close of the second quarter of $5.4 million ($3.4 million after tax) associated with the impairment of our investment in Inter-Tel.NET. The impairment was measured as the difference between the carrying value of Inter-Tel's 17% interest in Inter-Tel.NET/Comm-Services and the estimated current fair market value of the note plus the 17% ownership interest in Inter-Tel.NET. The charge is primarily non-cash.

Inter-Tel's management has not participated in the management of Inter-Tel.NET since the sale in July 2001. As a result, since July 24, 2001, we have accounted for the remaining Inter-Tel.NET/Comm-Services investment using the cost method of accounting. On December 30, 2001, Comm-Services entered into a merger agreement with Vianet. Inter-Tel's 17% investment in Comm-Services was converted to approximately 10% of Vianet stock. The $4.95 million loan was assumed by Vianet and Inter-Tel continues to hold collateral from the former shareholders of Comm-Services. Inter-Tel will account for the remaining 10% investment in Vianet using the cost method of accounting. The net investment in the notes receivable and 10% interest in Vianet (formerly Comm-Services) is recorded in other assets for approximately $3.7 million.

During 1999, 2000 and 2001, Inter-Tel.NET entered into operating lease agreements totaling approximately $6.5 million from an equipment vendor for network equipment and software. The lease agreements required Inter-Tel.NET to purchase vendor maintenance on their products. Inter-Tel originally guaranteed the indebtedness. In the second quarter of 2001, Inter-Tel.NET notified the vendor of network and network equipment problems encountered due to equipment and software recommended by the vendor, and supplied and financed by this vendor. Inter-Tel.NET requested that the vendor not only solve the problems, but also compensate Inter-Tel.NET for the problems and the resulting lost customers, lost revenues and lost profits. Pursuant to Inter-Tel's sale of 83% of Inter-Tel.NET, Comm-Services assumed the vendor lease and maintenance obligations and as such Inter-Tel has not recorded any liability for these obligations. However, the vendor has not released Inter-Tel from its guarantee of these obligations and Inter-Tel has not released the vendor from Inter-Tel's claims, nor did we assign our rights to these claims to Comm-Services.

Executone. On January 1, 2000 Inter-Tel purchased certain computer telephony assets and assumed certain liabilities of Executone Information Systems, Inc. (Executone) for $44.3 million in cash plus related acquisition costs, subject to purchase price adjustments as of the closing date. The Executone transaction was accounted for using the purchase method of accounting. The aggregate purchase price was allocated to the fair value of the assets and liabilities acquired, of which $5.4 million ($3.4 million after taxes) was written-off as purchased in-process research and development.

During the first quarter of 2000, the Executone division recognized losses of approximately $2.5 million ($1.5 million after taxes, or $.06 per diluted share) excluding the charge for in-process research and development. In connection with the Executone acquisition, we sold Executone's manufacturing assets and liabilities to Varian of Tempe, Arizona at a net book value of $6.6 million.

During the second quarter of 2000, the Executone division continued to experience significant losses. The Executone division recognized pre-tax losses during the second quarter and six months ended June 30, 2000 of $3.4 million, or $2.1 million after-tax ($.08 per diluted share) and $5.9 million, or $3.6 million after-tax ($.14 per diluted share), respectively. As a result of these losses, together with other considerations noted below, we decided to close the primary Executone facility in Milford, Connecticut and to recognize a restructuring charge related to the Executone operations. At the time the original purchase was recorded, we had not anticipated closing the Milford facility. After incurring higher than anticipated losses from Executone operations and after a deterioration in the Executone business, including loss of dealers and customers, delays in introduction and acceptance of new products, we decided it was in the best interests of us and our shareholders to close the Milford facility and consolidate operations into our metro-Phoenix, Arizona facilities.

We have accounted for the restructuring of the Executone operations, including severance and related costs, the shut down and consolidation of the Milford facility and the impairment of assets associated with the restructuring. We finalized our plan for the exiting of activities and the involuntary termination or relocation of approximately 137 employees in connection with the integration of Executone operations. Accrued costs associated with this plan were estimates, although the original estimates made for the second quarter of 2000 for reserve balances have not changed significantly as of December 31, 2001.

Exit costs associated with the closure of the Milford facility also included liabilities for building, furniture and equipment lease, and other contractual obligations. We are liable for the lease on the Milford buildings through January 2005. Various furniture leases run concurrently through March 2002. Other capital leases for computer and other equipment terminate on varying dates through September 2002. To date, we have entered into sublease agreements with third parties to sublease portions of the facility and equipment. The reserve for lease and other contractual obligations is identified in the table below.

The following tables summarize details of the restructuring charge in connection with the Executone acquisition, including the description of the type and amount of liabilities assumed, and activity in the reserve balances from the date of the charge through December 31, 2001. Activity represents payments made or amounts written off.

Description	Cash/ Non-Cash	Restructuring Charge	2000 Activity	2001 Activity	Reserve Balance At 12/31/01
			(In thousands)		
Personnel Costs:					
Severance and termination costs	Cash	$ (1,583)	$ 1,558	$ 2	$ (23)
Other Plant closure costs	Cash	(230)	30	200	--
Lease termination and other contractual obligations (net of anticipated recovery):					
Building and equipment leases	Cash	(7,444)	1,348	1,489	(4,607)
Other contractual obligations	Cash	(1,700)	--	1,700	--
Impairment of Assets:					
Inventories	Non-Cash	(3,454)	1,376	209	(1,869)
Prepaid inventory and other expenses	Non-Cash	(2,485)	2,485	--	--
Accounts receivable	Non-Cash	(1,685)	521	245	(919)
Fixed assets	Non-Cash	(3,151)	2,942	--	(209)
Net intangible assets	Non-Cash	(29,184)	29,184	--	--
Total		**$ (50,916)**	**$ 39,444**	**$ 3,845**	**$ (7,627)**

Included in the total Executone restructuring costs of $50.9 million is a $43.3 million restructuring charge for exit costs and asset impairment, and $7.6 million associated with the impairment of inventories, which has accordingly been recorded as additional costs of sales. Refer to Management's Discussion and Analysis for additional information.

Cirilium Joint Venture. In December 1999, Inter-Tel entered into an agreement with Hypercom Corporation to jointly form Cirilium. Cirilium comprised parts of Hypercom's data and Inter-Tel's packet telephony experience, products and services, including Inter-Tel's Vocal'Net gateway products and technology. We accounted for the Cirilium losses using the equity method of accounting through September 2000. In September 2000, we wrote-off our remaining investment in Cirilium. Our Cirilium ownership interest of 19.9% has been fully written-off in our financial statements, and we have not used the equity method of accounting since the date of the write-off.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS 141, "Business Combinations", and SFAS 142, "Goodwill and Other Intangible Assets", effective for our fiscal year beginning January 1, 2002. Inter-Tel has adopted SFAS 142 effective January 1, 2002. Application of the nonamortization provisions of SFAS 142 is expected to result in an increase in income from continuing operations before income taxes and trust distributions of approximately $1.8 million in 2002. Inter-Tel has tested goodwill for impairment using the two-step process prescribed in SFAS 142. The first step is a screen for potential impairment, while the second step measures the amount of the impairment, if any. Inter-Tel has performed the first of the required impairment tests for goodwill as of January 1, 2002 and has determined that the carrying amount of goodwill is not impaired.

In April 2001, the Emerging Issues Task Force (EITF) issued Issue 00-25, Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products. EITF 00-25 addresses the accounting and income statement classification of costs that a vendor incurs to or on behalf of a reseller in connection with the reseller's purchase or promotion of the vendor's products. The standard is effective for fiscal periods beginning after December 15, 2001 and will be adopted by us as of December 2002. It is not expected that the adoption of this standard will have a material impact on our financial position, results of operations or cash flows.

In July 2001, the FASB issued Statement No. 143, Accounting for Asset Retirement Obligations. The standard applies to obligations associated with the retirement of tangible long-lived assets. The standard is effective for fiscal periods beginning after June 15, 2002 and will be adopted by us as of December 2003. It is not expected that the adoption of this standard will have a material impact on our financial position, results of operations or cash flows.

In August 2001, the FASB issued Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (Statement) which supersedes FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of; however it retains the fundamental provisions of that statement related to the recognition and measurement of the impairment of long-lived assets to be "held and used." The standard is effective for fiscal periods beginning after December 15, 2001 and will be adopted by us as of December 2002. It is not expected that the adoption of this standard will have a material impact on our financial position, results of operations or cash flows.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The following discussion about our market risk disclosures involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. We are exposed to market risk related to changes in interest rates and foreign currency exchange rates. We do not use derivative financial instruments.

INVESTMENT PORTFOLIO. We do not use derivative financial instruments in our non-trading investment portfolio. Inter-Tel maintains a portfolio of highly liquid cash equivalents typically maturing in three months or less as of the date of purchase. Inter-Tel places its investments in instruments that meet high credit quality standards, as specified in our investment policy guidelines. Given the short-term nature of these investments, and that we have no borrowings outstanding other than short-term letters of credit, we are not subject to significant interest rate risk.

LEASE PORTFOLIO. We offer to our customers lease financing and other services, including our Total Solutions program, through our Inter-Tel Leasing subsidiary. We fund these programs in part through the sale to financial institutions of rental income streams under the leases. Upon the sale of the rental income streams, we continue to service the leases and maintain limited recourse on the leases. We maintain reserves for loan losses on all leases based on historical loss experience and specific account analysis. Although to date we have been able to resell the rental streams from leases under our lease programs profitably and on a substantially current basis, the timing and profitability of lease resales could impact our business and operating results, particularly in an environment of fluctuating interest rates and economic uncertainty. If we were required to repurchase rental streams and realize losses thereon in amounts exceeding our reserves, our operating results could be materially adversely affected. See "Liquidity and Capital Resources" in Management's Discussion and Analysis and Notes A and D to the financial statements for more information regarding our lease portfolio and financing.

IMPACT OF FOREIGN CURRENCY RATE CHANGES. We invoice the customers of our international subsidiaries primarily in the local currencies of our subsidiaries for product and service revenues. Inter-Tel is exposed to foreign exchange rate fluctuations as the financial results of foreign subsidiaries are translated into U.S. dollars in consolidation. The impact of foreign currency rate changes have historically been insignificant.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information required by this Item is incorporated by reference to Exhibit 13.0.

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

Not applicable.

PART III

Certain information required by Part III is omitted from this report in that the Registrant will file a definitive proxy statement pursuant to Regulation 14A (the "Proxy Statement") not later than 120 days after the end of the fiscal year covered by this Report, and the information included therein is incorporated herein by reference to the extent stated below.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information with respect to directors and executive officers is included at the end of Part I, Item 1 on this report under the caption "Directors and Executive Officers of the Registrant."

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference to the Company's Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this Item is incorporated by reference to the Company's Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None.

PART IV

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

(a) The following documents are filed as part of this Report:

1. Financial Statements

The following consolidated financial statements of Inter-Tel, Incorporated, and subsidiaries, are incorporated by reference to Exhibit 13.0:

Report of Ernst & Young LLP, Independent Auditors
Consolidated balance sheets--December 31, 2001 and 2000
Consolidated statements of operations--years ended December 31, 2001, 2000 and 1999
Consolidated statements of shareholders' equity--years ended December 31, 2001, 2000 and 1999
Consolidated statements of cash flows--years ended December 31, 2001, 2000 and 1999
Notes to consolidated financial statements

2. Financial Statement Schedules

The following consolidated financial statement schedule of Inter-Tel, Incorporated, and subsidiaries is filed as part of this Report and should be read in conjunction with the Consolidated Financial Statements of Inter-Tel, Incorporated and subsidiaries, and the notes thereto.

Schedule for the three years ended December 31, 2001:

Schedule II--Valuation and Qualifying Accounts   Page No. 40

Schedules not listed above have been omitted because they are not applicable or are not required or the information required to be set forth therein is included in the Consolidated Financial Statements or notes thereto.

3. Exhibits

3.1(10)	Articles of Incorporation, as amended.
3.2(16)	By-Laws, as amended.
10.15(1)	Registrant's form of standard Distributor Agreement.
10.16(1)	Registrant's form of standard Service Agreement.
10.34(2) *	1984 Incentive Stock Option Plan and forms of Stock Option Agreement.
10.35(3)	Agreement between Registrant and Samsung Semiconductor and Telecommunications Company, Ltd. dated October 17, 1984.
10.37(3) *	Tax Deferred Savings Plan.
10.51(11) *	1990 Directors' Stock Option Plan and form of Stock Option Agreement.
10.52(15) *	Inter-Tel, Incorporated Long-Term Incentive Plan and forms of Stock Option Agreements.
10.53(12)	Agreement between Registrant and Maxon Systems, Inc. dated February 27, 1990.
10.54(12)	Agreement between Registrant and Varian Tempe Electronics Center dated February 26, 1991.
10.55(12)	Agreement between Registrant and Jetcrown Industrial Ltd. dated February 18, 1993.
10.56(13) *	Employee Stock Ownership Plan.
10.57(14)	Loan and Security Agreement dated March 4, 1997 between Bank One, Arizona, N.A. and Registrant and Modification Agreement dated July 25, 1997.

10.58 (16) Development, Supply and License Agreement between Registrant and QUALCOMM dated January 17, 1996.

10.59(17) * Inter-Tel, Incorporated 1997 Long-Term Incentive Plan.

10.60(17) * Inter-Tel, Incorporated 1997 Employee Stock Purchase Plan.

10.61(18) * Inter-Tel, Incorporated Acquisition Stock Option Plan and form of Stock Option Agreement.

10.61(19) Computer Telephony Asset Purchase Agreement dated as of October 17, 1999 by and between Executone Information Systems, Inc., Inter-Tel, Incorporated and Executone Inter-Tel Business Information Systems, Inc.

13.0 (20) Excerpts from Annual Report to Security Holders.

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(1) Incorporated by reference to Registrant's Registration Statement on Form S-1 (File No. 2-70437).

(2) Incorporated by reference to Registrant's Registration Statement on Form S-8 (File No. 2-94805).

(3) Incorporated by reference to Registrant's Annual Report on Form 10-K for the year ended November 30, 1984 (File No. 0-10211).

(10) Incorporated by reference to Registrant's Annual Report on Form 10-K for the year ended December 31, 1988 (File No. 0-10211).

(11) Incorporated by reference to Registrant's Registration Statement on Form S-8 (File No. 33-40353).

(12) Incorporated by reference to Registrant's Registration Statement on Form S-1 (File No. 33-70054).

(13) Incorporated by reference to Registrant's Registration Statement on Form S-8 (File No. 33-73620).

(14) Incorporated by reference to Registrant's Annual Report on Form 10-K for the year ended December 31, 1998 (File No. 0-10211).

(15) Incorporated by reference to Registrant's Proxy Statement dated March 23, 1994.

(16) Incorporated by reference to Registrant's Annual Report on Form 10-K for the year ended December 31, 1995 (File No. 0-10211).

(17) Incorporated by reference to Registrant's Registration Statement on Form S-8 (File No. 333-41197).

(18) Incorporated by reference to Registrant's Registration Statement on Form S-8 (File No. 333-67261).

(19) Incorporated by reference to Registrant's Report on Form 8-K (File No. 333-67261).

(20) Filed herewith, except as noted.

* Management contracts or compensatory plan or arrangement required to be filed as an exhibit to this report on Form 10-K.

(b) Reports on Form 8-K. None.

(c) Exhibits.

13.0 Excerpts from Annual Report to Security Holders. Filed herewith.

23.0 Consent of Ernst & Young LLP, Independent Auditors.

24.1 Power of Attorney.

See Item 14(a) 3 also.

(d) Financial Statement Schedules. The response to this portion of Item 14 is submitted as a separate section of this report. See Item 8.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant, Inter-Tel, Incorporated, has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

INTER-TEL, INCORPORATED

BY: /S/ Steven G. Mihaylo
Steven G. Mihaylo
Chairman and Chief Executive Officer

Dated: March 21, 2002

EXHIBIT 24.1--POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steven G. Mihaylo and Kurt R. Kneip, jointly and severally, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

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

Signature	Title	Date
/S/ Steven G. Mihaylo Steven G. Mihaylo	Chairman and Chief Executive Officer	March 21, 2002
/S/ Kurt R. Kneip Kurt R. Kneip	Vice President and Chief Financial Officer	March 21, 2002
/S/ J. Robert Anderson J. Robert Anderson	Director	March 21, 2002
/S/ Jerry W. Chapman Jerry W. Chapman	Director	March 21, 2002
/S/ Gary D. Edens Gary D. Edens	Director	March 21, 2002
/S/ C. Roland Haden C. Roland Haden	Director	March 21, 2002

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

(In thousands)

	COL. A	COL. B	COL. C	COL. D	COL. E
		ADDITIONS			
DESCRIPTION	Balance at Beginning of Period	Charged to Costs & Expenses	Charged to Other Accounts Describe	Charged to Deductions Describe	Balance at End of Period
Year ended December 31, 2001					
Deducted from asset accounts:					
Allowance for doubtful accounts	$17,187	$6,260	$207 (4)	$11,796 (1, 2)	$11,858
Allowance for lease accounts	$8,870	$5,840	$--	$4,197 (2)	$10,513
Inventory allowance	$11,897	$1,614	$2,000 (4)	$2,309 (3)	$13,202
Year ended December 31, 2000					
Deducted from asset accounts:					
Allowance for doubtful accounts	$8,814	$6,793	$4,994 (4)	$3,414 (2)	$17,187
Allowance for lease accounts	$6,734	$4,927	$--	$2,791 (2)	$ 8,870
Inventory allowance	$5,849	$1,653	$6,278 (4)	$1,883 (3)	$11,897
Year ended December 31, 1999					
Deducted from asset accounts:					
Allowance for doubtful accounts	$4,604	$4,623	$2,628 (4)	$3,041 (2)	$8,814
Allowance for lease accounts	$5,716	$3,773	$ --	$2,755 (2)	$6,734
Inventory allowance	$5,453	$1,508	$83 (4)	$1,195 (3)	$5,849

(1) Includes $4.6 million related to 2000 acquisitions and included in balance at end of period 2000 (see item 4 below). Additionally, this includes $1.9 million transferred to Comm-Services with sale of Inter-Tel.NET that was also included in balance at end of period.
(2) Uncollectible accounts written off, net of recoveries.
(3) Inventory written off.
(4) Acquired in purchase transaction.

EXHIBIT 13.0 ANNUAL REPORT TO SECURITY HOLDERS

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Ernst & Young LLP, Independent Auditors

Shareholders and Board of Directors
Inter-Tel, Incorporated

We have audited the accompanying consolidated balance sheets of Inter-Tel, Incorporated and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2001. Our audits also included the financial statement schedule listed in the Index at Item 14(a) 2. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Inter-Tel, Incorporated and subsidiaries at December 31, 2001 and 2000, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/Ernst & Young LLP

Phoenix, Arizona
February 13, 2002

INTER-TEL, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2001 and 2000

(In thousands, except share amounts)	**2001**	**2000**
ASSETS		
CURRENT ASSETS		
Cash and equivalents	$ 61,795	$ 27,103
Accounts receivable, less allowances of $11,858 in 2001 and $17,187 in 2000	45,962	61,482
Inventories, less allowances of $13,202 in 2001 and $11,897 in 2000	20,848	35,060
Net investment in sales-leases	13,799	14,629
Income taxes receivable	3,257	9,157
Deferred income taxes	8,467	13,116
Prepaid expenses and other assets	4,891	7,668
TOTAL CURRENT ASSETS	159,019	168,215
PROPERTY, PLANT & EQUIPMENT	23,835	32,723
EQUIPMENT HELD UNDER LEASE, NET	70	423
GOODWILL AND OTHER INTANGIBLES	18,659	18,389
NET INVESTMENT IN SALES-LEASES	21,735	22,808
OTHER ASSETS	4,144	568
	$ 227,462	$ 243,126
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 21,812	$ 35,438
Other current liabilities	44,051	46,769
TOTAL CURRENT LIABILITIES	65,863	82,207
DEFERRED TAX LIABILITY	17,390	5,222
LEASE RECOURSE LIABILITY	8,890	7,697
RESTRUCTURING RESERVE	3,060	5,760
OTHER LIABILITIES	5,422	5,804
SHAREHOLDERS' EQUITY		
Common stock, no par value - authorized 100,000,000 shares; issued and outstanding – 24,166,430 shares in 2001 and 25,950,969 shares in 2000	108,968	109,132
Less: Shareholder loans	(942)	(1,018)
Retained earnings	54,877	44,099
Accumulated other comprehensive income	151	(280)
	163,054	151,933
Less: Treasury stock at cost – 2,995,393 shares in 2001 and 1,210,854 shares in 2000.	(36,217)	(15,497)
TOTAL SHAREHOLDERS' EQUITY	126,837	136,436
	$ 227,462	$ 243,126

See accompanying notes.

INTER-TEL, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended December 31, 2001, 2000 and 1999

(In thousands, except per share data)	2001	2000	1999
NET SALES	$ 385,655	$ 402,723	$ 314,221
Cost of sales	211,161	236,046	159,463
Cost of sales – Executone restructuring	--	7,639	--
GROSS PROFIT	174,494	159,038	154,758
Research and development	17,556	19,489	14,798
Selling, general and administrative	131,157	127,468	98,430
In-process research and development	--	5,433	--
Other charges	5,357	45,245	--
	154,070	197,635	113,228
OPERATING INCOME (LOSS)	20,424	(38,597)	41,530
Equity share of Cirilium Corp.'s net Losses	--	(5,938)	--
Write-off of Cirilium Corp. investment	--	(2,045)	--
Interest and other income	1081	1,474	2,391
Loss on foreign translation adjustments	(337)	(421)	(46)
Interest expense	(468)	(213)	(110)
INCOME (LOSS) BEFORE INCOME TAXES	20,700	(45,740)	43,765
INCOME TAXES			
Current	(3,647)	(9,904)	19,966
Deferred	11,306	(6,913)	(3,347)
	7,659	(16,817)	16,619
NET INCOME (LOSS)	$ 13,041	$ (28,923)	$ 27,146
NET INCOME (LOSS) PER SHARE			
Basic	$ 0.53	$ (1.10)	$ 1.05
Diluted	$ 0.52	$ (1.10)	$ 1.01
Weighted average basic common shares	24,488	26,273	25,949
Weighted average diluted common shares	25,240	26,273	27,004

See accompanying notes.

INTER-TEL, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
Years Ended December 31, 2001, 2000 and 1999

(In thousands)	Common Stock	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Share-Holder Loans	Total
Balance at December 31, 1998	$ 104,539	$ (15,851)	$ 54,194	$ (196)	$ --	$ 142,686
Stock repurchase		(6,700)				(6,700)
Exercise of stock options		8,027	(4,420)			3,607
Tax benefit from stock options	2,421					2,421
Shareholder loans					(1,116)	(1,116)
Stock issued under Employee Stock Purchase Plan		896	(45)			851
Adjustment to shares previously Issued in acquisition	(107)					(107)
Net income			27,146			27,146
Gain on currency translation				373		373
Comprehensive income						27,519
Dividends			(1,040)			(1,040)
Balance at December 31, 1999	106,853	(13,628)	75,835	177	(1,116)	168,121
Stock repurchase		(6,711)				(6,711)
Exercise of stock options		3,496	(1,468)			2,028
Tax benefit from stock options	1,852					1,852
Shareholder loan repayments					98	98
Stock issued under Employee Stock Purchase Plan		1,346	(293)			1,053
Issuance of shares in acquisition	427					427
Net loss			(28,923)			(28,923)
Loss on currency translation				(457)		(457)
Comprehensive loss						(29,380)
Dividends			(1,052)			(1,052)
Balance at December 31, 2000	109,132	(15,497)	44,099	(280)	(1,018)	136,436
Stock repurchase		(28,905)				(28,905)
Exercise of stock options		1,806	(509)			1,297
Tax benefit from stock options	263					263
Shareholder loan repayments					76	76
Stock issued under Employee Stock Purchase Plan		1,057	(91)			966
Issuance of treasury shares in conversion of subsidiary stock	(427)	5,322	(471)			4,424
Net income			13,041			13,041
Gain on currency translation				431		431
Comprehensive income						13,472
Dividends			(1,192)			(1,192)
Balance at December 31, 2001	$ 108,968	$ (36,217)	$ 54,877	$ 151	$ (942)	$ 126,837

See accompanying notes.

INTER-TEL, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2001, 2000 and 1999

(In thousands)	2001	2000	1999
OPERATING ACTIVITIES:			
Net income (loss)	$ 13,041	$ (28,923)	$ 27,146
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation of fixed assets	8,742	9,724	7,653
Amortization of intangibles	2,775	3,022	1,470
Provision for losses on receivables	12,100	11,720	8,396
Provision for inventory valuation	1,614	1,653	1,508
Increase in other liabilities	3,547	9,111	6,106
Loss on sale of property and equipment:	(39)	157	197
Deferred income taxes (benefit)	11,306	(6,913)	(3,347)
Effect of exchange rate changes	431	(457)	373
Purchased in-process research and development	--	5,433	--
Non-cash portion of other charges	5,357	41,783	--
Changes in operating assets and liabilities	16,132	(28,971)	(16,122)
NET CASH PROVIDED BY OPERATING ACTIVITIES	75,006	17,339	33,380
INVESTING ACTIVITIES:			
Additions to property and equipment	(7,988)	(9,597)	(12,486)
Additions to operating leases	--	(122)	(3,115)
Proceeds from sale of property and equipment and operating leases	173	39	2,904
Cash received from disposition of business segment	--	6,602	--
Cash used in acquisitions and joint ventures	(6,789)	(2,855)	(59,960)
NET CASH USED IN INVESTING ACTIVITIES	(14,604)	(5,933)	(72,657)
FINANCING ACTIVITIES:			
Cash dividends paid	(983)	(1,054)	(1,040)
Proceeds from exercise of stock options	1,373	2,126	2,491
Proceeds from stock issued under the Employee Stock Purchase Plan	966	1,053	851
Proceeds from term debt	3,387	3,319	--
Payments on term debt	(1,548)	(2,262)	(223)
Treasury stock purchases	(28,905)	(6,711)	(6,700)
NET CASH USED IN FINANCING ACTIVITIES	(25,710)	(3,529)	(4,621)
INCREASE (DECREASE) IN CASH AND EQUIVALENTS	34,692	7,877	(43,898)
CASH AND EQUIVALENTS AT BEGINNING OF YEAR	27,103	19,226	63,124
CASH AND EQUIVALENTS AT END OF YEAR	$ 61,795	$ 27,103	$ 19,226

See accompanying notes.

NOTE A – SIGNIFICANT ACCOUNTING POLICIES

Description of Business. Inter-Tel, incorporated in 1969, is a single point of contact, full service provider of business communications systems, voice mail systems and networking applications. We market and sell voice processing and unified messaging software, call accounting software, Internet Protocol (IP) telephony software, computer-telephone integration (CTI) applications, long distance calling services, and other communications services. Our products and services include the *Axxess* by Inter-Tel and *Eclipse²* by Inter-Tel business communication systems, with integrated voice processing and unified messaging systems, IP telephony voice and data routers, and ClearConnect Talk-to-Agent e-commerce software. We also provide maintenance, leasing and support services for our products. Our customers include business enterprises, government agencies and non-profit organizations. Our common stock is quoted on the Nasdaq National Market System under the symbol "INTL."

Principles of Consolidation. The consolidated financial statements include the accounts of Inter-Tel, Incorporated and all significant subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Cash and Equivalents. Cash and equivalents include all highly liquid investments with a remaining maturity of three months or less at date of acquisition. Excess cash and equivalents are primarily invested in mutual funds comprised of foreign and domestic high quality dollar denominated money market instruments rated A-1 by Standard & Poor's Ratings Group, or equivalent.

Inventories. Inventories, consisting principally of telephone systems, computer equipment and related components, are stated at the lower of cost (first-in, first-out method) or market.

Property, Plant and Equipment. Property, plant and equipment is stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the related real and personal property which range from 3 years to 30 years. Leasehold improvements are depreciated over the shorter of the related lease terms or the estimated useful lives of the improvements. Within the category "computer systems and equipment," including database and enterprise software, WAN and LAN equipment and software, personal computers, servers and related software, the range for estimated useful lives is 3 years to 7 years. See Note E for additional information.

Goodwill and Other Intangible Assets. Purchase prices of acquired businesses and technology that are accounted for as purchases have been allocated to the assets and liabilities acquired based on the estimated fair values on the respective acquisition dates. Based on these values, the excess purchase prices over the fair value of the net assets acquired ("goodwill") were being amortized over 3 to 40 years through December 31, 2001.

At December 31, 2001, goodwill, net of accumulated amortization, totaled $13.7 million. Other acquisition-related intangibles, net of accumulated amortization, totaled $5.0 million at December 31, 2001. Accumulated amortization through December 31, 2001 was $7.6 million. This amount includes $5.0 million of amortization of goodwill and $2.6 million of amortization of other acquisition-related intangibles. Other acquisition-related intangibles, comprised primarily of developed technology, customer lists and non-competition agreements, are amortized on a straight-line basis over periods ranging from 5-17 years. See Note F for additional information.

In June 2001 the Financial Accounting Standards Board issued Statements of Financial Accounting Standards (SFAS) 141, "Business Combinations," and 142, "Goodwill and Other Intangible Assets." SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS 141 also includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations completed after June 30, 2001. SFAS 142 prohibits the amortization of goodwill and intangible assets with indefinite useful lives. SFAS 142 requires that these assets be reviewed for impairment at least annually. Intangible assets with finite lives will continue to be amortized over their estimated useful lives. Additionally, SFAS 142 requires that goodwill included in the carrying value of equity method investments no longer be amortized.

Inter-Tel has adopted SFAS 142 effective January 1, 2002. Application of the nonamortization provisions of SFAS 142 is expected to result in an increase in income from continuing operations before income taxes of approximately $1.8 million in 2002. Inter-Tel has tested goodwill for impairment using the two-step process prescribed in SFAS 142. The first step is a screen for potential impairment, while the second step measures the amount of the impairment, if any. Inter-Tel has performed the first of the required impairment tests for goodwill as of January 1, 2002 and has determined that the carrying amount of goodwill is not impaired.

Sales-Leases. The discounted present values of minimum rental payments under sales-type leases are recorded as sales, net of provisions for continuing administration and other expenses over the lease period. The costs of systems installed under these sales-leases, net of residual values at the end of the lease periods, are recorded as costs of sales. Gains or losses resulting from the sale of rental income from such leases are recorded as net sales. Refer to Note D for additional information.

Income Taxes. Deferred income taxes result from temporary differences in the recognition of revenues and expenses for financial reporting and income tax purposes.

Advertising. The cost of advertising is expensed as incurred. We incurred $596,000; $513,000; and $559,000 in advertising costs during 2001, 2000, and 1999, respectively.

Revenue Recognition. We recognize revenue pursuant to Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements." Accordingly, revenue is recognized when all four of the following criteria are met: (i) persuasive evidence that arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is both fixed and determinable and; (iv) collectibility is reasonably probable. Revenue derived from sales of systems and services to end-user customers is recognized upon installation of the systems and performance of the services, respectively, allowing for use by our customers of these systems. Pre-payments for communications services are deferred and recognized as revenue as the communications services are provided.

For shipments to dealers and other distributors, our revenues are recorded as products are shipped and services are rendered, because the sales process is complete. These shipments are primarily to third-party dealers and distributors and title passes when goods are shipped (free-on-board shipping point). Long distance services revenues are recognized as service is provided.

Shipping and Handling Costs. EITF 00-10 "Accounting for Shipping and Handling Fees and Costs," addresses the accounting for shipping and handling fees and costs. Our policy is primarily not to bill customers for shipping costs, unless the customer requests priority shipping. Any amounts billed are recorded net in cost of goods sold. Billed shipping and handling costs in 2001 represented less than $1.16 million, or 0.3% of net sales, and are not a significant component of our operations.

Stock Based Compensation. We grant stock options for a fixed number of shares to employees with an exercise price equal to the fair market value of the shares at the date of grant. We account for stock option grants in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB 25") and related Interpretations, in accounting for stock based awards to employees. Under APB 25, we generally recognize no compensation expense with respect to such awards.

Foreign Currency Translation. For our foreign operations, the local currency is the functional currency. All assets and liabilities are translated at period-end exchange rates and all income statement amounts are translated at an average of month-end rates. Adjustments resulting from this translation are recorded in accumulated other comprehensive income.

Contingencies. We are a party to various claims and litigation in the normal course of business. However, it is management's opinion that the results of these matters will not have a material adverse impact on our financial position, results of operations or future cash flows.

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

Reclassifications. Certain reclassifications have been made to the 2000 and 1999 financial statements to conform to the 2001 presentation.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS 141, "Business Combinations", and SFAS 142, "Goodwill and Other Intangible Assets", effective for our fiscal year beginning January 1, 2002. Inter-Tel has adopted SFAS 142 effective January 1, 2002. Application of the nonamortization provisions of SFAS 142 is expected to result in an increase in income from continuing operations before income taxes of approximately $1.8 million in 2002. Inter-Tel has tested goodwill for impairment using the two-step process prescribed in SFAS 142. The first step is a screen for potential impairment, while the second step measures the amount of the impairment, if any. Inter-Tel has performed the first of the required impairment tests for goodwill as of January 1, 2002 and has determined that the carrying amount of goodwill is not impaired.

In April 2001, the Emerging Issues Task Force (EITF) issued Issue 00-25, Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products. EITF 00-25 addresses the accounting and income statement classification of costs that a vendor incurs to or on behalf of a reseller in connection with the reseller's purchase or promotion of the vendor's products. The standard is effective for fiscal periods beginning after December 15, 2001 and will be adopted by us as of January 2002. It is not expected that the adoption of this standard will have a material impact on our financial position, results of operations or cash flows.

In July 2001, the FASB issued Statement No. 143, Accounting for Asset Retirement Obligations. The standard applies to obligations associated with the retirement of tangible long-lived assets. The standard is effective for fiscal periods beginning after June 15, 2002 and will be adopted by us as of January 2003. It is not expected that the adoption of this standard will have a material impact on our financial position, results of operations or cash flows.

In August 2001, the FASB issued Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (Statement) which supersedes FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of; however it retains the fundamental provisions of that statement related to the recognition and measurement of the impairment of long-lived assets to be "held and used." The standard is effective for fiscal periods beginning after December 15, 2001 and will be adopted by us as of January 2002. It is not expected that the adoption of this standard will have a material impact on our financial position, results of operations or cash flows.

NOTE B – ACQUISITIONS, DISPOSITIONS AND RESTRUCTURING CHARGES

Convergent. On January 26, 2001, Inter-Tel Technologies, Inc., our wholly-owned subsidiary, acquired certain assets of Convergent Communications Services, Inc. (Convergent) for cash plus the assumption of various specific liabilities and related acquisition costs. The Company acquired segments of the voice customer base, accounts receivable, specified inventory and fixed assets, and assumed liabilities for warranty, maintenance and specified leased premises costs. The Convergent transaction was accounted for using the purchase method of accounting.

The adjusted purchase price paid by us in the Convergent transaction included cash of $3.9 million plus assumption of specific liabilities totaling $6.3 million. The final purchase price was adjusted pursuant to a settlement agreement with Convergent representatives which specified the return of $6.7 million to Inter-Tel, representing funds from escrow and other amounts owed to Inter-Tel by Convergent that were previously set aside by the bankruptcy court, as well as adjustments for assets to be acquired and liabilities to be assumed. The settlement payments only required adjustments or reallocations based on the specified assets acquired and liabilities assumed in connection with the purchase, and differences have been represented as adjustments to the net assets acquired. The Company recorded goodwill of $880,000 and other intangible assets of $120,000 in connection with this acquisition. Goodwill and intangibles were amortized through December 31, 2001. The net goodwill balance of $810,000 as of December 31, 2001 will no longer be amortized, but accounted for in accordance with SFAS 141 and 142. The net balance of $98,000 in other intangible assets will continue to be amortized for five years from the date of the acquisition.

MasterMind. On October 19, 2001, Inter-Tel Integrated Systems, Inc., our wholly-owned subsidiary, acquired certain of the assets and assumed certain stated liabilities from MasterMind Technologies, Inc., a Virginia corporation (MasterMind), for $2.0 million. $1.79 million was paid at or before closing with the balance placed into a bonus pool with earnout provisions for MasterMind shareholders and employees based on performance parameters. The portion relating to employees who have joined Inter-Tel will be charged to expenses. The Company recorded amortizable intangible technology assets totaling $1.4 million in connection with this acquisition. These technology assets are being amortized over 5 years.

Each of the acquisitions discussed above was accounted for using the purchase method of accounting. The results of operations of each of these acquisitions have been included in our accompanying consolidated statements of operations from the date of acquisitions.

Inter-Tel.NET and ICA. During the second quarter of 2000, Inter-Tel recorded a pre-tax charge associated with Inter-Tel.NET operations of $2.0 million ($1.2 million after-tax), related to the write-down to net realizable value of network equipment and lease termination costs of certain redundant facilities. The reserves established at the time of the write-down have been fully utilized as of December 31, 2001. The following table summarizes the details of the write-down and activity in the reserve balances from the date of the write-down through December 31, 2001. Activity represents payments made or amounts written off.

Description	Cash/ Non-Cash	Other Charge	2000 Activity	2001 Activity	Reserve Balance At 12/31/01
			(In thousands)		
Lease termination obligations (net of anticipated recovery):					
Building leases	Cash	$ (144)	$ 87	$ 57	$ --
Impairment of Assets:					
Fixed assets	Non-Cash	(1,824)	1,824	--	--
Total		**$ (1,968)**	**$ 1,911**	**$ 57**	**$ --**

In March 2000, the Company's Inter-Tel.NET subsidiary acquired the stock of Intercomm Americas, Inc. (ICA), an international IP communications reseller for $580,000 cash and 750,000 shares of Inter-Tel.NET, with conversion rights into Inter-Tel, Incorporated Common Stock. The acquisition purchase price was valued at $1.2 million at March 2000. The ICA shareholders did not intend to exercise conversion rights. However, due to market conditions they decided to convert their Inter-Tel.NET shares to Inter-Tel shares in July 2001. Based on the exercise of conversion rights in July 2001, the valuation of purchase price of ICA increased to $6.2 million in accordance with the provisions of the acquisition agreement. The conversion of Inter-Tel.NET shares into Inter-Tel, Incorporated common stock was treated as an acquisition by Inter-Tel of Inter-Tel.NET shares, rather than as an adjustment to the original purchase price of ICA, as the conversion rights were part of the original purchase agreement, even though the value of the conversion rights could not be readily determined at that time. As a result, Inter-Tel made adjustments totaling $4.85 million to goodwill based on the value of the converted Inter-Tel shares as of June 30, 2001.

On July 24, 2001, Inter-Tel agreed to sell 83% of Inter-Tel.NET to Comm-Services Corporation for a note of $4.95 million, secured by Comm-Services stock, other marketable securities of the shareholders of Comm-Services and 100% of the net assets of Inter-Tel.NET. The marketable securities held as collateral may be exchanged for cash or other readily marketable assets as long as the fair market value of the collateral exceeds $2.5 million. The note is due and payable interest only from October 16, 2001 through July 15, 2002; then a principal payment of $250,000 due July 15, 2002, monthly principal and interest payments based on 1% of collected monthly revenues from July 16, 2002 to October 15, 2002 and based on 2% of collected monthly revenues from October 16, 2002 until paid in full. Additionally, any funds due Comm-Services for services rendered can be applied against the note. The note is due and payable on December 31, 2007, or earlier in certain circumstances.

In connection with the sale of 83% of Inter-Tel.NET, we assessed the fair value of the remaining 17% investment in Inter-Tel.NET. Pursuant to SFAS 121, we recorded a charge as of the close of the second quarter of $5.4 million ($3.4 million after tax) associated with the impairment of our investment in Inter-Tel.NET. The impairment was measured as the difference between the carrying value of Inter-Tel's 17% interest in Inter-

Tel.NET/Comm-Services and the estimated current fair market value of the note plus the 17% ownership interest in Inter-Tel.NET. The charge is primarily non-cash.

Inter-Tel's management has not participated in the management of Inter-Tel.NET since the sale in July 2001. As a result, since July 24, 2001, we have accounted for the remaining Inter-Tel.NET/Comm-Services investment using the cost method of accounting. On December 30, 2001, Comm-Services entered into a merger agreement with Vianet. Inter-Tel's 17% investment in Comm-Services was converted to approximately 10% of Vianet stock. The $4.95 million loan was assumed by Vianet and Inter-Tel continues to hold collateral from the former shareholders of Comm-Services. Inter-Tel will account for the remaining 10% investment in Vianet using the cost method of accounting. The net investment in the note receivable and 10% interest in Vianet (formerly Comm-Services) is recorded in other assets for approximately $3.7 million.

During 1999, 2000 and 2001, Inter-Tel.NET entered into operating lease agreements totaling approximately $6.5 million from an equipment vendor for network equipment and software. The lease agreements required Inter-Tel.NET to purchase vendor maintenance on their products. Inter-Tel originally guaranteed the indebtedness. In the second quarter of 2001, Inter-Tel.NET notified the vendor of network and network equipment problems encountered due to equipment and software recommended by the vendor, and supplied and financed by this vendor. Inter-Tel.NET requested that the vendor not only solve the problems, but also compensate Inter-Tel.NET for the problems and the resulting lost customers, lost revenues and lost profits. Pursuant to Inter-Tel's sale of 83% of Inter-Tel.NET, Comm-Services assumed the vendor lease and maintenance obligations and as such Inter-Tel has not recorded any liability for these obligations. However, the vendor has not released Inter-Tel from its guarantee of these obligations and Inter-Tel has not released the vendor from Inter-Tel's claims, nor did we assign our rights to these claims to Comm-Services.

Executone. On January 1, 2000 Inter-Tel purchased certain computer telephony assets and assumed certain liabilities of Executone Information Systems, Inc. (Executone) for $44.3 million in cash plus related acquisition costs, subject to purchase price adjustments as of the closing date. The Executone transaction was accounted for using the purchase method of accounting. The aggregate purchase price was allocated to the fair value of the assets and liabilities acquired, of which $5.4 million ($3.4 million after taxes) was written-off as purchased in-process research and development.

During the first quarter of 2000, the Executone division recognized losses of approximately $2.5 million ($1.5 million after taxes, or $.06 per diluted share) excluding the charge for in-process research and development. In connection with the Executone acquisition, we sold Executone's manufacturing assets and liabilities to Varian of Tempe, Arizona at a net book value of $6.6 million.

During the second quarter of 2000, the Executone division continued to experience significant losses. The Executone division recognized pre-tax losses during the second quarter and six months ended June 30, 2000 of $3.4 million, or $2.1 million after-tax ($.08 per diluted share) and $5.9 million, or $3.6 million after-tax ($.14 per diluted share), respectively. As a result of these losses, together with other considerations noted below, we decided to close the primary Executone facility in Milford, Connecticut and to recognize a restructuring charge related to the Executone operations. At the time the original purchase was recorded, we had not anticipated closing the Milford facility. After incurring higher than anticipated losses from Executone operations and after a deterioration in the Executone business, including loss of dealers and customers, delays in introduction and acceptance of new products, we decided it was in the best interests of us and our shareholders to close the Milford facility and consolidate operations into our metro-Phoenix, Arizona facilities.

We have accounted for the restructuring of the Executone operations, including severance and related costs, the shut down and consolidation of the Milford facility and the impairment of assets associated with the restructuring. We finalized our plan for the exiting of activities and the involuntary termination or relocation of approximately 137 employees in connection with the integration of Executone operations. Accrued costs associated with this plan were estimates, although the original estimates made for the second quarter of 2000 for reserve balances have not changed significantly as of December 31, 2001.

Exit costs associated with the closure of the Milford facility also included liabilities for building, furniture and equipment lease, and other contractual obligations. We are liable for the lease on the Milford buildings through January 2005. Various furniture leases run concurrently through March 2002. Other capital leases for computer and other equipment terminate on varying dates through September 2002. To date, we have entered into sublease agreements with third parties to sublease portions of the facility and equipment. The reserve for lease and other contractual obligations is identified in the table below.

The following tables summarize details of the restructuring charge in connection with the Executone acquisition, including the description of the type and amount of liabilities assumed, and activity in the reserve balances from the date of the charge through December 31, 2001. Activity represents payments made or amounts written off.

Description	Cash/ Non-Cash	Restructuring Charge	2000 Activity	2001 Activity	Reserve Balance At 12/31/01
			(In thousands)		
Personnel Costs:					
Severance and termination costs	Cash	$ (1,583)	$ 1,558	$ 2	$ (23)
Other Plant closure costs	Cash	(230)	30	200	--
Lease termination and other contractual obligations (net of anticipated recovery):					
Building and equipment leases	Cash	(7,444)	1,348	1,489	(4,607)
Other contractual obligations	Cash	(1,700)	--	1,700	--
Impairment of Assets:					
Inventories	Non-Cash	(3,454)	1,376	209	(1,869)
Prepaid inventory and other expenses	Non-Cash	(2,485)	2,485	--	--
Accounts receivable	Non-Cash	(1,685)	521	245	(919)
Fixed assets	Non-Cash	(3,151)	2,942	--	(209)
Net intangible assets	Non-Cash	(29,184)	29,184	--	--
Total		**$ (50,916)**	**$ 39,444**	**$ 3,845**	**$ (7,627)**

Included in the total Executone restructuring costs of $50.9 million is a $43.3 million restructuring charge for exit costs and asset impairment, and $7.6 million associated with the impairment of inventories, which has accordingly been recorded as additional costs of sales. Refer to Management's Discussion and Analysis for additional information.

Cirilium Joint Venture. In December 1999, Inter-Tel entered into an agreement with Hypercom Corporation to jointly form Cirilium. Cirilium comprised parts of Hypercom's data and Inter-Tel's packet telephony experience, products and services, including Inter-Tel's Vocal'Net gateway products and technology. We accounted for the Cirilium losses using the equity method of accounting through September 2000. In September 2000, we wrote-off our remaining investment in Cirilium. Our Cirilium ownership interest of 19.9% has been fully written-off in our financial statements, and we have not used the equity method of accounting since the date of the write-off.

McLeod. During the first quarter of 2002, Inter-Tel acquired certain assets and assumed certain liabilities of McLeod USA, Inc. (McLeod) for cash of $8 million plus the assumption of various specific liabilities and related acquisition costs. Generally, Inter-Tel acquired the voice customer base in Minnesota, Iowa and Colorado and the DataNet operations in South Dakota, which also includes the related accounts receivable, inventory and fixed assets along with assumption of scheduled specific liabilities for warranty and maintenance obligations. The acquisition closed in January 2002 and the company has up to 90 days from the date of closing to dispute the existence of any scheduled acquired assets and $500,000 was placed in escrow to cover potential purchase price adjustments. We expect to record goodwill in connection with this acquisition, although the amount has not been fully quantified. This transaction was accounted for using the purchase method of accounting.

NOTE C – PURCHASED IN-PROCESS RESEARCH AND DEVELOPMENT CHARGE

During the first quarter of 2000, Inter-Tel completed the acquisition of Executone (see NOTE B). The aggregate purchase price of the Executone acquisition was allocated to the fair value of the assets and liabilities acquired, of which $5.4 million ($3.4 million after taxes), or $0.13 per diluted share, was written-off as purchased in-process research and development.

NOTE D – NET INVESTMENT IN SALES-LEASES

Net investment in sales-leases represents the value of sales-leases presently held under our Total Solution program. We currently sell the rental income from some of the sales-leases. We maintain reserves against potential recourse following the resales based upon loss experience and past due accounts. Activity during the years was as follows:

	Year Ended December 31		
(In thousands)	2001	2000	1999
Sales of rental income	$ 86,788	$ 95,127	$ 83,405
Sold income remaining unbilled at end of year	$202,715	$198,361	$163,728
Allowance for uncollectible minimum lease payments and recourse liability at end of year	$ 10,513	$ 8,870	$ 6,734

Sales of rental income represents the gross selling price or total present value of the payment stream on the sale of the rental income to third parties. Sold income remaining unbilled at the end of the year represents the total balance of off-book leases that are not included in our balance sheet. The allowance for uncollectible minimum lease payments and recourse liability at the end of the year represent reserves against the entire lease portfolio or allowance for collectibility from customers. These reserves are either netted in the current and long-term components of "Net investments in Sales-Leases" on the balance sheet, or included in long-term liabilities on our balance sheet for off-book leases.

We do not expect to incur any significant losses from the recourse provisions related to the sale of rental income. Inter-Tel is compensated for administration and servicing of rental income sold.

At December 31, 2001, future minimum lease payments related to the lease portfolio are: 2002 -- $14,483,000; 2003 -- $14,278,000; 2004 -- $5,023,000; 2005 – $2,235,000; 2006 -- $1,313,000; thereafter – $3,000.

NOTE E – PROPERTY, PLANT & EQUIPMENT

	December 31	
(In thousands)	2001	2000
Computer systems and equipment	$ 42,313	$ 47,047
Transportation equipment	2,872	2,909
Furniture and fixtures	5,056	4,839
Leasehold improvements	3,770	3,101
Building	7,297	7,297
Land	2,629	2,629
	63,937	67,822
Less: Accumulated depreciation and amortization	40,102	35,099
Net property, plant & equipment	$ 23,835	$ 32,723
Equipment Held For Lease		
Operating leases (telephone equipment)	1,712	$ 1,923
Less: Accumulated depreciation and amortization	1,642	1,500
Net Equipment held for lease	$ 70	$ 423

NOTE F – GOODWILL AND OTHER INTANGIBLES

(In thousands)	December 31 2001	2000
Goodwill	$ 18,681	$ 17,515
Less: Accumulated amortization	5,025	2,642
Net Goodwill	13,656	14,873
Acquired developed technology	5,786	4,347
Customer lists and non-competition agreements	1,841	1,721
Subtotal of Other intangibles	7,627	6,068
Less: Accumulated amortization	2,624	2,552
Net Other intangibles	5,003	3,516
Net Goodwill and other intangibles	$ 18,659	$ 18,389

NOTE G – OTHER ASSETS

(In thousands)	December 31 2001	2000
Note receivable and investment in Vianet (formerly Inter-Tel.Net)	$ 3,669	$ --
Other assets	475	568
	$4,144	$ 568

NOTE H – OTHER CURRENT LIABILITIES

(In thousands)	December 31 2001	2000
Compensation and employee benefits	$ 12,947	$ 12,284
Restructuring Charge	1,389	2,318
Deferred revenues	6,445	6,308
Miscellaneous taxes payable	3,994	8,147
Other accrued expenses	19,276	17,712
	$44,051	$ 46,769

NOTE I – CREDIT LINE

We maintain a $25,000,000 unsecured bank credit line at prime rate to cover international letters of credit and for other purposes. The credit agreement matures June 1, 2002 and contains certain restrictions and financial covenants. At December 31, 2001, $544,841of the credit line was committed under letter of credit arrangements.

NOTE J – LEASES

Rental expense amounted to $9,679,000; $8,818,000; and $6,254,000; in 2001, 2000, and 1999, respectively. Noncancellable operating leases are primarily for buildings. Certain of the leases contain provisions for renewal options and scheduled rent increases. At December 31, 2001, future minimum commitments under noncancellable leases, including our new headquarters facility and a 15 year lease for our research and development facility and 63 month lease for our distribution and support facility, are: 2002 -- $9,567,000; 2003 -- $7,798,000; 2004 -- $7,153,000; 2005 – $3,234,000; 2006 -- $1,630,000 thereafter – $1,071,000.

NOTE K – INCOME TAXES

We account for income taxes under Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"). Under SFAS 109, the liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined (and classified as current or long-term) based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Significant components of our deferred tax liabilities and assets as of December 31 are as follows:

(In thousands)	December 31 2001	2000
Deferred tax liabilities:		
Other	$ 4,944	$ --
Lease--sales and reserves	32,027	24,057
Total deferred tax liabilities	36,971	24,057
Deferred tax assets:		
Inventory basis differences	3,285	2,976
Accounts receivable reserves	2,789	3,039
Accrued vacation pay	1,223	980
Book over tax depreciation	771	2,787
Foreign loss carryforwards	956	1,358
In-process R&D write-off	6,581	7,950
Restructuring reserves	3,036	9,006
Lease Receivable	3,995	3,371
Other – net	6,226	1,842
Deferred tax assets	28,862	33,309
Less valuation reserve	814	1,358
Net deferred tax assets	28,048	31,951
Net deferred tax assets (liabilities)	$ (8,923)	$ 7,894

During 2001, 2000 and 1999, we recorded a loss of $437,000, income of $226,000, and losses of $341,000 respectively, from foreign operations. At December 31, 2001, we had foreign loss carryforwards of approximately $2,500,000, which will begin to expire in 2002. The valuation allowance in 2001 decreased by $544,000 and increased by $79,000 in 2000 due to expiration of foreign loss carryforwards and increases in foreign loss carryforward benefits.

Federal and state income taxes (benefit) consisted of the following:

(In thousands)	2001	2000	1999
Federal	$ 5,076	$ (15,101)	$ 13,832
State	2,583	(1,716)	2,787
	$ 7,659	$ (16,817)	$ 16,619

The principal reasons for the difference between total income tax expense (benefit) and the amount computed by applying the statutory federal income tax rate to income before taxes are as follows:

	2001	2000	1999
Federal tax at statutory rates			
Applied to pre-tax income	35 %	(35) %	35 %
State tax net of federal benefit	5	(4)	3
Credit for research activities	(5)	--	--
Other – net	2	2	--
	37 %	(37) %	38 %

NOTE L – EQUITY TRANSACTIONS

Treasury Stock. During the first quarter of 2001, we initiated a stock repurchase program under which the Board of Directors authorized the repurchase of up to 4,000,000 shares of our Common Stock. During the third quarter of 2000, we initiated a stock repurchase program under which the Board of Directors authorized the repurchase of up to 2,000,000 shares of Inter-Tel Common Stock. Under these authorizations, we purchased approximately 2,523,000 shares and expended approximately $28.9 million for stock repurchases during 2001, which was funded primarily through existing cash balances. We also expended approximately $6.7 million and $6.7 million for repurchases of approximately 562,000 and 558,000 shares of Inter-Tel's Common Stock during 2000 and 1999, respectively, which was funded primarily through existing cash balances. We reissued approximately 671,000, 379,000 and 740,000 shares in 2001, 2000 and 1999, respectively, through stock option and employee stock purchase plan exercises and issuances, and stock issued in conversion of subsidiary stock through an acquisition. The proceeds received for the stock reissued were less than our cost basis. Accordingly, the difference was recorded as a reduction to retained earnings.

Dividend Policy. On October 23, 2001, our Board of Directors increased the cash dividend (the "cash dividend") from $0.01 to $0.02 for every share of Common Stock, payable quarterly to shareholders of record beginning December 31, 2001, with dividend payments to commence on or about 15 days after the end of each fiscal quarter. From December 31, 1997 through the third quarter of 2001, we paid quarterly cash dividends of $0.01 for every share of Common Stock to shareholders of record. We have made quarterly dividend payments for each quarter since the dividend was declared in September 1997. Prior to the cash dividend, we had declared no cash dividends on our Common Stock since incorporation.

Stock Option Plans. In July 1990, we adopted the Director Stock Option Plan ("the Director Plan") and reserved a total of 500,000 shares of Common Stock for issuance thereunder. In July 2001, subject to shareholder approval at the annual shareholders' meeting in April 2002, the board of directors extended the term of the Director Plan to 2010. Options must be granted at not less than 100% of the fair market value of our stock at the dates of grant. Commencing with the adoption of the Plan, each Eligible Director received a one-time automatic grant of an option to purchase 5,000 shares of our Common Stock. In addition, each Eligible Director shall be granted an option to purchase 5,000 shares upon the date five (5) days after such person became Director, and an additional option to purchase 5,000 shares five (5) days after the date of the regularly scheduled board meeting following the close of our third quarter. All options granted through 2001 had a five-year term and fully vest at the end of six months from the grant date.

In November 1993, the Board of Directors authorized the Inter-Tel, Incorporated Long-Term Incentive Plan ("the 1994 Long Term Plan"). A total of 2,000,000 shares of Common Stock has been reserved for issuance under the 1994 Long Term Plan to selected officers and key employees. Options must be granted at not less than 100% of the fair market value of our stock at the dates of grant. Options generally vest over four or five years and expire five to ten years from the date of grant.

In February 1997, the Board of Directors authorized the Inter-Tel, Incorporated 1997 Long-Term Incentive Plan ("the 1997 Long Term Plan"). A total of 2,400,000 shares of Common Stock has been reserved for issuance under the 1997 Long Term Plan to selected officers and key employees. Option must be granted at not less than 100% of the fair market value of our stock at the dates of grant. Options generally vest over four or five years and expire ten years from the date of grant. In March 2000, the Board of Directors authorized an amendment to the 1997 Long Term Plan to add 1,250,000 more shares of Common Stock to the 1997 Long Term Plan for issuance to selected officers and key employees and to limit our ability to reprice options under the 1997 Long Term Plan.

On February 27, 2001 our Board of Directors authorized an amendment of the Long Term Plan, approved by the stockholders, that provides for an automatic increase in the number of shares of Common Stock reserved thereunder on the first day of each fiscal year equal to the lesser of (a) 2.5% of the outstanding shares on that date, (b) 750,000 shares (subject to appropriate adjustment for all stock splits, dividends, subdivisions, combinations, recapitalizations and like transactions) or (c) a lesser amount as determined by the Board of Directors (the "Renewal Feature"). For 2002, based on shares outstanding at January 1, 2002 and as approved by the Board of Directors in February 2002, this renewal feature provided for an increase of 604,161 shares for issuance under the Long Term Plan.

Under the 1994 and 1997 Long Term Plans, in some instances, predetermined performance goals and share market value increases must be met to allow the options to be exercised before the end of the option term.

In April 1998, the Board of Directors authorized the Inter-Tel, Incorporated Acquisition Stock Option Plan (the Acquisition Plan). A total of 82,428 shares of Common Stock was reserved for issuance under the Acquisition Plan to selected key employees hired as a result of the acquisition of TMSI. New options must be granted at not less than 100% of the fair market value of our stock at the dates of grant. Options generally vest over four or five years and expire ten years from the date of grant. A portion of the options granted were replacements for options held to purchase shares of stock of the selling company; such replacement grants retained the original terms, including grant dates for vesting purposes and the original grant prices, adjusted using the applicable conversion ratio of the fair value of Inter-Tel's stock compared to that of the selling company.

In March 2000, the Board of Directors authorized an additional 216,000 shares of Common Stock for issuance under the Acquisition Plan to selected employees hired as a result of the acquisition of Executone. Options must be granted at not less than 100% of the fair market value of our stock at the dates of grant. Options vest over five years and expire ten years from the date of grant.

In February 2001, the Board of Directors authorized an additional 300,000 shares of Common Stock for issuance under the Acquisition Plan to selected employees hired as a result of the acquisition of Convergent. In addition, in October 2001, the Board of Directors authorized an additional 150,000 shares of Common Stock for issuance under the Acquisition Plan to selected employees hired as a result of the acquisition of Mastermind Technologies. Options in each instance must be granted at not less than 100% of the fair market value of our stock at the dates of grant. Options vest over five years and expire ten years from the date of grant.

Option activity for the past three years under all plans is as follows:

		Number of Shares	
	2001	2000	1999
Outstanding at beginning of year	3,143,292	2,486,696	2,948,032
Granted	2,007,500	1,213,500	491,750
Exercised	(210,633)	(279,654)	(615,986)
Expired or canceled	(372,214)	(277,250)	(337,100)
Outstanding at end of year	4,567,945	3,143,292	2,486,696
Exercise price range	\$2.24-\$43.44	\$2.24-\$43.44	\$2.24-\$26.00
Exercisable at end of year	1,458,388	1,188,356	979,630
Weighted-average grant price of options granted	\$12.26	\$13.65	\$11.44
Weighted-average fair value of options granted during the year	\$6.42	\$6.83	\$5.15

At December 31, 2001, we have reserved 4,921,435 shares of Common Stock for issuance in connection with the stock option plans.

As permitted under Statement of Financial Accounting Standards No. 123 (FAS 123) "Accounting for Stock-Based Compensation," we have elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations, in accounting for stock based awards to employees. Under APB 25, we generally recognize no compensation expense with respect to such awards.

The following table summarizes information about stock options outstanding at December 31, 2001:

	Options Outstanding		
Range of	Number Outstanding	Weighted-Average Remaining	Weighted Average

Exercise Price	at 12-31-01	Contractual Life	Exercise Price
$2.24 - $4.31	244,203	3 years	$3.00
$4.81 - $7.06	231,100	5 years	$5.58
$7.25 - $13.44	3,066,200	8 years	$10.43
$15.13 - $43.44	1,026,442	7 years	$21.46

Options Exercisable

Range of Exercise Price	Number Exercisable at 12-31-01	Weighted-Average Remaining Contractual Life	Weighted Average Exercise Price
$2.24 - $4.31	244,203	3 years	$3.00
$4.81 - $7.06	173,300	5 years	$5.69
$7.25 - $13.44	620,700	8 years	$10.09
$15.13 - $43.44	420,185	7 years	$22.05

During 2001, the weighted average exercise price of options granted, exercised, and expired or canceled was $10.14, $8.05 and $15.02, respectively.

Had compensation cost for our stock option plans been determined based on the fair value at the grant date for awards in 2001, 2000 and 1999 consistent with the provisions of SFAS 123, the estimated fair value of the options would be amortized to expense over the option's vesting period and our net income and net income per share for the year ended December 31 would have been as follows:

(in thousands, except per share amounts)	2001	2000	1999
Net (loss) income as reported	$13,041	$(28,923)	$27,146
Pro forma net (loss) income	$10,595	$(30,480)	$26,043
Pro forma (loss) income per diluted share	$0.42	$(1.16)	$0.96

Pro forma results disclosed are based on the provisions of SFAS 123 using the Black-Scholes option valuation model and are not likely to be representative of the effects on pro forma net income for future years. In addition, the Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in our opinion, the estimating models do not necessarily provide a reliable single measure of the fair value of our employee stock options.

The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model using the low end of reasonable assumptions for input variables rather than attempting to identify a best-point estimate. The option pricing model utilized the following weighted average assumptions for 2001, 2000 and 1999, respectively: risk free interest rates of 4.5% for 2001 and 5.5% for 2000 and 1999; dividend yields of .50% for 2001 and .25% for 2000 and 1999; volatility factors of the expected market price of our stock averaged .766 for 2001 and .30 for 2000 and 1999; and a weighted average expected life of the option of 4 to 5 years for employee stock options which vest over four to five year periods with a weighted average vesting period of 2.5 years and 1.5 years for director options which vest at the end of six months from the grant date.

1997 Employee Stock Purchase Plan. In April 1997, the Board of Directors and stockholders adopted the Employee Stock Purchase Plan (the Purchase Plan) and reserved 500,000 shares for issuance to eligible employees. Under the Purchase Plan, employees are granted the right to purchase shares of Common Stock at a price per share that is 85% of the lesser of the fair market value of the shares at: (i) the participant's entry date into each six-month offering period, or (ii) the end of each six-month offering period. Employees may designate up to 10% of their compensation for the purchase of stock. Under the Plan, we sold 108,742 shares for approximately $966,000 ($8.89 per share) to employees in 2001, 105,485 shares for approximately $980,000

($9.29 per share) to employees in 2000, and 67,431 shares for approximately $851,000 ($12.62 per share) to employees in 1999. At December 31, 2001, 136,670 shares remained authorized under the Plan.

Stock Option Loans. During 1999, selected officers and employees of Inter-Tel were offered loans to acquire Inter-Tel common stock. Promissory Notes were established to cover the cost of exercise of stock options, including applicable taxes, or the cost of Inter-Tel common stock purchased in the open market during May and June of 1999. The loans are interest-only notes with balloon payments due on or before March 15, 2004. The loans bear interest at the mid-term applicable federal interest rate, compounded annually. Interest payments are due on or before March 15 of each anniversary beginning on March 15, 2000. The notes are full recourse loans and we retain the common stock certificates as collateral. The outstanding balance of loans at December 31, 2001 totaled $942,417.

NOTE M – EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

(In thousands, except per share amounts)	2001	2000	1999
Numerator:			
Net income (loss)	$13,041	$(28,923)	$27,146
Denominator:			
Denominator for basic earnings per Share – weighted average shares	24,488	26,273	25,949
Effect of dilutive securities:			
Employee and director stock options	752	--	1,055
Denominator for diluted earnings per Share – adjusted weighted average shares and assumed conversions	25,240	26,273	27,004
Basic income (loss) per share	$0.53	$(1.10)	$ 1.05
Diluted income (loss) per share	$0.52	$(1.10)	$ 1.01

Options that are antidilutive because the exercise price was greater than the average market price of the common shares, are not included in the computation of diluted earnings per share. For the year ended December 31, 2000, 689,000 shares were excluded from the computation of diluted EPS above because they were antidilutive for 2000.

NOTE N – RETIREMENT PLANS

We have two retirement plans for the benefit of our employees. Under our 401(k) Retirement Plan, participants may contribute an amount not exceeding 15 percent of compensation received during participation in the Plan. We make voluntary annual contributions to the Plan based on a percentage of contributions made by Plan participants of up to 10 percent of compensation. Contributions to the Plan totaled $1,476,000; $1,381,000; and $780,000; in 2001, 2000 and 1999, respectively.

In 1992, we initiated an Employee Stock Ownership Plan (ESOP), advancing $500,000 to the ESOP Trust for the purpose of purchasing Common Stock of the Company. The Trust purchased 307,000 shares of Inter-Tel Common Stock in July 1992. The loan was paid in full during 1997. As the principal amount of the loan was repaid to Inter-Tel through Company annual contributions, the equivalent number of shares released were allocated to employees' accounts to be held until retirement. Total shares so allocated were 32,380 in 1997. Contributions to the ESOP totaled $62,500 in 1997, and are based upon the historic cost of the shares purchased by the ESOP. After the final allocation of shares in 1997, the ESOP plan was "frozen," so that all eligible participants as of July 1, 1997 became 100% vested in their accounts, regardless of length of service. No further purchases are anticipated through the ESOP, and we do not anticipate making future allocations of shares from this plan.

NOTE O – SEGMENT INFORMATION

Inter-Tel adopted Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131") in the fiscal year ended December 31, 1998. SFAS 131 establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to stockholders. SFAS 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision making group, in making decisions as to how to allocate resources and assess performance. The Company's chief decision maker, as defined under SFAS 131, is the Chief Executive Officer.

Prior to 2000, we had viewed our operations as principally one segment: telephone systems, telecommunications software and hardware, and related long distance calling services. These services are provided through the Company's direct sales offices and dealer network to business customers throughout the United States, Europe, Asia, Mexico and South America. As a result, financial information disclosed previously represented substantially all of the financial information related to the Company's principal operating segment.

During 2000, the operations of Executone were identified separately in the first and second quarters of 2000. Beginning in the 3rd quarter and directly as a result of the charge and reorganization associated with the Executone operations, we no longer account for or directly report the Executone operations on a stand-alone basis. The operations have been integrated with the Company's existing wholesale, and national and government account, operations.

In December 1999, Inter-Tel entered into an agreement with Hypercom Corporation to jointly form Cirilium Corporation ("Cirilium"). Cirilium comprises parts of Hypercom's data and Inter-Tel's packet telephony products and services, including Inter-Tel's Vocal'Net gateway products and technology. As of the close of the third quarter of 2000, we wrote off our remaining investment and basis in Cirilium of $2.0 million. Total pre-tax losses from Cirilium from all sources were $8.6 million ($0.21 per diluted share) during 2000. As a result of the write-off, we do not expect to report the operations of Cirilium as a separate business segment. Refer to the table below for a summary of the operations for 2000.

During 2000, we determined that the operations of Inter-Tel.NET, Inter-Tel's former IP long distance subsidiary, would be separately disclosed as a business segment. The operations represented a more significant component of the consolidated operations in 2000 compared to prior years and had a significant impact on the revenues and net losses. On July 24, 2001, Inter-Tel agreed to sell 83% of Inter-Tel.NET to Comm-Services Corporation. As a result, since July 24, 2001, we have accounted for the remaining 17% Inter-Tel.NET/Comm-Services investment using the cost method of accounting. On December 30, 2001, Comm-Services entered into a merger agreement with Vianet. Inter-Tel's 17% investment in Inter-Tel.NET/Comm-Services was converted to approximately 10% of Vianet stock. Inter-Tel will account for the remaining 10% investment in Vianet using the cost method of accounting.

Commencing the third quarter of 2001, we began disclosing as a separate business segment operating results relating to local and long distance resale services. Inter-Tel offers these services to its customers as part of a total telephony solution approach. Results of operations for this segment, if the operations were not included as part of the consolidated group, could differ materially, as the operations are integral to the total telephony solution offered by us to our customers.

For the year ended December 31, we generated income from business segments, including charges, as follows:

(In thousands, except per share amounts)	Principal Segment	Executone (charges only)	Cirilium	Inter-Tel.NET	Resale of Local and long distance services	Total
2001						
Net sales	$346,094	$ --	$ --	$13,986	$25,575	$385,655
Gross profit (loss)	173,823	--	--	(5,892)	6,563	174,494
Charge (see Note B)	--	--	--	(5,357)	--	(5,357)
Operating income (loss)	30,911	--	--	(13,718)	3,231	20,424
Interest and other income	970	--	--	(1)	112	1,081
Loss on foreign translation adjustments	(337)	--	--	--	--	(337)
Interest expense	(293)	--	--	(173)	(2)	(468)
Net income (loss)	$19,688	$ --	$ --	$ (8,752)	$2,105	$13,041
Net income (loss) per diluted share (1)	$ 0.78	$ --	$ --	$ (0.36)	$ 0.08	$0.52
Weighted average diluted shares (1)	25,240	25,240	25,240	24,488	25,240	25,240
Total assets	$215,340	$ --	$ --	$--	$ 12,122	$ 227,462
Depreciation and amortization	9,247	--	--	2,114	156	11,517
2000						
Net sales	$353,313	$ --	$ --	$ 22,834	$26,576	$402,723
Cost of goods sold – Executone restructuring	--	(7,639)	--	--	--	(7,639)
Gross profit (loss)	173,328	(7,639)	--	(11,212)	4,561	159,038
Charges and write-off of IPRD (see Notes B and C)	--	(48,710)	--	(1,968)	--	(50,678)
Operating income (loss)	37,546	(56,349)	(574)	(19,087)	(133)	(38,597)
Equity share of Cirilium losses	--	--	(5,938)	--	--	(5,938)
Write-off of Cirilium investment	--	--	(2,045)	--	--	(2,045)
Interest and other income	1,423	--	--	2	49	1,474
Loss on foreign translation adjustments	(421)	--	--	--	--	(421)
Interest expense	(128)	--	--	(85)	--	(213)
Net income (loss)	$24,294	$ (35,631)	$ (5,411)	$ (12,122)	$(53)	$(28,923)
Net income (loss) per diluted share (1)	$ 0.90	$ (1.36)	$ (0.21)	$ (0.46)	$ (0.00)	$(1.10)
Weighted average diluted shares (1)	26,962	226,273	26,273	26,273	26,273	26,273
Depreciation and amortization	10,664	--	--	1,878	204	12,746

(1) Options that are antidilutive because the exercise price was greater than the average market price of the common shares are not included in the computation of diluted earnings per share when a net loss is recorded. See Note L for additional information.

Our revenues are generated predominantly in the United States. Total revenues generated from U.S. customers totaled $375.6 million, $392.1 million, and $306.5 million, of total revenues for the years ended December 31, 2001, 2000 and 1999, respectively. Revenues from international sources were primarily generated from customers located in the United Kingdom, Europe, Asia, Mexico and South America. In 2001, 2000 and 1999, revenues from customers located internationally accounted for 2.6%, 2.6%, and 2.5% of total revenues, respectively.

NOTE P – FINANCIAL INSTRUMENTS

Concentration of Credit Risk. Financial instruments that potentially subject Inter-Tel to significant concentrations of credit risk consist principally of cash investments, trade accounts receivable, and net investment in sales-leases. We maintain cash and equivalents not invested in money market funds with a major bank in our marketplace. We perform periodic evaluations of the relative credit standing of the financial institution. Concentrations of credit risk with respect to trade accounts receivable and net investment in sales-leases are limited due to the large number of entities comprising our customer base.

Fair Value of Financial Instruments. The carrying amount of cash and equivalents, accounts receivable, net investment in sales-leases, and accounts payable reported in the consolidated balance sheets approximate their fair value.

NOTE Q – SUPPLEMENTAL CASH FLOW

(In thousands)	2001	2000	1999
Cash paid for:			
Interest	$ 468	$ 213	$ 65
Income taxes paid (received)	$ (11,398)	$ 4,788	$ 12,405
Changes in operating assets			
And liabilities:			
(Increase) decrease in receivables	$ 2,064	$ (8,472)	$ (13,208)
(Increase) decrease in inventories	14,647	(15,034)	(656)
(Increase) decrease in prepaid expenses and other assets	15,620	(20,640)	(8,277)
(Increase) decrease in long-term other assets	1,583	14,717	(13,525)
Increase (decrease) in accounts payable And other current liabilities	(17,782)	458	19,544
	$ 16,132	$ (28,971)	$ (16,122)

NOTE R – QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

A summary of the quarterly results of operations for the years ended December 31, 2001 and 2000 follows:

(In thousands, except per share amounts)

2001	**1st Qtr**	**2nd Qtr**	**3rd Qtr**	**4th Qtr**
Net sales	$ 93,702	$ 103,835	$ 93,487	$ 94,630
Gross profit	39,648	44,920	43,276	46,650
Net income	1,948	185	4,378	6,531
Net income per share--Basic	$ 0.08	$ 0.01	$ 0.18	$ 0.27
Net income per share--Diluted	$ 0.08	$ 0.01	$ 0.18	$ 0.26
Weighted average basic common shares	25,500	24,389	23,949	24,116
Weighted average diluted common shares	25,843	24,910	24,804	25,334

2000	**1st Qtr**	**2nd Qtr**	**3rd Qtr**	**4th Qtr**
Net sales	$ 96,363	$ 101,089	$ 102,650	$ 102,621
Gross profit	41,540	30,410	43,798	43,290
Net (loss) income	(1,221)	(34,162)	2,084	4,376
Net (loss) income per share--Basic	$ (0.05)	$ (1.30)	$ 0.08	$ 0.17
Net (loss) income per share--Diluted	$ (0.05)	$ (1.30)	$ 0.08	$ 0.17
Weighted average basic common shares	26,249	26,371	26,435	26,039
Weighted average diluted common shares	26,249	26,371	26,940	26,368

NOTE S – SUBSEQUENT EVENT

In May 2001, Inter-Tel entered into an agreement to submit a lawsuit filed by Inter-Tel in 1996 to binding arbitration. The arbitration was completed in January 2002 and as a result of the arbitration, Inter-Tel received a gross cash award of $20 million in February 2002. Income taxes, attorney's fees, expert witness costs, arbitration costs and additional costs and expenses, including $1.3 million in bonus payments to employees who assisted in the litigation and arbitration, totaled approximately $10.7 million in 2002. Accordingly, net proceeds from this arbitration totaled approximately $9.3 million. This transaction concluded in 2002; therefore no cash proceeds were included in the 2001 financial statements.

Included in the $1.3 million total bonus payments to employees for assistance in the litigation and arbitration were payments to executive officers totaling $740,000 in February 2002. Payments of $250,000, $225,000, $225,000 and $40,000 were made to Steven G. Mihaylo, Norman Stout, Craig Rauchle and Jeff Ford, respectively, in connection with this settlement.

This transaction will be included in the 2002 first quarter results. No cash was received and no income was included in 2001 from this arbitration. However, Inter-Tel incurred costs and expenses, including attorney's fees, totaling approximately $1.3 million from 1997 through 2001 that were expensed through operations in each period. Such expenses are not included in the net award indicated above.

EXHIBIT 21
SUBSIDIARIES OF INTER-TEL, INCORPORATED

Listed below are all the subsidiaries of Inter-Tel, Incorporated, as well as the jurisdiction under the laws of which each was organized, and the percentage of the outstanding voting stock of each owned by Inter-Tel, Incorporated.

Name	Percentage of Voting Stock Owned	State or Jurisdiction of Organization
Inter-Tel Integrated Systems, Inc.	100%	Arizona
Inter-Tel Technologies, Inc.	100%	Arizona
Inter-Tel Leasing, Inc.	100%	Arizona
Inter-Tel Software and Services, Inc.	100%	Arizona
Inter-Tel Midwest, Inc.	100%	Delaware
Inter-Tel Incorporated-New Jersey	100%	Delaware
Inter-Tel NetSolutions, Inc.	100%	Texas
Inter-Tel DataCom, Inc.	100%	Delaware
Southwest Telephone Systems, Inc.	100%	New Mexico
American Telcom Corp. of Georgia, Inc.	100%	Georgia
Access West, Inc.	100%	Delaware
Inter-Tel Integrated Systems (UK), Ltd.	100%	United Kingdom
Inter-Tel Japan, Inc.	100%	Japan
Tri-Com Communications, Inc.	100%	North Carolina
Florida Telephone Systems, Inc.	100%	Florida
NTL Corporation dba ComNet of Ohio	100%	Ohio
Integrated Telecom Services Corporation	100%	Kentucky
Telephone Corporation of America, Inc. (Telcoa)	100%	Maryland
TDI Services Corporation, Technology Dynamics for the 21st Century	100%	Virginia
Executone Inter-Tel Business Information Systems, Inc.	100%	Arizona

EXHIBIT 23.0--CONSENT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

We consent to the incorporation by reference in Registration Statement (Form S-3 No. 33-58161), Registration Statement (Form S-3 No. 33-61437), Registration Statement (Form S-3 No. 333-01735), Registration Statement (Form S-3 No. 333-12433), Registration Statement (Form S-3 No. 333-39221), Registration Statement (Form S-8 No. 2-94805), Registration Statement (Form S-8 No. 33-40353), Registration Statement (Form S-8 No. 33-73620), Registration Statement (Form S-8 No. 333-41197) and in Registration Statement (Form S-8 No. 333-67261) of our report dated February 13, 2002, with respect to the consolidated financial statements and schedule included in this Annual Report (Form 10-K) of Inter-Tel, Incorporated for the year ended December 31, 2001.

Phoenix, Arizona
March 22, 2002

/S/ ERNST & YOUNG LLP

EXHIBIT C

APPLICANT'S PROPOSED TARIFF

TITLE PAGE

SOUTH DAKOTA

INTEREXCHANGE TELECOMMUNICATIONS TARIFF

OF

INTER-TEL NETSOLUTIONS, INC.

This Tariff contains the descriptions, regulations, and rates applicable to the furnishing of intrastate (intraLATA and interLATA) Telecommunications Services provided by Inter-Tel NetSolutions, Inc., with corporate offices at 3550 North Central Avenue, Suite 800, Phoenix, Arizona 85012, and Business Offices at 885 Trademark Drive, Reno, Nevada 89511, to Customers within the state of South Dakota. Authority to provide Service was granted on ____________________________, 2002, in Docket No. ____________. 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.

CHECK SHEET

Pages in this Tariff are effective as of the date shown at the bottom of the respective page(s). Original and revised pages as named below comprise all changes from the original Tariff and are currently in effect as of the date on the bottom of this page.

PAGE	REVISION	PAGE	REVISION	PAGE	REVISION
1	Original*	31	Original*	61	Original*
2	Original*	32	Original*	62	Original*
3	Original*	33	Original*	63	Original*
4	Original*	34	Original*	64	Original*
5	Original*	35	Original*	65	Original*
6	Original*	36	Original*	66	Original*
7	Original*	37	Original*	67	Original*
8	Original*	38	Original*	68	Original*
9	Original*	39	Original*	69	Original*
10	Original*	40	Original*	70	Original*
11	Original*	41	Original*	71	Original*
12	Original*	42	Original*	72	Original*
13	Original*	43	Original*	73	Original*
14	Original*	44	Original*	74	Original*
15	Original*	45	Original*	75	Original*
16	Original*	46	Original*	76	Original*
17	Original*	47	Original*	77	Original*
18	Original*	48	Original*	78	Original*
19	Original*	49	Original*	79	Original*
20	Original*	50	Original*	80	Original*
21	Original*	51	Original*	81	Original*
22	Original*	52	Original*	82	Original*
23	Original*	53	Original*	83	Original*
24	Original*	54	Original*	84	Original*
25	Original*	55	Original*		
26	Original*	56	Original*		
27	Original*	57	Original*		
28	Original*	58	Original*		
29	Original*	59	Original*		
30	Original*	60	Original*		

* Indicates a sheet submitted with this filing.

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APPLICATION OF TARIFF

Inter-Tel NetSolutions, Inc. is a Texas corporation with its corporate headquarters in Phoenix, Arizona. The Company provides Telecommunications Services in South Dakota. This Tariff contains the description of the Services offered, the terms and conditions under which each of its Services is provided, and all effective rates and charges applicable to the furnishing of Intrastate Interexchange Service by the Company in the state of South Dakota. The rates and Services provided in this Tariff are filed at the Commission pursuant to state statues and the rules adopted by the Commission. Only those Services, terms and conditions, and rates and charges contained in this Tariff may be provided to Customers within the state of South Dakota.

TARIFF FORMAT

A. Page Numbering - Page numbers appear in the upper right corner of the page. Pages are numbered sequentially. However, new pages are occasionally added to the Tariff. When a new page is added between pages already in effect, a decimal point and a number are added. For example, a new page added between sheets 14 and 15 would be 14.1.

B. Page Revision Numbers - Revision numbers also appear in the upper right corner of each page. These numbers are used to determine the most current version on file with the Commission. For example, the 4th revised Page 14 cancels the 3rd revised Page 14.

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 Pages contained in the Tariff, with a cross-reference to the current revision number. When new pages are added, the Check Sheet is changed to reflect the revision. All revisions in a filing are designated by an asterisk (*). The Tariff user should refer to the latest Check Sheet to find out if a particular page is the most current on file with the Commission.

CONCURRING, CONNECTING, OR OTHER PARTICIPATING CARRIERS

1. Concurring Carriers - None.

2. Terminating Carriers - None

3. Other Participating Carriers - None.

4. Billing Agents - None

SECTION 1 - SYMBOLS, TECHNICAL TERMS AND ABBREVIATIONS

1.1 Symbols

The following symbols will be used in the right-hand margins of revised Tariff pages to indicate changes made on the pages:

C – Indicates a change in a regulation but no change in a rate or charge

D – Indicates a discontinued rate or regulation.

E – Indicates a correction of an error made during a previous revision

I – Indicates a change resulting in an increase to a Customer's bill

M – Indicates moved text

N – Indicates a new rate or regulation

R – Indicates a rate reduction

T – Indicates a change in text but no change in rate or regulation

In addition to symbols for revisions, each provision or rate element changed will contain a vertical line that will identify the lines being changed.

SECTION 1 - SYMBOLS, TECHNICAL TERMS AND ABBREVIATIONS (continued)

1.2 Definitions

Account means either a Customer's physical location or individual Service represented by a unique account number within the Company's billing system. Multiple Services, each with a unique account number, may be part of one physical location.

Application for Service means a standard form that includes all pertinent billing, technical, and other descriptive information that will enable Company to provide and bill for Services. The Company's order process that includes technical, billing and other descriptive information provided by Customer that allows the Company to provide requested communications Services for Customer and Customer's Authorized Users. Upon acceptance by the Company, the Application for Service becomes a binding contract between Customer and the Company for the provision and acceptance of Services.

Authorized User means a person that is either authorized by the Customer to use telephone Service at the Customer's Premise or other location, or is placed in a position by the Customer, either through acts or omission, to use the Customer's Service.

Business Hours means the time after 5:00 A.M. and before 6:00 P.M. Pacific Time, Monday through Friday, excluding holidays.

Business Office means the primary location where the business operations of the Company are performed and where copies of the Company's Tariffs are made available for public inspection. The Business Office address is 885 Trademark Drive, Reno, Nevada 89511.

Calling Card Service means a telephone calling card issued by the Company, at the Customer's request, that enables the Customer or Authorized Users to place calls over the network and to have the charges for such calls billed to the Customer's Account.

Central Office means a Local Exchange Carrier's office where a Customer's lines are terminated for the purpose of offering Local Exchange Service and to connect with Interexchange Carriers.

Company means Inter-Tel NetSolutions, Inc.

Commission means the South Dakota Public Utilities Commission.

SECTION 1 - SYMBOLS, TECHNICAL TERMS AND ABBREVIATIONS (continued)

1.2 Definitions (continued)

Customer or Subscriber means a person or other entity that orders Service and is responsible for payment of charges due and compliance with the Company's Tariff.

Customer-Provided Equipment means Terminal Equipment provided by the Customer to utilize the Company's Service.

Customer Trouble Report means any oral or written report given to the Company's repair service or contact person by a Customer relating to a defect or difficulty or dissatisfaction with the provision of the Telecommunications Service provided by the Company.

Delinquent means a payment for a billing for Services to be provided, which is not in dispute and for which payment is not received on or before the due date printed on the Customer's bill.

Discontinuance means the disconnection of a Service or a circuit, dedicated access line, or port connection being used for existing Service.

End User means the ultimate user of the Telecommunications Services.

Equipment means the physical components utilized to provide Service.

Exchange means a geographic area established and approved by the Commission for the administration of Local Exchange Service in a specified area that usually embraces a city, town, or village and its environs. It may consist of one or more Central Offices together with associated plant used in furnishing communication Service in that area.

Facility or Facilities means any item or items of communications plant or Equipment used to provide or connect to the Company's Services.

FCC means the Federal Communications Commission.

Interexchange Carrier or IXC means a common carrier that provides long distance domestic and international Interexchange Services to the public.

SECTION 1 - SYMBOLS, TECHNICAL TERMS AND ABBREVIATIONS (continued)

1.2 Definitions (continued)

Interexchange Service means the provision of long distance service between LATAs.

LATA means a Local Access and Transport Area established pursuant to the Modification of Final Judgment entered by the United States District Court for the District of Columbia in Civil Action No. 82-0192; or any other geographic area designated as a LATA in the National Exchange Carrier Association, Inc. Tariff F.C.C. No. 4.

Local Access Facility means the channel provided by the LEC (or other Local Service Provider) to connect the Point-of-Presence to a Customer location.

Local Exchange Company (LEC) means the telephone company that furnishes Local Exchange Services to Customers.

Local Exchange Service means access to the Public Switched Telephone Network and the ability to make calls in a Customer's geographic area without incurring toll charges.

Monthly Recurring Charges means the monthly charges to the Customer for Services, Facilities, and Equipment, which continue for the agreed upon duration of the Service.

Nonbusiness Hours means the time period after 6:00 P.M. and before 5:00 A.M., Pacific Time, Monday through Friday, all day Saturday, Sunday, and the dates the following holidays are observed: New Year's Day, Memorial Day, Independence Day, Labor Day, Thanksgiving, and Christmas.

Non-Recurring Charge (NRC) means the initial charge, usually assessed on a one-time basis, to initiate and establish Service.

Other Common Carrier means a specialized or other type of common carrier authorized by the Federal Communications Commission to provide domestic or international communications Service.

SECTION 1 - SYMBOLS, TECHNICAL TERMS AND ABBREVIATIONS (continued)

1.2 Definitions (continued)

Premises means a building or buildings on contiguous property (except railroad rights-of-way, etc.).

Primary Interexchange Carrier (PIC) means the Interexchange Carrier to which a switched access line is presubscribed.

Rate Periods - The times included in the terms Peak Rate Period and Off-Peak Rate Period shall be as follows:

Peak Rate Period: Monday-Friday, 8:00 a.m. - 5:00 p.m.

Off-Peak Rate Period: All time periods not included in Peak Period.

Service means Service in its broadest and most inclusive sense, and includes any and all acts done, rendered, or performed and any and all things furnished or supplied by the Company in the provision of Telecommunications Service to its Customers.

Service Commencement Date means the first day that the requested Service or Facility is available for use, unless extended by the Customer's refusal to accept Service that does not conform to standards set forth in the Service Order or this Tariff, in which case the Service Commencement Date is the date of the Customer's acceptance. The Company and Customer may mutually agree on a substitute Service Commencement Date. If the Company does not have an executed Service Order from a Customer, the Service Commencement Date will be the first date on which the Customer used the Service or Facility.

Service Order means the written request for Service executed by the Customer and the Company in the format devised by the Company. The signing of a Service Order by the Customer and acceptance by the Company initiates the respective obligations of the parties as set forth therein and pursuant to this Tariff, but the duration of the Service is calculated from the Service Commencement Date.

Switch means an electronic device that is used to provide circuit sharing, routing, and control of Telecommunications Services.

SECTION 1 - SYMBOLS, TECHNICAL TERMS AND ABBREVIATIONS (continued)

1.2 Definitions (continued)

Tariff means a document filed with the South Dakota Public Utilities Commission or the FCC that describes Services, Facilities, Equipment, and pricing offered by the Company to all potential Customers.

Telecommunications Service means any Service provided by the Company, including voice, data, and all other types of communications services, that provides for the transmission, reception, and switching of electronic or optical signals by wire, fiber, or electromagnetic means.

Timely Payment means a payment on a Customer's Account made on or before the due date.

Terminal Equipment means telephones and other Equipment installed at the end of a telephone line.

Underlying Carrier means the provider of Telecommunications Services whose network is being utilized to transmit and receive the Customer's telecommunications traffic.

SECTION 2 - RULES AND REGULATIONS

2.1 Undertaking of the Company

2.1.1 The Company provides long distance Telecommunications Services originating and terminating throughout the state of South Dakota in accordance with the terms of this Tariff.

The Company is authorized to serve as its Customers' agent for purposes of ordering changes to and maintenance of the Telecommunications Services provided by any Interexchange or Local Exchange Company that may be necessary to implement and maintain the Company's Services provided to a Customer. The Company is authorized by its Customers to deal directly with any such carriers and with any other vendor in all matters pertaining to its provision of Service to a Customer. A Customer's appointment of the Company as its agent shall not apply to any software modifications that may be necessary with respect to traffic routing or least-cost routing features or functions, which modifications must be made by the Customer through appropriate interaction with the responsible vendor of such features or functions. The Company's appointment as a Customer's agent remains in effect unless modified or revoked in writing or other means approved by the Commission.

2.1.2 The Company is responsible under this Tariff only for the Services and Facilities provided herein, and it assumes no responsibility for any Service provided by any other entity.

2.1.3 Services provided under this Tariff shall not be used for unlawful purposes. Service will not be furnished if any law enforcement agency, acting within its jurisdiction, advises that such Services are being used in violation of the law.

2.1.4 The Company's Services are available twenty-four (24) hours per day, seven (7) days per week.

2.1.5 The Company will comply with all rules and regulations of the Commission.

SECTION 2 - RULES AND REGULATIONS (continued)

2.2 Terms and Conditions

2.2.1 Except as otherwise provided herein, the minimum period of Service is one month (30 days). The Company will issue a billing invoice monthly.

2.2.2 Any termination of Service shall not relieve Customer of its obligation to pay any charges incurred under the Service Agreement and this Tariff prior to termination. The Company's and the Customer's rights and obligations, which by their nature extend beyond the termination of the term of the Service Agreement, shall survive such termination.

2.2.3 This Tariff shall be interpreted and governed by the laws of the State of Texas.

SECTION 2 - RULES AND REGULATIONS (continued)

2.3 Obligations of the Customer

2.3.1 When placing an order for Service, the Customer must provide:

(A) The name(s) and address of the person(s) responsible for the payment of charges for Service; and

(B) The name(s), telephone number(s), and address(es) of the Customer contact person(s); and

(C) The payment of all applicable charges pursuant to this Tariff.

2.3.2 The Customer must reimburse the Company for damages to, or loss of, Facilities or other Equipment caused by the acts or omissions of the Customer; or the noncompliance by the Customer, with these regulations; or by fire or theft or other casualty on the Customer's Premises, unless caused by the negligence or willful misconduct of the employees or agents of the Company. The Company will, upon reimbursement for damages, cooperate with the Customer in prosecuting a claim against the person causing such damage and the Customer shall be subrogated to the Company's right of recovery of damages to the extent of such payment;

2.3.3 The Customer must provide a safe place to work and comply with all laws and regulations regarding the working conditions on the Premises at which Company employees and agents shall be installing or maintaining the Facilities and Equipment. The Customer may be required to install and maintain Facilities and Equipment within a hazardous area if, in the Company's opinion, injury or damage to the Company's employees or property might result from installation or maintenance by the Company. The Customer shall be responsible for identifying, monitoring, removing and disposing of any hazardous material (e.g. friable asbestos) prior to any construction or installation work;

SECTION 2 - RULES AND REGULATIONS (continued)

2.3 Obligations of the Customer (continued)

2.3.4 The Customer must comply with all laws and regulations applicable to, and obtain all consents, approvals, licenses and permits as may be required with respect to, the location of Facilities and Equipment in any Customer Premises or the rights-of-way for which Customer is responsible, and granting or obtaining permission for the Company at any time for the purpose of installing, inspecting, maintaining, repairing, or upon termination of Service as stated herein, removing Facilities or Equipment;

2.3.5 The Customer may not create or allow to be placed or maintained any liens or other encumbrances on Facilities or Equipment; and

2.3.6 The Customer must make Facilities and Equipment located on the Customer's Premises available periodically for maintenance purposes at a time agreeable to both the Company and the Customer. No allowance for interruptions in Service will be made for the period during which Service is interrupted for such purposes.

SECTION 2 - RULES AND REGULATIONS (continued)

2.4 Liability of the Customer

2.4.1 The Customer will be liable for damages to Facilities or Equipment and for all incidental and consequential damages caused by the negligent or intentional acts or omissions of the Customer, its officers, employees, agents, invitees, or contractors where such acts or omissions are not the direct result of the Company's negligence or intentional misconduct.

2.4.2 To the extent caused by any negligent or intentional act of the Customer, the Customer shall indemnify, defend and hold harmless the Company from and against all claims, actions, damages, liabilities, costs and expenses, including reasonable attorneys' fees, for (1) any loss, destruction or damage to property of any third party and (2) any liability incurred by the Company to any third party pursuant to this or any other Tariff of the Company, or otherwise, for any interruption of, interference to, or other defect in any Service provided by the Company to such third party.

2.4.3 The Customer shall not assert any claim against any other Customer or user of the Company's Services for damages resulting in whole or in part from or arising in connection with the furnishing of Service under this Tariff including but not limited to mistakes, omissions, interruptions, delays, errors or other defects or misrepresentations, whether or not such other Customer or user contributed in any way to the occurrence of the damages, unless such damages were caused solely by the negligent or intentional act or omission of the other Customer or user and not by any act or omission of the Company. Nothing in this Tariff is intended to expand the Customer's right to assert any claims against third parties for damages of any nature other than those described in the preceding sentence.

SECTION 2 - RULES AND REGULATIONS (continued)

2.5 Claims

2.5.1 With respect to any Service or Facility provided by the Company, the Customer shall indemnify, defend and hold harmless the Company from and against all loss, claims, actions, damages, liabilities, costs and expenses, including reasonable attorney's fees for:

(A) Any loss, destruction or damage to property of the Company or any third party, or the death of or injury to persons, including, but not limited to, employees or invitees of either the Company or the Customer, to the extent caused by or resulting from negligent or intentional act or omission of the Customer, its employees, agents, representatives or invitees; or

(B) Any claim, loss damage, expense or liability for infringement of any copyright, patent, trade mark or service mark, trade secret, or any proprietary or intellectual property right of any third party, arising from any act or omission by the Customer arising out of the material, data, information, or other content transmitted over the network, including use of Services or Facilities in a manner not contemplated by the agreement between the Customer and the Company.

(C) Any act or omission of: (a) the Customer, (b) any other entity furnishing Service, Facilities, or Equipment for use in conjunction with Services or Facilities provided by the Company; or (c) common carriers or warehousemen, except as contracted by the Company;

(D) Any delay or failure of Service, Facilities, or Equipment due to causes beyond the Company's control, including but not limited to, acts of God, fires, floods, earthquakes, hurricanes, or other catastrophes; national emergencies, insurrections, riots, wars or other civil commotion; strikes, lockouts, work stoppages or other labor difficulties; criminal actions taken against the Company; unavailability, failure or malfunction of Facilities or Equipment provided by the Customer or third parties; and any law, order, regulation or other action of any governing authority or agency thereof;

(E) Any unlawful or unauthorized use of Services or Facilities;

SECTION 2 - RULES AND REGULATIONS (continued)

2.5 Claims (continued)

(F) Libel, slander, invasion of privacy or infringement of patents, trade secrets, or copyrights arising from or in connection with the material transmitted by means of Company-provided Services or Facilities; or by means of the combination of Company-provided Services or Facilities;

(G) Breach in the privacy or security of communications;

(H) Changes in any of the Facilities, operations or procedures of the Company that render any Services, Facilities, or Equipment provided by the Customer obsolete, or require modification or alteration of such Services, Facilities, or Equipment, or otherwise affect their use or performance, except where the Customer provides the Company of its requirement for reasonable notice and such notice is not provided to the Customer, in which event the Company's liability is limited as set forth in of Sections 2.27 et seq.

(I) Defacement of or damage to Customer Premises resulting from the furnishing of Services or Equipment on such Premises or the installation or removal thereof;

(J) Injury to property or injury or death to persons, including claims for payments made under workers' compensation law or under any plan for employee disability or death benefits, arising out of, or caused by, any act or omission of the Customer, or the construction, installation, maintenance, presence, use or removal of the Customer's Facilities or Equipment connected, or to be connected to the Company's Facilities;

(K) Any noncompletion of calls due to network busy conditions;

(L) Any calls not actually attempted to be completed by the Company during any period that Service is unavailable; or

(M) Any other claim resulting from any act or omission of the Customer or patron(s) of the Customer relating to the use of the Company's Services or Facilities.

SECTION 2 - RULES AND REGULATIONS (continued)

2.6 Payment for Service

2.6.1 The Customer is responsible for payment of all charges for Service and Facilities furnished by the Company to the Customer or Authorized Users. If any entity other than the Company imposes charges on the Company, in addition to its own internal costs, in connection with a Service for which a Company Non-Recurring Charge is specified, those charges may be passed on to the Customer.

2.6.2 All charges due from the Customer are payable to any agency duly authorized by the Company to receive such payments. The billing agency may be the Company, an agent of the Company, a credit card company, or other billing service. Terms of payment shall be according to the rules and regulations of the agency, but must comply with the Commission's rules and regulations.

2.6.3 Adjustments to the Customer's bill(s) may be made by the Company to the extent that circumstances exist that reasonably indicate that such changes are appropriate.

2.7 Returned Check Charge

2.7.1 A returned check charge in the amount of the greater of one percent (1%) of the amount owed or $20.00 shall be applied if a check offered by a Customer for payment of Service provided is dishonored by a bank or other financial institution for insufficient or uncollected funds, closed account, apparent tampering, missing signature or endorsement, or any other insufficiency or discrepancy necessitating return of the instrument at the discretion of the drawee bank or other financial institution.

SECTION 2 - RULES AND REGULATIONS (continued)

2.8 Transfer or Assignment

2.8.1 After obtaining the Company's written consent, the Customer of record may assign or transfer the use of Service where there is no interruption or physical relocation. All terms and provisions contained in this Tariff will apply to any assignee or transferee. Services provided by the Company may not be transferred or assigned to a new Customer unless the following conditions have been met:

(A) The Customer of record (Assignor Customer) requests such assignment or transfer in writing at least fifteen (15) days prior to the effective date of any requested assignment or transfer; and,

(B) The new Customer (Assignee Customer) notifies the Company in writing that it agrees to assume all outstanding obligations of the Assignor Customer for use of the Company's Services. These obligations include all outstanding indebtedness for the use of the Company's Service; and,

(C) Prior written consent of the Company is secured. The Company agrees to respond to a request to assign or transfer to an Assignee Customer within fifteen (15) days of receipt of the request. Consent to such transfer or assignment will not be unreasonably withheld.

(E) Such a transfer will be treated as a Discontinuation of existing Service and installation of new Service, and Non-Recurring Installation Charges as stated in this Tariff will apply.

2.8.2 Any permitted transfer or assignment of the Company's Service will not relieve or discharge any Customer from remaining jointly and severally liable with the new Customer for any obligations existing at the time of transfer or assignment.

2.8.3 This Tariff, in its entirety, shall apply to all such permitted assignees or transferees.

SECTION 2 - RULES AND REGULATIONS (continued)

2.9 Use of Service

2.9.1 The Company's Service(s) may be used for any lawful purpose within the scope of the Company's certificated authority and consistent with the transmission and switching parameters of the Facilities or Equipment utilized by the Company in the provision of such Service(s).

2.9.2 The use of the Company's Service(s) to make calls that might reasonably be expected to frighten, abuse, torment, or harass another, or in such a way as to unreasonable interfere with use by others, is prohibited.

2.9.3 Business and residential Customers may not purchase Services for aggregation, sharing, or resale purposes. The Company's Services may not be resold for any purpose unless the Customer is a duly authorized regulated common carrier.

2.9.4 The Company may require a Customer to immediately shut down its transmission of signals if said transmission is causing interference to others.

2.9.5 The use of the Company's Service(s) without payment for Service(s) or attempting to avoid payment for Service(s) by fraudulent means, devices, or schemes, such as false or invalid numbers, credit cards or phone cards or numbers of such cards, is prohibited.

2.9.6 The Company's Service(s) may be denied or Discontinued for nonpayment of charges or for other violations of this Tariff.

2.9.7 Any charges for long distance, toll, or other Services are billed to, due from, and payable by the Customer unless billed directly to the Customer by another provider of Services.

SECTION 2 - RULES AND REGULATIONS (continued)

2.9 Use of Service (continued)

2.9.8 Prohibited Uses

(A) The Company's Services shall not be used for any unlawful purpose or for any use for which the Customer has not obtained all required governmental approvals, authorizations, licenses, consents and permits.

(B) The Company may block any signals being transmitted by Customers over its network that cause interference to the Company or other users. Customer shall be relieved of all obligations to make payments for charges relating to any blocked Service and shall indemnify the Company for any claim, judgment or liability resulting from such blockage.

SECTION 2 - RULES AND REGULATIONS (continued)

2.10 Disclaimer of Warranties and Limitation of Liabilities of the Company

2.10.1 The Company's liability for damages arising out of mistakes, interruptions, omissions, delays, errors or defects in the installation, transmission, provision, termination, maintenance, repair, or restoration occurring in the course of furnishing Service(s) or Facilities, representations, or use of these Services shall, in no event, exceed an allowance equivalent to the proportionate charge to the Customer for the period during which the faults in transmission occur, as described in Sections 2.27 et seq.

2.10.2 When the Company uses the Facilities of other carriers, the Company is not liable for any act or omission of the other carrier(s).

2.10.3 The Company shall not be liable for claim or loss, expense or damage (including, but not limited to, direct, indirect, reliance, consequential, incidental, or special damages or lost revenues or profits), for any interruption, delay, error, omission, or defect in any Service, Facility or transmission provided under this Tariff, if caused by any person or entity other than the Company, its employees, or agents, by any malfunction of any Service or Facility provided by an Underlying Carrier, by an Act of God, fire, war, civil disturbance, or act of government, or by any other cause beyond the Company's direct control, whether a claim for such liability is premised upon breach of contract, tort, misrepresentation, fraud, or any other theory, and regardless of the foreseeability of such damages.

2.10.4 The liability of the Company for damages arising out of the furnishing of its Services including, but not limited to, Service outages, installation, activation, termination, delay, transfers, interruptions, errors or other defects, representations by the Company, or use of the Services or damages arising out of the failure to furnish the Service whether caused by act or omission, shall be limited to the extension of allowances for interruption as described in Sections 2.27 et seq. and shall be the sole remedy of the Customer and the sole liability of the Company.

SECTION 2 - RULES AND REGULATIONS (continued)

2.10 Disclaimer of Warranties and Limitation of Liabilities of the Company (continued)

2.10.5 The Company will not be liable for any direct, indirect, incidental, special, reliance, consequential, exemplary or punitive damages or lost profits suffered by the Customer for any reason whatsoever in connection with or arising out of its provision of Services including, but not limited to, Service outages, installation, activation, termination, interruption, delay, or transfer, whether caused by any act or omission, including, but not limited to, mistake, negligence of the Company's employees or agents, failure to perform or provide any Service, or any failure in or breakdown of Facilities, whether a claim for such liability is premised upon a Deceptive Trade Practices Act, breach of contract, tort, misrepresentation, fraud, or any other theory, and regardless of the foreseeability of such damages.

2.10.6 The Company will comply with the Commission's rules pertaining to refunds for overbilling. If a Customer believes that the Company has charged an amount greater than the Company's Tariff, terms and conditions of Service, or Customer-specific contract, the Customer must submit a claim for overpayment to the Company.

2.10.7 The liability of the Company for errors in billing that result in overpayment by the Customer shall be limited to a credit equal to the dollar amount erroneously billed or, in the event that payment has been made and Service has been discontinued, to a refund of the amount erroneously billed.

2.10.8 The Company shall not be liable for any claim, loss, or refund as a result of loss or theft of Customer-specific identifying codes issued for use with the Company's Services.

SECTION 2 - RULES AND REGULATIONS (continued)

2.10 Disclaimer of Warranties and Limitation of Liabilities of the Company (continued)

2.10.10 The Company shall not be liable for any defacement of or damages to the Premises of a Customer resulting from the furnishing of Service(s) or the attachment of Equipment, instruments, apparatus, and associated wiring furnished by the Company on the Customer's Premises or by the installation or removal thereof, that is not the direct or indirect result of the Company's negligence. No agents or employees of other carriers shall be deemed to be agents or employees of the Company without written authorization by the Company. Customer will indemnify and save the Company harmless from any claims of the owner of Customer's Premises or other third party for such damages.

2.10.11 The Company shall not be liable for any delay or failure of Service, Facilities, or Equipment due to causes beyond its control, including but not limited to: acts of God, fire, flood, explosion or other catastrophes; and law, order, regulation, direction, action or request of the United States government or of any other government, including state and local governments having or claiming jurisdiction over the Company, or of any department, agency, commission, bureau, corporation or other instrumentality of any one or more of these federal, state, or local governments, or of any military authority; third party nonperformance (including the failure of performance for reasons beyond the control of common carriers, Interexchange Carriers, Local Exchange Carriers, suppliers, and subcontractors) or other such cause beyond its reasonable control, including failures or fluctuations in electrical Equipment; preemption of existing Service in compliance with national emergencies; insurrections; riots; wars; unavailability of rights-of-way or materials, or strikes, lockouts, work stoppages, or other labor difficulties. Both parties retain all rights of recourse against any third parties for any failures that may create a force majeure condition for the other party.

2.10.12 The Company shall not be liable for: (a) any act or omission of any entity furnishing the Company's or the Customer's Facilities or Equipment used for or with the Services the Company offers; or (b) for the acts or omissions of Other Common Carriers or Local Exchange Companies.

SECTION 2 - RULES AND REGULATIONS (continued)

2.10 Disclaimer of Warranties and Limitation of Liabilities of the Company (continued)

2.10.13 The Company shall not be liable for any damages or losses due to the fault or negligence of, or any omission by, the Customer or due to the failure or malfunction of Customer-Provided Facilities or Equipment.

2.10.14 The Company shall use reasonable efforts to make Services available by the estimated Service Commencement Date. The Company shall not be liable for any damages whatsoever resulting from delays in meeting the estimated Service Commencement Date due to delays resulting from normal installation procedures. Such delays shall include, but not be limited to, delays in obtaining necessary regulatory approvals for construction, delays in obtaining right-of-way approvals, delays in actual construction work being done by vendor(s), and any delays due to the inability of any Local Exchange Company or Underlying Carrier to meet such estimated Service Commencement Date that is beyond the Company's control and upon which the Company is relying to provide Service.

2.10.15 With respect to the Services, Facilities, Equipment and materials provided hereunder, the company makes no promises, agreements, understandings, representations or warranties, expressed or implied, and hereby expressly disclaims all warranties, expressed or implied, not stated in this Tariff and in particular disclaims all warranties of merchantability and fitness for a particular purpose.

SECTION 2 - RULES AND REGULATIONS (continued)

2.11 Limitations on the Use of Service

2.11.1 Service is offered subject to the availability of the necessary Facilities or Equipment and subject to the provisions of this Tariff. The obligation of the Company to provide Service is dependent upon its ability to procure and maintain Facilities that are required to meet Customer's order for Service. The Company will make all reasonable efforts to secure the necessary Facilities.

2.11.2 The Company reserves the right to limit or to allocate the use of existing Facilities, or Facilities in the process of being acquired by the Company, when necessary because of lack of Facilities, relevant resources, or due to causes beyond the Company's control. In addition, the Company reserves the right to discontinue Service when Customer is using the Service in violation of law or the provisions of this Tariff.

2.11.3 The Company does not undertake to transmit messages, but offers the use of Facilities when available, and will not be liable for errors in transmission or for failure to establish connections.

SECTION 2 - RULES AND REGULATIONS (continued)

2.12 Rendering and Payment of Bills

2.12.1 Service is provided on a monthly (30 day) basis. Initial charges for Monthly Recurring Charges for a partial month will be prorated.

2.12.2 Billing of Customers is scheduled monthly. The bill statement date is dependent on the billing cycle assigned to the Customer.

2.12.3 Customers will receive bills by one of two methods:

(A) Customers may be billed directly by the Company.
(B) Customers may be billed on the Company's behalf by a third party billing service.

2.12.4 A bill will be considered rendered to the Customer after having been deposited in the United States mail for two days with postage prepaid. If the delivery is by other than United States mail, the bill will be considered rendered when delivered to the last known address of the Customer in the Company's billing records.

2.12.5 Each Customer's monthly bill will provide detailed information on charges for Services obtained from the Company, including the specific date and time of each call, its duration, place of termination, and charge. Monthly Recurring Charges are billed monthly in advance. Usage charges are billed in arrears.

2.12.6 Bills are payable upon receipt and in accordance with the terms of this Tariff. All charges for Services are payable only in United States currency, and may be made by check, money order, or cashiers check.

2.12.7 The Customer is responsible for all charges for Services and Facilities furnished by the Company to Customer and to all End Users authorized by Customer, including all calls placed from the Customer's location or by use of the Customer's authorization code(s).

SECTION 2 - RULES AND REGULATIONS (continued)

2.12 Rendering and Payment of Bills (continued)

2.12.8 Payments must be sent to the Company's address listed on the bill.

2.12.9 If the Company does not receive payment by the date due, the Customer's Account will be considered Delinquent. The Company may impose a maintenance or delinquency fee on Delinquent Accounts per the schedule of rates in Section 2.12.14.

2.12.10 Each bill shall also provide the following information:

(A) Name and address of Customer;

(B) Customer's Account number and phone number;

(C) Itemized charges and taxes;

(D) Balance forward and balance due;

(E) Due date;

(F) A customer service number to call to discuss questions about the bill; and

(G) Any information needed to comply with the Commission's rules.

2.12.11 For Delinquent Customers whose Service is Discontinued, the Monthly Recurring Charges for the fraction of the month in which Service was furnished will be calculated on a pro rata basis. For this purpose, every month is considered to have thirty (30) days.

2.12.12 If the Customer's payment is not received by the due date specified on the bill, the Company, at its discretion, may debit any credit card number provided by the Customer for the full amount of the invoice plus any late charges that may apply.

SECTION 2 - RULES AND REGULATIONS (continued)

2.12 Rendering and Payment of Bills (continued)

2.12.13 The Customer shall be responsible for payment of all costs of collection of past due amounts, including reasonable attorney's fees incurred by the Company.

2.12.14 A late fee of 1.5 percent per month will be charged for past due Accounts unless otherwise prescribed by law, in which event the past due Accounts fee will be charged at the highest rate allowed by law.

2.12.15 In the event of any change in the rates or tariffs of the carriers whose Services the Company resells to its Customers, the Company shall revise this Tariff and provide its Customers 30 days' written notice of any effect of such change in the billing rate of or Service provided to the Customer. Unless a Customer notifies the Company in writing of its request for alteration or termination of Services, any new billing rate or Service change shall be deemed accepted and effective the date specified in the Company's notice.

SECTION 2 - RULES AND REGULATIONS (continued)

2.13 Billing Dispute Resolution

2.13.1 Questions regarding the Company's Services or charges assessed on a Customer's bill may be directed to the Company's Customer Service Department toll-free at (800) 821-1661

2.13.2 The Company shall investigate the particular case and report the results to the Customer.

2.13.3 During the period that the disputed amount is under investigation, the Company shall not pursue any collection procedures or assess late fees with regard to the disputed amount.

2.13.4 The Customer must pay the undisputed part of the bill, and if the undisputed charges are not paid, the Company may discontinue Service.

2.13.5 In the event the disputed charges are not resolved, the Company shall inform the Customer that the Customer may utilize the complaint procedures of the Commission. The Company shall provide the Customer with the following information:

Consumer Affairs
South Dakota Public Utilities Commission
Capitol Building, 1st Floor
500 East Capitol Avenue
Pierre, South Dakota 57501-5070
(800) 332-1782

SECTION 2 - RULES AND REGULATIONS (continued)

2.14 Taxes, Fees and Assessments

2.14.1 Sales, use, gross receipts, excise or other local, state and federal taxes, charges or assessments, may be imposed on or based upon the provision, sale or use of the Company's Services in accordance with state and federal law.

2.14.2 The Customer is responsible for the payment of any sales, use gross receipts, excise, access or other local, state and federal taxes, assessments, charges or surcharges (including 9-1-1 surcharges) excluding taxes on the Company's net income assessed in conjunction with Service used.

2.14.3 To the extent allowed by law, all state and local sales taxes, other taxes, municipal fees, and assessments will be listed as separate items on the Customer's bill and are not included in the Tariff rate(s).

2.14.4 Taxes shall be billed to Customers receiving Service(s) within the territorial limits of the state, county, city or other taxing authority assessing the taxes. Any taxes imposed by a local jurisdiction (e.g. County and municipal taxes) will only be recovered from those Customers residing in the affected jurisdictions. The billing shall allocate the tax, charge and/or assessment among Customers uniformly on the basis of each Customer's monthly charges for the types of Service made subject to such tax, charge and/or assessment.

2.14.5 It shall be the Customer's responsibility to pay any taxes that become applicable retroactively.

SECTION 2 - RULES AND REGULATIONS (continued)

2.15 Customer Application for Service

Customers wishing to obtain Service from the Company must execute a Customer Service agreement that includes the Customer's authorization for the Company to instruct other carriers to provide certain Services on the Customer's behalf.

Service will be provided for the term of Service elected by the Customer in the Service agreement it enters into with the Company. Unless the Company receives a written Service termination notice by the Customer on or before 30 days from the end of the agreed Service period, the Services provided hereunder shall continue on a monthly basis until either party shall give the other party at least 30 days' written notice.

2.16 Establishment or Reestablishment of Credit

Applicants may be required at any time to make an advance payment up to an amount equaling three months' actual or estimated charges for the Services to be provided. The Company reserves the right to examine a credit record of all applicants and Customers and refuse Service to Customers that are unable to demonstrate good credit or payment histories. Deposits shall be administered pursuant to Commission rules and this Tariff.

2.17 Equipment

Service(s) and Facilities may be used with or terminated at Customer-Provided Terminal Equipment or Customer-Provided Equipment, such as a telephone set. Such Terminal Equipment shall be furnished and maintained at the expense of the Customer. The Customer is responsible for all costs at its Premises, including personnel, wiring, electrical power, and the like, incurred in the use of the Equipment that shall comply with the generally accepted minimum protective criteria standards of the telecommunications industry as approved by the Federal Communications Commission.

2.18 Installation

Service is installed upon mutual agreement between the Customer and the Company. The Service agreement does not alter rates specified in this Tariff.

SECTION 2 - RULES AND REGULATIONS (continued)

2.19 Customer Service

Company Customer Service representatives are available at (800) 821-1661 to assist with Customer Service and billing inquiries Monday through Friday between 5:00 a.m. - 6:00 p.m., Pacific Time. Customer inquiries may also be addressed in writing to the Company at the address provided in Section 2.20.2. Twenty-four hour emergency service is also available seven days a week by dialing (800) 927-6098.

2.20 Notices

2.20.1 Any notice or demand required of the Company will be effective when it is mailed, properly addressed, with postage prepaid to the Customer at the address listed in the Company's billing records.

2.20.2 Unless otherwise provided by these rules, any notice, including changes of address, from any Customer or his authorized representative must be given by written notice, by mail, to the Company's Business Office:

Inter-Tel NetSolutions, Inc.
885 Trademark Drive
Reno, Nevada 89511

SECTION 2 - RULES AND REGULATIONS (continued)

2.21 Cancellation of an Application for Service by the Customer

2.21.1 The Customer may cancel an Application for Service prior to the start of Service. No charges will be imposed except for those specified below.

(A) The cancellation charge shall be all Non-Recurring Charges reasonably expended by the Company to establish Service to the Customer.

(B) Where, prior to cancellation by the Customer, the Company incurs any expenses in installing the Service or in preparing to install the Service that it otherwise would not have incurred, the Customer's responsibility shall be limited to a charge equal to the costs the Company incurred, less net salvage. In no case shall this charge exceed the sum of the charge for the minimum period of Service ordered, including installation charges, and all charges others levy against the Company that would have been chargeable to the Customer had Service begun.

2.22 Termination or Discontinuance of Service by the Customer

The Customer is responsible for payment of all charges for Service furnished to the Customer prior to the actual termination of the Customer's Service. In addition, in the event a Customer terminates its Service agreement with the Company prior to the end of the Service period specified therein, the Customer shall pay, in addition to all other charges due for Service provided, a sum equal to the average of one month's Service and long distance billing times the number of months remaining on the Service agreement plus a sum equal to the value of any promotional credit awarded the Customer during the term of the agreement.

SECTION 2 - RULES AND REGULATIONS (continued)

2.23 Cancellation of an Application for Service by the Company

2.23.1 The Company may discontinue Service or cancel an Application for Service without incurring any liability under the following circumstances:

(A) Non-payment of any sum owing to the Company;

(B) For insufficient or fraudulent billing information, invalid or unauthorized telephone numbers, credit card numbers or pre-arranged Account code numbers;

(C) The violation by the Customer of any law, rule or regulation of any governmental authority having jurisdiction over the Service;

(D) The prohibition against the Company from furnishing Services by order of a court or other governmental authority having jurisdiction; or

(E) The providing of false or misleading credit information by the Customer.

2.23.2 The Company will provide the Customer written notice of such discontinuance 10 days prior to discontinuance.

SECTION 2 - RULES AND REGULATIONS (continued)

2.24 Termination or Discontinuance of Service by the Company

2.24.1 The Company may terminate Service for any of the following reasons:

(A) Connection of Service without authority;

(B) Reconnection of Service without authority;

(C) Where there are instances of tampering with the Company's Equipment, evidence of theft of Service, or other acts to defraud the Company;

(D) Unauthorized use of telephone utility Equipment in a manner that creates an unsafe condition or creates the possibility of damage or destruction to such Equipment;

(E) Nonpayment of any undisputed Delinquent charge or bill within the period prescribed in the Company's Tariff;

(F) Excessive or improper use of Telecommunications Services, or used in such manner as to interfere with reasonable Service to other Customers.

(G) Failure to substantially comply with terms of a settlement agreement;

(H) Refusal after reasonable notice to permit inspection, maintenance or replacement of telephone utility Equipment;

(I) Upon material misrepresentation of identify in obtaining telephone utility Service; or

(J) Violation of or noncompliance with any provision of law, Commission rules and regulations or the Company's approved Tariffs.

SECTION 2 - RULES AND REGULATIONS (continued)

2.24 Termination or Discontinuance of Service by the Company (continued)

2.24.2 If requested by the Customer, the Company shall provide additional documentation to the Customer stating the reason(s) for termination of Service.

2.24.3 The suspension or discontinuance of Service(s) by the Company pursuant to this Section does not relieve the Customer of any obligation to pay the Company for charges due and owing for Service(s) furnished during the time of or up to suspension or discontinuance.

2.24.4 Upon the Company's discontinuance of Service to the Customer under this Section, all applicable charges shall become due. This is in addition to all other remedies that may be available to the Company at law or in equity or under any other provision of this Tariff.

2.24.5 Residential Service may be discontinued during normal Business Hours on or after the date specified in the Discontinuation Notice. Service shall not be discontinued on a weekend, holiday, or the day before a weekend or a holiday unless the Company's offices are available to facilitate reconnection of Service.

2.24.6 The Company will comply with the rules of the Commission pertaining to the Discontinuation of Service

SECTION 2 - RULES AND REGULATIONS (continued)

2.24 Termination or Discontinuance of Service (continued)

2.24.7 The Company will not suspend or discontinue Service if the Customer, before the date of suspension or Discontinuation, establishes that suspension or Discontinuation will prevent the Customer from summoning emergency medical help for someone who is seriously ill residing at a residence served by the Company.

(A) Each time a Customer seeks to avoid Discontinuation of Service under this subsection, the Customer before the date of Discontinuation, shall:

1. Have the person's attending physician (for purposes of this subsection, the term Physician shall mean any public health official, including, but not limited to, medical doctors, doctors of osteopathy, nurse practitioners, registered nurses, and any other similar public health official) contact the Company by the stated date of Discontinuation;
2. Have the person's attending Physician submit a written statement to the Company; and
3. The Customer must enter into a deferred payment plan with the Company.

(B) The prohibition against suspension or Discontinuation provided by this subsection shall last 63 days from the issuance of the Company's bill or a shorter period agreed upon by the Company and the Customer or physician.

SECTION 2 - RULES AND REGULATIONS (continued)

2.25 Restoration of Service

2.25.1 If Service has been Discontinued for nonpayment or as otherwise provided herein and the Customer wishes Service reinstated, Service shall be restored when all past due amounts are paid or the event giving rise to the discontinuance (if other than nonpayment) is corrected.

2.26 Continuity of Service

In the event of the Company's advance knowledge of an interruption of Service for a period exceeding 24 hours, the Company will use its best efforts to notify the Customer in advance by telephone or in writing.

SECTION 2 - RULES AND REGULATIONS (continued)

2.27 Allowances for Interruptions in Services

2.27.1 General

(A) For Services not listed in Sections 2.29 et seq., a credit allowance will be given when Service is interrupted, except as specified in Section 2.27.2 following. A Service is interrupted when it becomes inoperative to the Customer, e.g., the Customer is unable to transmit or receive Telecommunications Services, because of a failure of a component furnished by the Company under this Tariff. Services in Sections 2.29 et seq. list remedies for interruption of those services.

(B) An interruption period begins when the Customer reports a Service, Facility or circuit to be inoperative and, if necessary, releases it for testing and repair. An interruption period ends when the Service, Facility or circuit is operative.

(C) If the Customer reports a Service, Facility or circuit to be interrupted but declines to release it for testing and repair, or refuses access to its Premises for test and repair by the Company, the Service, Facility or circuit will considered to be impaired but not interrupted. No credit allowances will be made for a Service, Facility or circuit considered by the Company to be impaired.

(D) The Customer shall be responsible for the payment of service charges as set forth herein for visits by the Company's agents or employees to the Premises of the Customer when the Service difficulty or Customer Trouble Report results from the use of Facilities or Equipment provided by any party other than the Company, including but not limited to the Customer.

E) In order to be eligible for a credit allowance for interruptions in individual calls and for reaching wrong numbers, the Customer must notify the Company and furnish the called number, the trouble experienced, the type of service, and the time the call was placed.

SECTION 2 - RULES AND REGULATIONS (continued)

2.27 Allowances for Interruptions in Service (continued)

2.27.2 Limitations of Allowances

No credit allowance will be made for any interruption in Service:

(A) Due to the negligence of or noncompliance with the provisions of this Tariff by any person or entity other than the Company, including but not limited to the Customer, Authorized User, or joint user;

(B) Due to the failure of power, Equipment, systems, connections or Services not provided by the Company;

(C) Due to circumstances or causes beyond the reasonable control of the Company, including interruptions caused by the Customer, Authorized User, or third parties, or Force Majeure events.

(D) During any period in which the Company is not given full and free access to Facilities and Equipment for the purposes of investigating and correcting interruptions;

(E) A Service will not be deemed to be interrupted if a Customer continues to voluntarily make use of such Service. If the Service is interrupted, the Customer can get a Service credit, use another means of communications provided by the Company, or utilize another Service provider;

(F) During any period when the Customer has released Service to the Company for maintenance purposes or for implementation of a Customer order for a change in Service arrangements;

(G) That occurs or continues due to the Customer's failure to authorize replacement of any element of special construction; and

(H) That was not reported to the Company within thirty (30) days of the date that Service was affected.

(I) Non-completion of calls due to busy network conditions.

SECTION 2 - RULES AND REGULATIONS (continued)

2.27 Allowances for Interruptions in Service (continued)

(J) Interruptions caused by the failure of a Private Line Service connected to a Private Line Local Channel Service, or vice versa. In such cases, only the failed portion of the overall Service will be eligible for a credit.

(K) Interruptions due to the failure of the Company's enhanced services.

(L) When the Customer elects other available credits, compensation, or remedies under this tariff or the applicable contract for the same interruption or failure.

2.27.3 Use of Another Method of Communications

If the Customer elects to use another means of Telecommunication Services during the period of interruption, the Customer must pay the charges for the alternative Service used.

2.27.4 Application of Credits for Interruptions in Service

(A) Credits for interruptions in Service that is provided and billed on a flat rate basis for a minimum period of at least one month, beginning on the date that billing becomes effective, shall in no event exceed an amount equivalent to the proportionate charge to the Customer for the period of Service during which the event that gave rise to the claim for a credit occurred. A credit allowance is applied on a pro rata basis against the rates specified hereunder and is dependent upon the length of the interruption. The Customer will receive a credit only for those Services or Facilities on the interrupted portion of the circuit.

(B) For calculating credit allowances, every month is considered to have thirty (30) days.

(C) A credit allowance will be given for interruptions of thirty (30) minutes or more. Two or more interruptions of fifteen (15) minutes or more during any one 24-hour period shall be combined into one cumulative interruption.

SECTION 2 - RULES AND REGULATIONS (continued)

2.27 Allowances for Interruptions in Service (continued)

(D) Interruptions of 24 Hours or Less

Length of Interruption	Amount of Service To Be Credited
Less than 30 minutes	None
30 minutes up to, but not including, 3 hours	1/10 Day
3 hours up to, but not including, 6 hours	1/5 Day
6 hours up to, but not including, 9 hours	2/5 Day
9 hours up to, but not including, 12 hours	3/5 Day
12 hours up to, but not including, 15 hours	4/5 Day
15 hours up to, but not including, 24 hours	One Day

(E) Interruptions Over 24 Hours and Less Than 72 Hours

Interruptions over 24 hours and less than 72 hours will be credited 1/5 day for each 3-hour period or fraction thereof. No more than one full day's credit will be allowed for any period of 24 hours.

(F) Interruptions Over 72 Hours

Interruptions over 72 hours will be credited 2 days for each full 24-hour period. No more than thirty (30) days credit will be allowed for any one-month period.

SECTION 2 - RULES AND REGULATIONS (continued)

2.28 Customer Liability for Fraud and Unauthorized Use of the Network

2.28.1 The Customer is liable for the unauthorized use of the network obtained through the fraudulent use of Services or a Company calling card, if such a card is offered by the Company, or an accepted credit card, provided that the unauthorized use occurs before the Company has been notified.

2.28.2 A Company calling card is a telephone calling card issued by the Company at the Customer's request, which enables the Customer or user(s) authorized by the Customer to place calls over the network and to have the charges for such calls billed to the Customer's Account.

2.28.3 An accepted credit card is any credit card that a cardholder has requested or applied for and received, or has signed, used, or authorized another person to use to obtain credit. Any credit card issued as a renewal or substitute in accordance with this paragraph is an accepted credit card when received by the cardholder.

2.28.4 The Customer must give the Company written or oral notice that an unauthorized use of a Company calling card or an accepted credit card has occurred or may occur as a result of loss or theft.

2.28.5 The Customer is responsible for payment of all charges for Calling Card Services furnished to the Customer or to users authorized by the Customer to use Service provided under this Tariff, unless the charges are due to the negligence of the Company. This responsibility is not changed due to any use, misuse, or abuse of the Customer's Service or Customer-Provided Equipment by third parties, the Customer's employees, or the public.

2.28.6 The Customer's liability for unauthorized use of the network by credit card fraud will not exceed the lesser of fifty dollars ($50.00) or the amount of money, property, labor, or Services obtained by the Unauthorized User before notification to the Company.

SECTION 2 - RULES AND REGULATIONS (continued)

2.29 Allowances for Interruptions in Frame Relay Service

This Section describes the Company's measurements and standards for the percentage of time a Domestic Frame Relay (Frame Relay) Port is available for the Customer's use. The Company will maintain the following monthly Port availability, as applicable, or the Company will provide the Customer the remedies described in Section 2.29.3.

2.29.1 End-to-End Port Availability

(A) Company provided Enhanced Metropolitan-Area SONET Access. The Company will maintain 100% end-to-end Port availability (Committed Port Availability) for each Domestic Port that utilizes Company-provided enhanced metropolitan-area SONET access.

(B) Company provided Non-Enhanced Metropolitan-Area SONET Access or Dedicated Local Access. The Company will maintain 99.90% or greater end-to-end Port availability (Committed Port Availability) for each Domestic Port that utilizes Company provided non-enhanced metropolitan-area SONET access or dedicated local access.

2.29.2 POP-to-POP Port Availability.

The Company will maintain 100% POP-to-POP Port availability (Committed Port Availability) for each Domestic Port that utilizes Customer-provided local access.

(A) Port Availability Calculation. Port availability is calculated monthly as follows:

$$\frac{\text{(24 Hours x Days in Month)} - \text{Port Outage Time (hours)}}{\text{(24 Hours x Days in Month)}} = \text{Port Availability}$$

(B) Components Included in Port Availability. Port availability is calculated based on the performance of:

1. All Frame Relay network components; and
2. Company provided local access facilities used to access the Frame Relay Network.

SECTION 2 - RULES AND REGULATIONS (continued)

2.29 Allowances for Interruptions in Frame Relay Service (continued)

(C) Outage Time. Excluding outages caused by the factors listed below, outage time (Port Outage Time) is the total time in a month that a Customer's Port is unable to receive or transmit Local Management Interface (LMI) traffic. Port Outage Time does not include outages of less than 120 seconds duration, outages attributed to Ports that are added or reconfigured during the month, or time attributed to the Customer's delay in responding to the Company's requests for assistance to repair an outage. Port Outage Time will not include outages caused by:

1. Failure of any components not included in subsection 2.29.2 (B);
2. Failure of Customer-provided local access facilities used to access the Frame Relay network;
3. Scheduled maintenance from 12:01 – 5:00 A.M., Eastern time, every Sunday;
4. Failure of any components beyond the Frame Relay side of a network-to network interface (NNI);
5. Failure of any components on the ATM side of a Frame Relay-ATM gateway or the Internet or Intranet side of a Frame Relay-IP gateway;
6. Failure of any components that the Company cannot correct because the Customer is inaccessible;
7. Troubles resolved as "No Trouble Found";
8. The Customer's negligence or willful misconduct or the negligence or willful misconduct of others authorized by the Customer to use the Frame Relay Products and Services;
9. The failure of any PVCs provisioned to the Port;
10. The failure of any Company equipment, on the customer's premise, beyond the local telephone companies demarcation device or smart-jack; or
11. The failure of any non-Company certified customer premise equipment (CPE) that terminates a Company Frame Relay connection.

(D) Port Outage Time Measurement/Validation. Port Outage Time may be determined using the Company Trouble Ticket system.

SECTION 2 - RULES AND REGULATIONS (continued)

2.29 Allowances for Interruptions in Frame Relay Service (continued)

2.29.3 Port Availability Remedy

If the Customer believes that the Company has failed to meet its Committed Port Availability, the Customer must contact Customer Service. Upon the Company's verification that the actual Port Availability is below the Committed Port Availability, the Company will issue a service credit (Service Credit) to the Customer. The Service Credit will equal the applicable amount from the table below. Service Credits will not exceed the limits in Section 2.29.4. Usage-based backup PVC's are not eligible for Service Credits.

Total Monthly Port Outage Time	Service Credit*
Less than or equal to 1 hour	2-Days Service Credit
Greater than 1 hour	2-Days Service Credit plus ½ -Day Service Credit for each whole hour of Port Outage Time in excess of 1 hour

* 1-Day Service Credit is equal to 1/30 of the monthly recurring charge for the affected Port and the PVCs provisioned to the affected Port in the applicable month. N-Days Service Credit is equal to 1-Day Service Credit multiplied by N, where N is the number of Days of Service Credit.

2.29.4 Maximum Service Credits

(A) Monthly Service Credit.

1. The combined cumulative total of Service Credits issued in any month for any PVC under this Section or any other Frame Relay credit will not exceed the monthly recurring charges for the affected PVC.

2. The combined cumulative total of Service Credits issued in any month for a Port under this Section or any other Frame Relay credit will not exceed the monthly recurring charges for the affected Port.

SECTION 2 - RULES AND REGULATIONS (continued)

2.30 Allowances for Interruptions in PVC Delay Service

This Section describes the Company's measurement and standards for the time it takes for data or voice traffic to cross the Domestic NetSolutions Frame Relay (Frame Relay) network.

2.30.1. Committed PVC Delay

(A) Company Commitment. The Company will maintain the following average, end-to-end, one-way Domestic PVC Delay (Committed PVC Delay) based on the Customer's class of service (SNA, Voice or LAN) and access bandwidth, or the Company will provide the Customer the remedies described in Section 2.30.3.

Class of Service	**SNA/Voice**			**LAN**		
Access Bandwidth	DS1 NxDS1	256K– < DS1	56K– <256K	DS1 NxDS1	256K– < DS1	56K– <256K
Committed PVC Delay in milliseconds (ms)	Less than or equal to 55 ms	Less than or equal to 70 ms	Less than or equal to 115 ms	Less than or equal to 70 ms	Less than or equal to 85 ms	Less than or equal to 130 ms

If PVC end-points have different access bandwidths, the Committed PVC Delay value for the lower bandwidth end-point will apply. One millisecond of delay must be added to the below Committed PVC Delay values for each 100 fiber route miles over 3,500.

(B) Customer Requirements. The Customer's Frame Relay Products and Services must have the following characteristics for this Section to apply:

1. Routers must be configured to support the testing methods described in subsections 2.30.2 (B) and (C) and must not be set in "Debug" mode;
2. Both end-points must be Frame Relay Ports in Domestic locations; and
3. Test/ping frame size must be 200 bytes.

SECTION 2 - RULES AND REGULATIONS (continued)

2.30 Allowances for Interruptions in PVC Delay Service (continued)

2.30.2 Average PVC Delay Calculation

(A) Calculation. End-to-End, one-way delay between 2 PVC end-points is based on the average delay response time as determined by either:

1. The Company's Web-based Network Manager SLA report; or
2. Customer-initiated Ping Tests for PVC. The calculation is as follows:

   Average PING Round-Trip Response Time
   – 9 ms (for router delay)
   = One-Way PVC Delay

(B) Average PVC Delay Measurement Criteria using Customer-Initiated PING Tests. Customers using the PING test Method will measure Average PVC Delay in accordance with the following criteria:

1. PING Tests must be performed during the same 4-hour period for a minimum of 5 consecutive business days to determine a consistent average performance level for the calculation;
2. Customer initiation and termination routers and Ports connected by the Domestic PVC being tested must not exceed 60% Utilization during the PING Test; and
3. PINGs must be initiated one-way.

SECTION 2 - RULES AND REGULATIONS (continued)

2.30 Allowances for Interruptions in PVC Delay Service (continued)

(C) PING Test Parameters. The PING Test parameters are:

1. The PING initiation location is the IP address of the local router's serial Port that is directly connected to the Company's Frame Relay network;
2. The PING termination location is the IP address of the remote router's serial Port that is directly connected to the Frame Relay network;
3. The PING type is IP ICMP;
4. The PING size is 200 bytes; and
5. The number of PINGS in a PING Test equals a minimum of 20 PINGs for each 64k of bandwidth for the lower speed PVC end-point. For example, if a Host T1 Port is connected to a Remote 128k Port, there are 40 PINGS in the PING test (i.e., PING Number = (128,000/64,000) x 20 = 40).

(D) Components Included in Average PVC Delay. Subject to the exceptions listed in subsection 2.30.2 (E), average PVC delay is calculated based on the performance of:

1. All Frame Relay network components;
2. Company provided local access facilities used to access the Frame Relay network; and
3. Company provided Customer Premise Equipment (CPE).

SECTION 2 - RULES AND REGULATIONS (continued)

2.30 Allowances for Interruptions in PVC Delay Service (continued)

(E) Components Excluded form Average PVC Delay. Average PVC Delay does not include delays caused by:

1. Failure of any components not included in subsection 2.30.2(D) above;
2. Failure of any components beyond the Frame Relay size of a network-to network interface (NNI);
3. Failure of any components on the ATM side of an ATM-Frame Relay Gateway Service or the Internet or Intranet side of a Frame Relay-IP Gateway Service;
4. The Customer's negligence or willful misconduct or the negligence or willful misconduct of others authorized by the Customer to use the Frame Relay Products and Services;
5. Force majeure events:
6. Scheduled maintenance from 12:01 – 5:00 A.M., Eastern Time, every Sunday;
7. Any non-Company certified customer premise equipment (CPE) that terminates a Company Frame Relay connection; or
8. PVCs added or reconfigured during the month.

2.30.3 Average PVC Delay Remedy

If the Customer believes that the Company has failed to meet its Committed PVC Delay, the Customer must contact Customer Service. Upon verification that the actual Average PVC Delay is greater than the Committed PVC Delay, the Company will issue a service credit (Service Credit) to the Customer. The Service Credit will equal 50% of the monthly recurring charges for each affected PVC in the applicable month, not to exceed the limits in Section 2.30.4.

SECTION 2 - RULES AND REGULATIONS (continued)

2.30 Allowances for Interruptions in PVC Delay Service (continued)

2.30.4 Maximum Service Credits

(A) Monthly Service Credit. The Service Credit issued in any month for PVC under this Section will not exceed 50% of the monthly recurring charges for the affected PVC. This Service Credit is in lieu of all other remedies for the affected PVC.

(B) Yearly Service Credit. The combined cumulative total of Service Credits issued during a contract year under this Section and any other Frame Relay credits will not exceed 20% of the Customer's total Frame Relay Products and Services invoiced during that contract year.

SECTION 2 - RULES AND REGULATIONS (continued)

2.31 Allowances for Interruptions in Data Delivery Rate (DDR) Service

This Section describes the Company's measurement and standards for the adjusted ratio of kiloframes delivered (Egress Kiloframes) to kiloframes offered (Ingress Kiloframes) to the Domestic NetSolutions Frame Relay (Frame Relay) network.

2.31.1 Committed DDR

The Company will maintain 99.0% or greater DDR for all Domestic 0 Committed Information Rate (CIR) PVCs and 99.9% or greater for all Domestic CIR PVCs (Committed DDR), or the Company will provide the remedies described in Section 2.31.4.

2.31.2 Committed DDR Calculation

(A.) Calculation. Subject to the excluded components listed in subsection 2.31.2(C), DDR is calculated using aggregate monthly statistics for all PVCs installed. DDR is calculated monthly as follows:

$$\frac{\text{Total Egress Kiloframes}}{\text{Total Ingress Kiloframes} - (\text{Bc} + \text{Be Exceeded Kiloframes})} = \text{DDR}$$

(B) Definitions. The following definitions are used in this Section:

1. Bc (Committed Burst Size) – means the number of bits that the Frame Relay Network commits to transfer under normal conditions.

2. Be (Excess Burst Size) – means the number of bits over Bc that the Frame Relay Network attempts to transfer under normal conditions.

3. Bc + Be Exceed Kiloframes – means the number of Ingress Kiloframes that are discarded because the Customer's Equipment has transmitted them above the maximum rate for given PVC.

SECTION 2 - RULES AND REGULATIONS (continued)

2.31 Allowances for Interruptions in Data Delivery Rate (DDR) Service (continued)

(C) Components Excluded from DDR. The DDR calculation will not include data loss attributed to or caused by:

1. Failures of local access facilities used to access the Frame Relay Network;
2. Scheduled maintenance from 12:01 – 5:00 A.M., Eastern Time, every Sunday;
3. Failure of any components beyond the Frame Relay side of a network-to-network interface (NNI);
4. Failure of any components on the ATM side of a Frame Relay-ATM gateway or the Internet or Intranet side of a frame Relay-IP gateway;
5. Force majeure events;
6. The Customer's negligence or willful misconduct or the negligence or willful misconduct of others authorized by the Customer to use the Frame Relay Products and Services;
7. The Customer's failure to transmit, in aggregate, at least 5,000 Kiloframes of data in any month;
8. Failures of usage-based backup PVCs or dial-up PVCs;
9. PVCs or Ports added or reconfigured during the month;
10. Lost call detail records resulting in inaccurate statistics; or
11. Failures of any non-Company certified customer premise equipment (CPE) that terminates on a Company Frame Relay connection.

2.31.3 DDR Measurement

DDR may be determined using the Company monthly Frame Relay Performance Report.

SECTION 2 - RULES AND REGULATIONS (continued)

2.31 Allowances for Interruptions in Data Delivery Rate (DDR) Service (continued)

2.31.4 DDR Remedy

If the Customer believes that the Company has failed to meet its Committed DDR, the Customer must contact Customer Service. Upon the Company's verification that the actual DDR is below the Committed DDR, the Company will issue a service credit (Service Credit) to the Customer equal to 50% of the monthly charge for each affected PVC in the applicable month, not to exceed the limits in Section 2.31.5.

2.31.5 Maximum Service Credits

(A) Monthly Service Credit.

1. The Service Credit issued in any month for a PVC under this Section will not exceed the monthly recurring Charges for the affected PVC. This Service Credit is in lieu of all other remedies for the affected PVC.

2. The Service Credit issued in any month for a Port under this Section will not exceed the monthly recurring charges for the affected Port. This Service Credit is in lieu of all other remedies for the affected Port.

(B) Yearly Service Credit. The combined cumulative total of Service Credits issued during a contract year under this Section and any other Frame Relay Slaps will not exceed 20% of the Customer's total Frame Relay Products and Services invoiced during that contract year.

(C) Contractual Service Credit. Service Credits issued during a Contract Year for the Company's' failure to meet this or any others under this Agreement will not exceed either 20% of the Customer's Minimum Annual Frame Relay Commitment or 20% of the Customer's Minimum Monthly Frame Relay Commitment.

Commitment multiplied by 12, as applicable. The Customer is entitled to this exclusive remedy, in lieu of other remedies, if Services fail to meet the applicable standards.

SECTION 2 - RULES AND REGULATIONS (continued)

2.31 Allowances for Interruptions in Data Delivery Rate (DDR) Service (continued)

2.31.6 Applicability

This Section applies to new Frame Relay Customers on or after October 1, 2001, or existing Frame Relay Customers who extend the Term of their existing Frame Relay Agreement.

SECTION 2 - RULES AND REGULATIONS (continued)

2.32 Allowances for Interruptions in Internet and IP Products

This Section describes the Company's measurements and standards for the time it takes for data to cross the IP Network and the percentage of time a Port is available for the Customer's use.

2.32.1 Committed Network Delay

(A) Company Commitment. The Company will maintain the following average round-trip POP-to-POP network delay (Committed Network Delay) for its IP Networks, or the Company will provide the Customer with the remedies described in Section 2.32.3.

Committed Internet Network Delay	Committed Intranet Network Delay
Less than or equal to 70 milliseconds (ms)	Less than or equal to 70 milliseconds (ms)

(B) Customer Requirements. Both end-point NetSolutions Access Nodes must be located within the 48 contiguous United States or the District of Columbia.

SECTION 2 - RULES AND REGULATIONS (continued)

2.32 Allowances for Interruptions in Internet and IP Products (continued)

2.32.2 Average Network Delay Calculation.

(A) Average Network Delay is calculated by using Company initiated PING Tests, as follows:

1. Calculation for Dial IP Delay. POP-to-POP round-trip delay is the time it takes for a Company generated PING to go from a Company Rotary to a Company Ping server at the Company Access Node to which the Customer's IP site is connected and back to the Company Rotary. The performance guarantee is based on the monthly average delay response times for the Company initiated PING Tests at 10 Customer-selected Dial Access Sites. The calculation is as follows:

$$\frac{\text{Sum of Round-trip Delays (Internet or Intranet Networks) For 10 Customer Selected Rotaries}}{10} = \text{Average Network Delay}$$

2. Calculation for Dedicated Internet Network Delay. POP-to-POP round-trip delay is the time it takes for a Company generated PING to go round-trip between two Company Access Nodes to which the Customer's IP sites are connected. The calculation is based on the monthly average delay response time.

SECTION 2 - RULES AND REGULATIONS (continued)

2.32 Allowances for Interruptions in Internet and IP Products (continued)

(B) Definitions. The following definitions are used in this Section:

1. Rotary – means the NPA-NXX-XXXX number dialed by the Customer's modems to access Company IP Networks.

2. Company Access Node – means Company owned facilities connected by SONET long- distance fiber lines that collectively form Company IP Networks.

(C) PING Test Parameters. The PING Test parameters are:

1. The PING type is IP ICMP
2. The Ping size is 64 bytes; and
3. PING time-outs shall equal 1 second (1000 milliseconds).

(D) Components Included in Average Network Delay. Subject to the exceptions listed in subsection 2.32.2(E), Average Network Delay is calculated based on the performance of:

1. All IP Networks Components; and
2. Rotaries.

SECTION 2 - RULES AND REGULATIONS (continued)

2.32 Allowances for Interruptions in Internet and IP Products (continued)

(E) Components Excluded From Average Network Delay. Average Network Delay does not include delays caused by:

1. Any components not included in subsection 2.32.2(D) above;
2. Failure of any components beyond the IP side of a network-to-network interface (NNI);
3. Failure of any components on the Frame Relay side of an IP-Frame Relay Gateway Service or the ATM side of an IP-ATM Gateway Service;
4. The Customer's negligence or willful misconduct or the negligence or willful misconduct of others authorized by the Customer to use the IP Products and Services;
5. Scheduled maintenance from 12:00 A.M. – 6:00 A.M., Local time at site, Mondays for Internet, Wednesdays for Intranet.
6. Company operated modems and Company Domain Name Servers (DNS); or
7. Any components operated by an Internet Service Provider or a network operator other than Company.

2.32.3 Average Network Delay Remedy

If the Customer believes that the Company has failed to meet its Committed Network Delay, the Customer must contact Customer Service. Upon the Company's verification that the actual average network delay in a month is greater than the Committed Network Delay, the Company will issue a service credit (Service Credit) to the Customer. The Service Credit will equal 10% of the monthly recurring charge for the affected IP Port in the applicable month, not to exceed the limits in Section 2.32.4.

SECTION 2 - RULES AND REGULATIONS (continued)

2.32 Allowances for Interruptions in Internet and IP Products (continued)

2.32.4 Maximum Service Credits

(A) Monthly Service Credit. Service Credits issued in any month for a Port under this Section will not exceed 10% of the monthly recurring charges for the affected Port.

(B) Yearly Service Credit. The combined cumulative total of Service Credits issued during a Contract Year under this Section and any other credits will not exceed 20% of the Customer's total IP Products and Services invoiced during that Contract Year.

(C) Contractual Service Credit. Service Credits issued during a Contract Year for the Company's failure to meet this or any other standards under this Agreement will not exceed either 20% of the Customer's Minimum Annual Commitment or 20% of the Customer's Minimum Monthly Commitment multiplied by 12, as applicable. The Customer is entitled to this exclusive remedy, in lieu of other remedies, if Services fail to meet the applicable standards.

SECTION 2 - RULES AND REGULATIONS (continued)

2.33 Committed Port Availability

This Section describes the Company's measurements and standards for Committed Port Availability. The Company will maintain the following monthly Port availability, as applicable, or the Company will provide the Customer with the remedies described in Section 2.33.4.

2.33.1 End-to-End Port Availability.

(A) Company provided Enhanced Metropolitan-Area SONET Access. The Company will maintain 100% end-to-end Port availability (Committed Port Availability) for each Port that utilizes Company-provided enhanced metropolitan-area SONET access.

(B) Company provided Non-Enhanced Metropolitan-Area SONET Access or Dedicated Local Access. The Company will maintain 99.90% or greater end-to-end Port availability (Committed Port Availability) for each Port that utilizes Company-provided non-enhanced metropolitan-area SONET access or dedicated local access.

2.33.2 POP-to-POP Port Availability

The Company will maintain 100% percent POP-to-POP Port Availability (Committed Port Availability) for each Port that utilizes Customer-provided local access.

SECTION 2 - RULES AND REGULATIONS (continued)

2.33 Committed Port Availability (continued)

2.33.3 Port Availability Calculation

(A) Calculation. Port availability is calculated monthly as follows:

$$\frac{(24 \text{ Hours X Days in Month}) - \text{Port Outage Time (hours)}}{(24 \text{ Hours x Days in Month}} = \text{Port Availability}$$

(B) Components Included in Port Availability. Port availability is calculated based on the performance of:

1. All IP Network components; an
2. Company provided local access facilities used to access the IP Network.

SECTION 2 - RULES AND REGULATIONS (continued)

2.33 Committed Port Availability (continued)

(C) Outage Time. Excluding outages caused by the factors listed below, outage time (Outage Time) is the total time in a month that a Customer's Port is unable to transmit or receive High Level Data Link Control (HDLC) traffic. Outage Time is measured from the time the Company opens a trouble ticket to the time a problem is repaired. Outage Time does not include outages of less than 60 seconds duration, or time attributed to the Customer's delay in responding to the Company's requests for assistance to repair an outage. Outage Time will not include outages caused by:

1. Failure of any component not included in subsection 2.33.3(B);
2. Failure of Customer-provided local access facilities used to access the Company's IP Network;
3. Scheduled maintenance from 12:00 A.M. – 6:00 A.M., Local time at site, Mondays for Internet, Wednesdays for Intranet.
4. Failure of any components beyond the IP side of a network-to-network interface (NNI);
5. Failure of any components on the Frame Relay side of an IP-Frame Relay Gateway Service or the ATM side of an IP-ATM Gateway Service;
6. Failure of any components that the Company cannot correct because the Customer is inaccessible;
7. Troubles resolved as "No Trouble Found";
8. The Customer's negligence or willful misconduct or the negligence or willful misconduct of others authorized by the Customer to use the IP Products and Services; or
9. Lateral Exchange Network Service.

SECTION 2 - RULES AND REGULATIONS (continued)

2.33 Committed Port Availability (continued)

2.33.4 Port Availability Remedy

If the Customer believes that the Company has failed to meet its Committed Port Availability, the Customer must contact its Account Manager. Upon the Company's verification that the actual Port availability is below the Committed Port Availability, the Company will issue a service credit (Service Credit) to the Customer. The Service Credit will equal the applicable amount from the table below. Service Credits will not exceed the limits in Section 2.33.5.

Total Monthly Outage Time	Service Credit*
Less than or equal to 1 hour	2-Days Service Credit
Greater than 1 hour	2-Days Service Credit plus 1/2-Day Service Credit for each whole hour of Outage Time in excess of 1 hour

* 1-Day Service Credit is equal to 1/30 of the monthly recurring charge for the affected Port in the applicable month. N-Days Service Credit is equal to 1-Day Service Credit multiplied by N, where N is the number of Days of Service Credit.

SECTION 2 - RULES AND REGULATIONS (continued)

2.33 Committed Port Availability (continued)

2.33.5 Maximum Service Credits

(A) Monthly Service Credit. Service Credits issued in any month for a Port under this Section will not exceed the monthly recurring charges for the affected Port.

(B) Yearly Service Credit. The combined cumulative total of Service Credits issued during a Contract Year under this Section and any other IP credits will not exceed 20% of the Customer's total IP Products and Services invoiced during that Contract Year.

(C) Contractual Service Credit. Service Credits issued during a Contract Year for the Company's failure to meet this or any other standards will not exceed either 20% of the Customer's Minimum Annual IP Commitment or 20% of the Customer's Minimum Monthly IP Commitment multiplied by 12, as applicable. The Customer is entitled to this exclusive remedy, in lieu of other remedies, if Services fail to meet the applicable standards.

2.33.6 Applicability

This performance guarantee applies to new IP Customers on or after October 1, 2001, or existing IP Customers that extend the Term of their existing IP Agreement.

2.34 Voice Long Distance Service Interruptions

When the following interruptions or failures occur, Section 2.27 will apply and a credit allowance will be limited for the usage charge for the applicable call(s):

Interruptions in individual voice calls because of
Poor transmission (e.g., noisy circuit condition),
One-way transmission (one party is unable to hear the other), or
Involuntary disconnection (cut-off) of the call caused by the Company.

For outbound (originating) voice calls only, reaching the wrong number.

SECTION 3 - DESCRIPTION OF SERVICE

3.1 Call Timing for Usage Sensitive Services

Where charges for a Service are specified based on the duration of use, such as the duration of a long distance telephone call, the following rules apply:

3.1.1 Calls are timed and measured by the Underlying Carrier whose Services are resold by the Company, in accordance with its own Tariff.

3.1.2 Calls are measured in durational increments identified for each Service. All calls that are fractions of a measurement increment are rounded-up to the next whole unit.

3.1.3 Timing on completed calls begins when the called party answers the call. Answering is determined by hardware answer supervision in all cases where this signaling is provided by the terminating local carrier and any intermediate carrier(s).

3.1.4 Timing terminates on all calls when the calling party hangs up or the Company's network receives an off-hook signal from the terminating carrier. If the called station "hangs up" but the calling station does not, chargeable time ends when the automatic timing equipment in the network releases the connection.

3.1.5 When the Company's Services are directly connected to Customer-Provided Equipment at the Customer's Premises, chargeable time begins when a call terminates in, or passes through, the first Customer Equipment on that Customer provided communications system.

3.1.6 Calls originating in one time period and terminating in another will be billed in proportion to the rates in effect during different segments of the call.

3.1.7 All times refer to local time of the calling party.

SECTION 3 - DESCRIPTION OF SERVICE (continued)

3.2 Rate Period Overlap

Calls that overlap rate periods will be rated in relation to the amount of minutes that correspond to each rate period.

3.3 Minimum Call Completion Rate

The Company's network is engineered for network blockage purposes to a P.01 grade of service.

SECTION 3 - DESCRIPTION OF SERVICE (continued)

3.4 WATS and Toll-Free Service Offerings

3.4.1 Direct Dial WATS/Day and Night Service

Basic "1+" direct dialed intrastate Telecommunications Service available in all equal access areas for use by subscribers 24 hours a day.

Calls are charged on a flat-rated, per minute of use basis, with peak and off-peak periods. Billing for this Service is calculated in six -second increments with an 18 second minimum call period.

One to five-digit accounting codes are available to enable Customers to easily track calls by project, client, department or other accounting group. A travel card is available to Customers at no extra charge.

3.4.2 T-1 WATS Service

Interexchange Service utilizing dedicated T-1 access for high volume Customers. Calls are charged on a flat-rated, per minute of use basis, with peak and off-peak periods. 24 separate access lines provide the capability of handling 24 simultaneous calls. Billed in six-second increments, with an 18 second minimum. Account and security codes are available.

SECTION 3 - DESCRIPTION OF SERVICE (continued)

3.4 Service Offerings (continued)

3.4.3 Non-Dedicated Toll Free Service

This in-bound toll Service permits calls to be completed at the subscriber's location without charge to the calling party. Calls are charged on a flat-rated basis with peak and off-peak periods. Access to this Service is gained by dialing a 10-digit telephone number (800 or 888-NXX-XXXX) that will terminate at the subscriber's location. Toll Free access is available from anywhere in the United States.

The subscriber may elect to permit calls to originate from any location within the state or may geographically restrict access based on the caller's area code.

Calls are originated and terminated via normal shared use Facilities. The intrastate charge for switched Toll Free Service is a fixed rate per minute. Billed in six-second increments, with an 18 second minimum.

3.4.4 T-1 Toll Free Service

Toll Free flat usage-based rated Service utilizing dedicated T-1 access for high volume Customers. Calls are charged on a flat-rated, per minute of use basis, with peak and off-peak periods. Calls are billed in six-second increments, with an 18-second minimum. Special features include Route Advance, Dialed Number Identification Service, Area Code and Exchange Routing, Time Routing, Area Code Selection, and Automatic Number Identification.

SECTION 3 - DESCRIPTION OF SERVICE (continued)

3.5 IntraLATA Long Distance Services

3.5.1 Long Distance Services are available from the Company pursuant to terms, conditions, regulations and rates as provided for in this Tariff. Service is available for use by Customers twenty-four (24) hours a day. The Company's Long Distance Service enables a User of an Exchange access line to place calls to any station on the Public Switched Telephone Network bearing an NPA-NXX designation associated with points outside the Customer's Local Calling Area. Such Service is offered for both intraLATA and interLATA calling. Customers must arrange for intraLATA and interLATA Service from the Interexchange Carriers of their choice. Customers may choose the Company as their carrier for intraLATA calls or interLATA calls.

3.6 Carrier Presubscription

3.6.1 Carrier Presubscription is a procedure whereby a Customer designates the Interexchange Carrier that the Customer wishes to be the carrier of choice for intraLATA and interLATA toll calls. Such calls are automatically directed to the designated carrier, without the need to use carrier access codes or additional dialing to direct the call to the designated carrier. Presubscription does not prevent a Customer from using carrier access codes or additional dialing to direct calls to an alternative long distance carrier on a per call basis.

SECTION 3 - DESCRIPTION OF SERVICE (continued)

3.6 Carrier Presubscription (continued)

3.6.2 Customers may select the same carrier or separate carriers for intraLATA and interLATA long distance. Depending on the Service subscribed to by the Customer, the following options for long distance presubscription may be available:

Option A: Customer may select the Company as the presubscribed carrier for IntraLATA calls, subject to presubscription, and some other carrier as the presubscribed carrier for interLATA toll calls, subject to presubscription.

Option B: Customer may select no presubscribed carrier for intraLATA toll calls, which will require the Customer to dial a carrier access code to route all intraLATA toll calls to the carrier of choice, and the Company for interLATA toll calls, subject to presubscription.

Option C: Customer may select the Company for intraLATA toll calls subject to presubscription and no presubscribed carrier for interLATA toll calls which will require the Customer to dial a carrier access code to route all interLATA toll calls to the carrier of choice.

Option D: Customer may select some other carrier as the presubscribed carrier for intraLATA toll calls, subject to presubscription, and the Company as the presubscribed carrier for interLATA calls, subject to presubscription.

Option E: Customer may select the company for both intra LATA and interLATA toll calls, subject to presubscription.

SECTION 3 - DESCRIPTION OF SERVICE (continued)

3.6 Carrier Presubscription (continued)

3.6.3 Rules and Regulations

(A) Customers of record will retain their Primary Interexchange Carrier(s) until they request that their dialing arrangements be changed.

(B) Customers of record or new Customers may select Option A, B, C, D, or E for intraLATA Presubscription.

(C) Customers may change their selected presubscribed Interexchange Carrier at any time, subject to charges specified in this Tariff.

3.6.4 Carrier Presubscription Charges

(A) Application of Charges

After a Customer's initial selection for a presubscribed toll carrier and as detailed in this Tariff, for any change thereafter, an Presubscription Change Charge, as set for the below will apply. Customers who request a change in intraLATA and interLATA carriers with the same order will be assessed a single charge per line.

SECTION 3 - DESCRIPTION OF SERVICE (continued)

3.7 Special Features

3.7.1 The following special features are available with Non-Dedicated Toll Free and Dedicated Toll Free Service:

(A) Enhanced Toll Free Routing - Routing is available to improve call handling efficiency and productivity by allowing the Customer to route traffic by service group, area code, time of day, day of week and day of the year.

(B) Area Code Selection - Area Code Selection allows a Customer to geographically restrict access to its Toll Free number based on the call's area code.

3.7.2 The following special features are available with Dedicated Toll Free Service:

(A) Route Advance - Route Advance ensures that all calls are answered during peak calling periods by overflowing to the Customer's local business lines.

(B) Uniform Call Distribution - Uniform Call Distribution (UCD) enables a Customer's operators to work more efficiently by evenly distributing Toll Free calls over all lines in a service group.

(C) Dialed Number Identification - Dialed Number Identification Service permits multiple Toll Free numbers to terminate on the same service group to increase the efficiency and cost effectiveness of each service group. The Customer's operators can provide more personalized customer service because they immediately know the 800 number the caller has dialed.

SECTION 3 - DESCRIPTION OF SERVICE (continued)

3.8 Calling Card Service

The Company's Calling Card Service can be used for domestic or international calling at locations other than the Customer's Premises. Calling card calls can be placed from rotary and touch-tone phones. Multiple calls may be placed using the # button on a touch-tone phone. A scrambled 14-digit code provides security and lessens the chance for code abuse. A misdialed/correction feature permits fast, easy correction of misdialed numbers. Call detail is provided in conjunction with Calling Card Service and permits the Customer to monitor usage. The Company will replace lost or stolen cards quickly and at no charge to the Customer. Calls are billed in 60-second increments.

SECTION 3 - DESCRIPTION OF SERVICE (continued)

3.9 Operator and Directory Assistance

The Company does not provide operator or directory assistance services.

3.10 Special Promotions

3.10.1 The Company may, from time to time, engage in special promotional trial Service offerings of limited duration designed to attract new Customers or to increase Customer awareness of a particular Tariff offering.

3.10.2 These promotional offerings may only apply to certain Services and may be limited to specific dates, times and locations.

3.10.3 Except for the rates charged under special promotions offerings, all other terms and conditions of Service contained in this Tariff will apply to such Service offerings.

3.10.4 Promotional offerings will be presented to the Commission for its review in accordance with rules and regulations established by the Commission, and will be included in the Company's Tariff as an addendum to the Company's price lists.

3.11 Competitive Pricing Promotions

3.11.1 The Company may, at its discretion, match certain standard or promotional offerings of other companies in order to acquire new Customers or to retain existing Customers. The Customer must demonstrate to the Company's satisfaction that 1) an alternative Service offering is valid and currently available from a competing company and 2) the Customer intends to either subscribe or remain subscribed with the competing company.

SECTION 3 - DESCRIPTION OF SERVICE (continued)

3.12 Individual Case Basis Pricing

3.12.1 Individual Case Basis Pricing is a service arrangement in which the regulations, rates and charges are developed based on the specific circumstances of the Customer.

3.12.2 Rates, terms or conditions for Services may be determined on an Individual Case Basis and determined by contract between the Company and the Customer.

3.12.3 Customer-specific contracts may include, but are not limited to:

(A) Central Office-based Services;
(B) High Speed Private Line Services;
(C) Customized Services that are unique because of size or configuration;
(D) Customer volume or revenue commitments for which the Company must meet competitive demands of the marketplace
(E) Any other Service for which the Company has authority to enter into Customer-specific contracts pursuant to the Commission's rules.

3.12.3 The Company will comply with the Commission's rules pertaining to ICB contracts.

SECTION 4 - RATES

4.1 Rate Applicability

This Tariff is applicable to all Customers.

4.2 Rate Periods

Peak Rate Period: Monday-Friday, 8:00 a.m. - 5:00 p.m.

Off-Peak Rate Period: All time periods not included in Peak Period

4.3 Uncompleted Calls

No charge will be incurred for calls where there is a busy signal, or no answer from the called party.

4.4 T-1 and PRI Service

Service	NRC	MRC
T-1 (0 to 30 miles)	$995.00*	$300.00
T-1 (over 30 miles)	ICB	ICB
PRI	$995.00*	$500.00

* T-1 and PRI non-recurring charges are waived if the Customer enters into a 2 or 3 year contract with the Company

4.5 Expedite Fees

11-14 Business Days	$750.00
15-21 Business Days	$500.00

SECTION 4 – RATES (continued)

4.6 WATS and Toll-Free Rates and Charges

All charges in dollars per minute

	Service Type	Rate
4.6.1	Direct Dial WATS/ Day and Night Service	$0.189
4.6.2	T-1 WATS Service	$0.119
4.6.3	Non-Dedicated Toll Free	$0.189
4.6.4	T-1 Toll Free Service	$0.119

4.7 Intrastate Long Distance Services

4.7.1 Intrastate Switched Long Distance $0.189

4.7.2 Intrastate Dedicated Long Distance $0.119

4.7.3 Intrastate Calling Card Long Distance $0.15

4.8 Carrier Presubscription Charges

Non-Recurring Charges
Per business or residence line, trunk, or port

Initial Line, or Trunk or Port	$ 5.00
Additional Line, Trunk or Port	$ 5.00

SECTION 4 – RATES (continued)

4.9 Special Features

Enhanced Toll-Free Routing	TBD
Area Code Selection	TBD
Route Advance	TBD
Uniform Call Distribution	TBD
Dialed Number Identification	TBD
Non-Verified Account Codes	No charge

For Toll Free Services, there is a one-time charge of $135.00 for selection of one or more originating area codes. The charge remains the same regardless of the number of area codes chosen. There is also a $135.00 one-time charge to change an existing area code selection plan. The charge remains the same regardless of the number of area codes changed.

Security Codes	(verified account codes):
1-50 codes	$ 5.00
51-200	$10.00
201+	$25.00

For Security Codes, there is a one-time charge of $15.00 for installation and per change/day charge of 15.00.

4.10 Operator and Directory Assistance

The Company does not provide operator or directory assistance services.

SECTION 4 – RATES (continued)

4.11 Special Promotions

Reserved for future use.

4.12 Competitive Pricing Promotions

The Company may, at its discretion, match certain standard or promotional offerings of other companies in order to acquire new Customers or to retain existing Customers. The Customer must demonstrate to the Company's satisfaction that 1) an alternative Service offering is valid and currently available from a competing company and 2) the Customer intends to either subscribe or remain subscribed with the competing company.

EXHIBIT D

APPLICANT'S TECHNICAL ABILITIES AND MANAGERIAL RESOURCES

Management and Telecommunications Experience of the Officers and Directors of Inter-Tel NetSolutions, Inc.

Jon Brinton, President

Mr. Brinton joined NetSolutions as President on July 1, 2000. Prior to that he was President of Inter-Tel Network Services Agency, a position he still holds today. From January 1, 1996, to June 30, 1999, Mr. Brinton was President, and the primary shareholder, of Network Services Agency Inc. (NSA). Inter-Tel acquired NSA in June of 1999 and incorporated it as a division of Inter-Tel Technologies. NSA's primary business was the sale and implementation of telecommunications services with an emphasis on local service delivery to business customers. NSA subcontracted local service agency programs for Inter-Tel representing Regional Bell Operating companies. Primary providers were Qwest, SBC, and Pacific Bell. Prior to acquiring NSA from its founders, Mr. Brinton served as a representative of NSA in 1994 and 1995, marketing telecommunications services to business customers. From 1987 to 1994 his work experience was focused in the advertising industry. Mr. Brinton is a 1987 Graduate of Grand Canyon University where he received his Bachelor of Science Degree.

Steven G. Mihaylo, Vice President and Director

Mr. Mihaylo founded Inter-Tel, Inc. in 1969 to give businesses the ability to choose more advanced and cost-effective business telephone systems from a source other than the "telephone company." He has served as Chairman of the Board of Directors of Inter-Tel since September 1983, as President since May 1998 and as Chief Executive Officer of Inter-Tel since its formation in July 1969. Mr. Mihaylo served as President of Inter-Tel from 1969 to 1983 and from 1984 to December 1994, and as Chairman of the Board of Directors from July 1969 to October 1982. Mr. Mihaylo is also a director of MicroAge, Inc.

Kurt R. Kneip, Vice President, Secretary, and Director

Mr. Kneip joined Inter-Tel, Inc. in May 1992 as Director of Corporate Tax, after seven years with the accounting firm of Ernst & Young. He has served as Vice President and Chief Financial Officer of Inter-Tel, Inc. since September 1993. Mr. Kneip is a Certified Public Accountant, and holds an undergraduate degree in Commercial Economics from South Dakota State University and a Masters Degree in Professional Accountancy from the University of South Dakota.

Management and Telecommunications Experience
of the Officers and Directors
of
Inter-Tel NetSolutions, Inc.

John C. Abbott, Treasurer

Mr. Abbott joined Inter-Tel, Inc. in 1996 as Treasurer with responsibility for managing wholesale credit, commercial banking and cash investment relationships for Inter-Tel, Inc. Prior to joining Inter-Tel, Mr. Abbott was vice president and commercial loan officer for Bank One Arizona, NA. He began his career in 1983 as a consultant with Andersen Consulting. Mr. Abbott holds a Masters of Business Administration degree from the University of Arizona and Bachelor of Science degree from the University of Illinois.

Ross E. McAlpine, Director

Mr. McAlpine joined Inter-Tel, Inc. in July 1991when it acquired Telecommunications Specialists, Inc. Prior to joining Inter-Tel, Mr. McAlpine worked 17 years in the leasing and financial services industry. He is Senior Vice President of Sales and Marketing for Inter-Tel Leasing, Inc. Mr. McAlpine was elected Senior Vice President in September 1997. He also has served as President of Inter-Tel Leasing, Inc., a wholly owned subsidiary of Inter-Tel, since April 1993, President of Inter-Tel NetSolutions, Inc. from 1997 to 2001, and President of Inter-Tel.NET, Incorporated since 1997. He also served as Vice President of Inter-Tel Communications, Inc. from April 1991 to April 1992 and Treasurer since April 1992. Mr. McAlpine holds an undergraduate degree in Accounting from Southwest Texas State University.

Management and Telecommunications Experience
of the Management Team
of
Inter-Tel NetSolutions, Inc.

Dave Read, Director of Operations

Mr. Read joined NetSolutions as Director of Operations in April 2001. Prior to joining NetSolutions, he was Director of Operations for Inter-Tel.NET, a VOIP Service Provider. He held numerous key positions within Inter-Tel.NET, and was an integral part of its organizational team. Prior to joining to Inter-Tel in January of 1998, Dave was responsible for National Sales and Operations for the Spiegel Group and their subsidiary companies and was promoted to become their National Sales Director Liaison in his final position there. Mr. Read brings over 18 years of progressive management experience in competitive, high-volume, customer-oriented environments to the NetSolutions management team. His solid background in managing operations at single and multi-site locations, achieving bottom line profitability, cost containment, and decisive team leadership optimize the "Total Solution" offered by Inter-Tel and NetSolutions.

Allison Andrews, Manager of Provisioning and Customer Service

Ms. Andrews is the Manager of the Provisioning and Customer Service Departments for Inter-Tel NetSolutions. A nine-year industry veteran, she has an extensive telecommunications background specializing in switched 1+ voice and dedicated long distance services. Ms. Andrews joined NetSolutions in 1996 and served for 3 years in various positions within the provisioning and customer service departments prior to becoming the Customer Service Supervisor in 1998. She was promoted in 1999 to the position of Manager of the Provisioning and Customer Service departments. Prior to joining Inter-Tel, Ms. Andrews was employed by LDDS WorldCom in Phoenix, Arizona, as an Executive Account Manager for large business accounts.

Mathew Gahan, Network Services Manager

Mr. Gahan joined Inter-Tel NetSolutions in April 1995 as a Sales Support Representative. Mr. Gahan also worked in customer and Dedicated Services Provisioning. Mr. Gahan became the Supervisor for Dedicated Services Provisioning in 1998. In 1999, he was promoted to Network Services Manager with responsibility for Dedicated Services Provisioning and NetSolutions Service Management Center. Prior to joining Inter-Tel, Mr. Gahan had six years of experience working in various facets of the telecommunications industry. He is a 1989 graduate of Arizona State University where he completed his studies with a Bachelor of Science degree.

South Dakota
Public Utilities Commission

State Capitol Building, 500 East Capitol Avenue, Pierre, South Dakota 57501-5070

VIA FAX: 512-480-9200

September 4, 2002

Mr. Bradford W. Bayliff
Attorney at Law
Casey & Gentz, L.L.P.
919 Congress Avenue, Suite 1060
Austin, TX 78701-2157

RE: Application for Certificate of Authority
Inter-Tel NetSolutions, Inc.

Dear Mr. Bayliff:

We received your Application for a Certificate of Authority to operate as an interexchange telecommunications company in the state of South Dakota. Pursuant to SDCL 49-31-3, telecommunication companies shall submit a $250 application fee when filing:

> **SDCL 49-31-3. Each telecommunications company that plans to offer or provide interexchange telecommunications service shall file an application for a certificate of authority with the commission pursuant to this section. Telecommunications companies seeking to provide any local exchange service shall submit an application for certification by the commission pursuant to §§ 49-31-1 through 49-31-89. Applications required by this section shall be filed by the company no less than sixty days before its initiation of telecommunications service in this state. The commission shall have the exclusive authority to grant a certificate of authority. Each telecommunications company shall submit a two hundred fifty dollar application fee with its application which shall be deposited into the gross receipts tax fund established pursuant to § 49-1A-2.**

We cannot take any action on your application until we receive the applicable fee.

Thank you for your cooperation in this matter.

Sincerely,

Delaine Kolbo

Delaine Kolbo
Legal Secretary

Capitol Office
Telephone (605)773-3201
FAX (605)773-3809

Transportation/
Warehouse Division
Telephone (605)773-5280
FAX (605)773-3225

Consumer Hotline
1-800-332-1782

TTY Through
Relay South Dakota
1-800-877-1113

Internet Website
www.state.sd.us/puc

CASEY & GENTZ, L.L.P.
ATTORNEYS AT LAW

919 Congress Ave., Ste. 1060
Austin, Texas 78701-2157
Phone 512-480-9900
Fax 512- 480-9200

Writer's Direct Number:
512-225-0027

Robin A. Casey
Susan C. Gentz
Diane M. Barlow
Valerie P. Kirk
Bill Magness
Bradford W. Bayliff

September 4, 2002

Via Federal Express
(605) 773-3201

Delaine Kolbo
Legal Secretary
South Dakota Public Utilities Commission
Capitol Building, 1st Floor
500 East Capitol Avenue
Pierre, South Dakota 57501-5070

Dear Ms. Kolbo:

I am attaching our firm check in the amount of $250.00 for the application fee for the Inter-Tel NetSolutions, Inc. Application for a Certificate of Authority. The application fee is required by SDCL 49-31-3. Thank you for your cooperation and your prompt notification of the necessity to submit the application fee.

Sincerely yours,

Bradford W. Bayliff

Enclosure

CASEY & GENTZ, L.L.P.
919 CONGRESS AVENUE, STE. 1060
AUSTIN, TX 78701
(512) 480-9900

CHASE BANK OF TEXAS, N.A.
32-115/1110

6829

09/04/2002

PAY TO THE ORDER OF: South Dakota Public Utilities Commission $ **250.00

Two Hundred Fifty and 00/100*** DOLLARS

South Dakota Public Utilities Commission

Security features. Details on back.

MEMO filing fee 114-00

Valerie P. Kirk
AUTHORIZED SIGNATURE

⑈006829⑈ ⑆111001150⑆ ⑈099812963565⑈

CASEY & GENTZ, L.L.P.

6829

South Dakota Public Utilities Commission 09/04/2002

filing fee 114.00 250.00

TC02-120

Chase Oper. Acct. filing fee 114-00 250.00

South Dakota Public Utilities Commission
WEEKLY FILINGS
For the Period of August 29, 2002 through September 4, 2002

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 report. Phone: 605-773-3705 Fax: 605-773-3809

CONSUMER COMPLAINTS

CT02-035 In the Matter of the Complaint filed by Sharon and Robert Herrick, Emery, South Dakota, against Sprint Communications Company L.P. Regarding Unauthorized Switching of Services.

Complainants state that their service was switched without their authorization. Sprint has indicated in its informal response to the complaint that the switch was made over the internet by Robert. Complainants state that they did not switch service over the internet and that the social security number and date of birth for Robert are incorrect. Complainants request $1,000.00 allowed under South Dakota law.

Staff Analyst: Mary Healy
Staff Attorney: Kelly Frazier
Date Docketed: 09/03/02
Intervention Deadline: N/A

TELECOMMUNICATIONS

TC98-146 In the Matter of the Filing by GCC License Corporation for Designation as an Eligible Telecommunications Carrier.

On October 18, 2001, the Public Utilities Commission (Commission) granted eligible telecommunications carrier (ETC) designation to GCC License Corporation (GCC) in select study areas of rural telephone companies upon GCC's compliance with certain conditions as stated in the Commission's order. By letter dated January 20, 2000, the Commission was notified that GCC License L.L.C. had changed its name to WWC License L.L.C. Pursuant to the Commission's order which designated WWC License LLC, a subsidiary of Western Wireless Corporation (Western Wireless), as an ETC in South Dakota, Western Wireless on August 29, 2002, submitted its compliance filing with the Commission.

Staff Analyst: Harlan Best
Staff Attorney: Karen E. Cremer
Date Docketed: 08/25/98
Intervention Deadline: N/A

universal service support and to otherwise verify that Dickey Rural Communications will use all federal universal service support received in a manner that is consistent with the federal universal service provisions of 47 U.S.C. Section 254.

Staff Analyst: Harlan Best
Staff Attorney: Karen E. Cremer
Date Docketed: 09/03/02
Intervention Deadline: 09/13/02

TC02-119 In the Matter of the Request of Interstate Telecommunications Cooperative, Inc. for Certification Regarding its Use of Federal Universal Service Support.

On September 3, 2002, Interstate Telecommunications Cooperative, Inc. (Interstate) provided information constituting Interstate's plan for the use of its federal universal service support and to otherwise verify that Interstate will use all federal universal service support received in a manner that is consistent with the federal universal service provisions of 47 U.S.C. Section 254.

Staff Analyst: Harlan Best
Staff Attorney: Karen E. Cremer
Date Docketed: 09/03/02
Intervention Deadline: 09/13/02

TC02-120 In the Matter of the Application of Inter-Tel NetSolutions, Inc. for a Certificate of Authority to Provide Interexchange Telecommunications Services in South Dakota.

Application by Inter-Tel NetSolutions, Inc. to provide resold interexchange telecommunications services in South Dakota. The applicant intends to provide services only to business customers of its affiliates and its parent Inter-Tel and residential services to its employees and employees of its customers, affiliates and Inter-Tel.

Staff Analyst: Dave Jacobson
Staff Attorney: Kelly Frazier
Date Docketed: 09/04/02
Intervention Deadline: 09/20/02

Amendment. Any party wishing to comment on the agreement may do so by filing written comments with the Commission and the parties to the agreement no later than September 23, 2002. Parties to the agreement may file written responses to the comments no later than twenty days after the service of the initial comments.

Staff Attorney: Kelly Frazier
Date Docketed: 09/03/02
Initial Comments Due: 09/23/02

TC02-116 In the Matter of the Filing for Approval of an Amendment to an Interconnection Agreement between Qwest Corporation and Level 3 Communications, LLC.

On September 3, 2002, the Commission received for approval a Filing of Single Point of Presence (SPOP) Amendment to the Interconnection Agreement between Level 3 Communications, LLC (Level 3) and Qwest Corporation (Qwest). According to the parties, this is an Amendment to the negotiated Interconnection Agreement between Level 3 and Qwest which was approved by the Commission on June 17, 2002, in Docket No. TC02-060. The Amendment is made in order to add terms and conditions for SPOP in the LATA as set forth in Attachment 1 and Exhibit A, attached to the Amendment. Any party wishing to comment on the agreement may do so by filing written comments with the Commission and the parties to the agreement no later than September 23, 2002. Parties to the agreement may file written responses to the comments no later than twenty days after the service of the initial comments.

Staff Attorney: Kelly Frazier
Date Docketed: 09/03/02
Initial Comments Due: 09/23/02

TC02-117 In the Matter of the Request of Dickey Rural Telephone Cooperative for Certification Regarding its Use of Federal Universal Service Support.

On September 3, 2002, Dickey Rural Telephone Cooperative (Dickey Rural Cooperative) provided information constituting Dickey Rural Cooperative's plan for the use of its federal universal service support and to otherwise verify that Dickey Rural Cooperative will use all federal universal service support received in a manner that is consistent with the federal universal service provisions of 47 U.S.C. Section 254.

Staff Analyst: Harlan Best
Staff Attorney: Karen E. Cremer
Date Docketed: 09/03/02
Intervention Deadline: 09/13/02

TC02-118 In the Matter of the Request of Dickey Rural Communications, Inc. for Certification Regarding its Use of Federal Universal Service Support.

On September 3, 2002, Dickey Rural Communications, Inc. (Dickey Rural Communications) provided information constituting Dickey Rural Communications's plan for the use of its federal

TC02-113 In the Matter of the Filing for Approval of Statement of Generally Available Terms and Conditions for Interconnection, Unbundled Network Elements, Ancillary Services and Resale of Telecommunications Services between Qwest Corporation and New Edge Network, Second Revision.

On August 29, 2002, the Commission received for approval a Filing for Approval of Statement of Generally Available Terms (SGAT) and Conditions for Interconnection, Unbundled Network Elements, Ancillary Services and Resale of Telecommunications Services between Qwest Corporation (Qwest) and New Edge Network (New Edge), Second Revision. According to the parties this SGAT sets forth the terms, conditions and prices under which Qwest will offer and provide to any requesting CLEC network Interconnection, access to unbundled network elements, ancillary services, and telecommunication services available for resale within the geographical areas in which Qwest is providing local exchange service at the time and for which Qwest is the incumbent local exchange carrier within the state of South Dakota for purposes of providing local telecommunication services. Any party wishing to comment on the agreement may do so by filing written comments with the Commission and the parties to the agreement no later than September 18, 2002. Parties to the agreement may file written responses to the comments no later than twenty days after the service of the initial comments.

Staff Attorney: Kelly Frazier
Date Docketed: 08/29/02
Initial Comments Due: 09/18/02

TC02-114 In the Matter of the Request of Kennebec Telephone Company For Certification Regarding its Use of Federal Universal Service Support.

On August 30, 2002, Kennebec Telephone Company (Kennebec) provided information constituting Kennebec's plan for the use of its federal universal service support and to otherwise verify that Kennebec will use all federal universal service support received in a manner that is consistent with the federal universal service provisions of 47 U.S.C. Section 254.

Staff Analyst: Harlan Best
Staff Attorney: Karen E. Cremer
Date Docketed: 08/30/02
Intervention Deadline: 09/13/02

TC02-115 In the Matter of the Filing for Approval of an Amendment to an Interconnection Agreement between Qwest Corporation and Ionex Communications North, Inc.

On September 3, 2002, the Commission received for approval a Filing of Bill and Keep Compensation Amendment to the Interconnection Agreement between Ionex Communications North, Inc. for South Dakota (Ionex) and Qwest Corporation (Qwest). According to the parties, this is an Amendment to the negotiated interconnection agreement between Ionex and Qwest which was approved by the Commission on September 14, 1999, and is made to utilize the Bill and Keep Compensation Mechanism as set forth in Attachment 1, attached to the

CASEY & GENTZ, L.L.P.

ATTORNEYS AT LAW

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Austin, Texas 78701-2157
Phone 512-480-9900
Fax 512- 480-9200

Writer's Direct Number:
512-225-0027

Robin A. Casey
Susan C. Gentz
Diane M. Barlow
Valerie P. Kirk
Bill Magness
Bradford W. Bayliff

September 25, 2002

RECEIVED

SEP 26 2002

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

Via Federal Express
(605) 773-3201

Ms. Debra Elofson
Executive Director
South Dakota Public Utilities Commission
Capitol Building, 1st Floor
500 East Capitol Avenue
Pierre, South Dakota 57501-5070

RE: Docket TC02-120; *Application of Inter-Tel NetSolutions, Inc. for a Certificate of Authority to Provide Telecommunications Services in South Dakota*; Filing of Confidential Information

Dear Ms. Elofson:

I am enclosing a sealed envelope that contains confidential and proprietary financial information about the Applicant in the above-referenced docket. The financial information contains highly confidential and sensitive information that is not currently available to the general public and for which the Applicant has taken appropriate measures to protect in other jurisdictions. The Applicant seeks to maintain intact the confidential nature of this information.

If the enclosed financial information were to be made available to the general public, competitors could readily ascertain or infer the economic condition and prospective marketing strategies of Applicant. Disclosure of the Applicant's financial documents would cause it to suffer an unfair business disadvantage and cause irreparable harm to Applicant's business operations. On this basis, Applicant requests that the Commission protect its financial documents from public disclosure.

In addition, the Applicant believes that the need for confidentiality outweighs the public interest in disclosure. The public interest will be served by the ability of Commission staff to review and analyze the submitted documents and make a recommendation to the Commission regarding the Applicant's financial capacity to provide service to customers in South Dakota.

I am enclosing an extra copy of this letter to be file-stamped and returned to me in the enclosed postage-paid envelope. Please contact me if you have questions about the confidential information or the Applicant.

Ms. Debra Elofson
Page 2
September 25, 2002

Sincerely yours,

Bradford W. Bayliff

Enclosures

INTER-TEL NETSOLUTIONS, INC.
BALANCE SHEET
FYE 12/31/2001

	BALANCE AT 12/31/01
ASSETS	
CURRENT ASSETS	
CASH & EQUIVALENTS	0
ACCOUNTS RECEIVABLE	5,983,050
PREPAID EXPENSES AND OTHER CURRENT ASSETS	6,003,058
TOTAL CURRENT ASSETS	11,986,108
OTHER ASSETS	
PROPERTY AND EQUIPMENT (NET)	135,709
DUE FROM AFFILIATES	0
TOTAL OTHER ASSETS	135,709
TOTAL ASSETS	12,121,817
LIABILITIES AND SHAREHOLDER'S EQUITY	
CURRENT LIABILITIES	
ACCOUNTS PAYABLE	3,007,500
NOTES PAYABLE	0
ACCRUED EXPENSES	1,645,822
OTHER	27,560
TOTAL CURRENT LIABILITIES	4,680,882
SHAREHOLDER'S EQUITY	
COMMON STOCK	1,000
RETAINED EARNINGS	7,439,935
TOTAL SHAREHOLDER'S EQUITY	7,440,935
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	12,121,817

INTER-TEL NETSOLUTIONS, INC.
INCOME STATEMENT
FYE 12/31/2001

NET SALES	30,138,977	
COST OF SALES	(23,575,689)	
GROSS MARGIN	6,563,288	
GENERAL & ADMIN. EXPENSES	(2,809,798)	
SELLING EXPENSE	(270,448)	
INTEREST INCOME	104,542	
INTEREST EXPENSE	0	
OTHER MISC. INCOME/(EXPENSE)	(246,476)	
NET INCOME	3,341,108	3,341,108.00

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE APPLICATION OF INTER-TEL NETSOLUTIONS, INC. FOR A CERTIFICATE OF AUTHORITY TO PROVIDE INTEREXCHANGE TELECOMMUNICATIONS SERVICES IN SOUTH DAKOTA	)))))	**ORDER GRANTING CERTIFICATE OF AUTHORITY** **TC02-120**

On September 4, 2002, 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 Inter-Tel NetSolutions, Inc. (Inter-Tel).

Inter-Tel proposes to provide services only to business customers of its affiliates and its parent Inter-Tel and residential services to its employees and employees of its customers, affiliates and Inter-Tel. A proposed tariff was filed by Inter-Tel. The Commission has classified long distance service as fully competitive.

On September 5, 2002, the Commission electronically transmitted notice of the filing and the intervention deadline of September 20, 2002, to interested individuals and entities. No petitions to intervene or comments were filed and at its March 4, 2003, meeting, the Commission considered Inter-Tel's request for a certificate of authority. Commission Staff recommended granting a certificate of authority.

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 Inter-Tel has met the legal requirements established for the granting of a certificate of authority. Inter-Tel has, in accordance with SDCL 49-31-3, demonstrated sufficient technical, financial and managerial capabilities to offer telecommunications services in South Dakota. The Commission approves Inter-Tel's application for a certificate of authority. As the Commission's final decision in this matter, it is therefore

ORDERED, that Inter-Tel's application for a certificate of authority to provide interexchange telecommunications services is hereby granted. It is

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

Dated at Pierre, South Dakota, this 7th day of March, 2003.

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: 3/11/03

(OFFICIAL SEAL)

BY ORDER OF THE COMMISSION:

Robert K. Sahr

ROBERT K. SAHR, Chairman

Gary Hanson

GARY HANSON, Commissioner

James A. Burg

JAMES A. BURG, Commissioner

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

CERTIFICATE OF AUTHORITY

To Conduct Business As ATelecommunications Company
Within The State of South Dakota

Authority was Granted as of the date of the
Order Granting Certificate of Authority
Docket No. TC02-120

This is to certify that

INTER-TEL NETSOLUTIONS, INC.

is authorized to provide interexchange 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 7th day of March, 2003.

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION:

ROBERT K. SAHR, Chairman

GARY HANSON, Commissioner

JAMES A. BURG, Commissioner