



11951 Freedom Drive
 Suite 1300
 Reston, VA 20190
 Phone: 703.251.4878
 Facsimile: 703.942.7146
 www.telecom-legal.com

ORIGINAL

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COMMISSION
CLERK

August 1, 2002

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BY FEDERAL EXPRESS

Florida Public Service Commission
 Division of Records and Reporting
 2540 Shumard Oak Boulevard
 Tallahassee, Florida 32399-0850

020862-TI

**RE: ePHONE Telecom, Inc.
 Application for Authority to Provide Interexchange
 Telecommunications Service Between Points Within the
 State of Florida**

Dear Sir/Madame:

Enclosed please find an original and six (6) copies of ePHONE Telecom, Inc's application for authority to provide interexchange telecommunications service between points within the State of Florida. Also enclosed please find a check in the amount of \$250.00 made payable to the Florida Public Service Commission to cover the non-refundable application fee. Please return the date stamp copy in the enclosed self-addressed stamped envelope.

Should you have any questions or require additional information, please contact me or Karen Overman, Director, Regulatory Services. Karen can be reached by telephone on (703) 251-4878, by fax on (703) 691-2502 or via e-mail at koverman@telecom-legal.com.

Respectfully submitted,

Cheryl Lynn Schneider / 70

Cheryl Lynn Schneider
 Counsel to ePHONE Telecom, Inc.
 Telecom Legal Services International, Inc.
 1776 I Street, NW - 9th Floor
 Washington, D.C. 20006
 Phone: (202) 756-4833
 Fax: (202) 756-1513
 E-mail: cschneider@telecom-legal.com

Check is being forwarded to Finance for deposit.
 Fiscal to forward a copy of check to RAR with proof of deposit.

Initials of person who forwarded check:

[Handwritten initials]

Enclosures

RECEIVED & FILED
[Handwritten initials]
 FPSC-BUREAU OF RECORDS

DOCUMENT NUMBER-DATE

08105 AUG -2 8

FPSC-COMMISSION CLERK

ORIGINAL

1. This is an application for (check one):
- Original certificate** (new company).
 - Approval of transfer of existing certificate:** Example, a non-certificated company purchases an existing company and desires to retain the original certificate of authority.
 - Approval of assignment of existing certificate:** Example, a certificated company purchases an existing company and desires to retain the certificate of authority of that company.
 - Approval of transfer of control:** Example, a company purchases 51% of a certificated company. The Commission must approve the new controlling entity.

2. Name of company:

ePHONE Telecom, Inc.

3. Name under which applicant will do business (fictitious name, etc.):

ePHONE Telecom, Inc.

4. Official mailing address (including street name & number, post office box, city, state, zip code):

1145 Herndon Parkway

Herndon, VA 20170

5. Florida address (including street name & number, post office box, city, state, zip code):

CT Corporation System

1200 South Pine Island Road Plantation, FL 33324 6.

Select type of business your company will be conducting (check all that apply):

- Facilities-based carrier** - company owns and operates or plans to own and operate telecommunications switches and transmission facilities in Florida.

- () **Operator Service Provider** - company provides or plans to provide alternative operator services for IXC's; or toll operator services to call aggregator locations; or clearinghouse services to bill such calls.
- (x) **Reseller** - company has or plans to have one or more switches but primarily leases the transmission facilities of other carriers. Bills its own customer base for services used.
- () **Switchless Rebiller** - company has no switch or transmission facilities but may have a billing computer. Aggregates traffic to obtain bulk discounts from underlying carrier. Rebills end users at a rate above its discount but generally below the rate end users would pay for unaggregated traffic.
- () **Multi-Location Discount Aggregator** - company contracts with unaffiliated entities to obtain bulk/volume discounts under multi-location discount plans from certain underlying carriers, then offers resold service by enrolling unaffiliated customers.
- (x) **Prepaid Debit Card Provider** - any person or entity that purchases 800 access from an underlying carrier or unaffiliated entity for use with prepaid debit card service and/or encodes the cards with personal identification numbers.

7. Structure of organization;

- | | |
|-------------------------|-------------------------|
| () Individual | (x) Corporation |
| () Foreign Corporation | () Foreign Partnership |
| () General Partnership | () Limited Partnership |
| () Other _____ | |

8. **If individual**, provide: **NOT APPLICABLE**

Name: _____

Title: _____

Address: _____

City/State/Zip: _____

Telephone No.: _____ Fax No.: _____

Internet E-Mail Address: _____

Internet Website Address: _____

9. **If incorporated in Florida**, provide proof of authority to operate in Florida:

(a) **The Florida Secretary of State Corporate Registration number:**
P9600039673

10. **If foreign corporation**, provide proof of authority to operate in Florida: **NOT APPLICABLE**

(a) **The Florida Secretary of State Corporate Registration number:**

11. **If using fictitious name-d/b/a**, provide proof of compliance with fictitious name statute (Chapter 865.09, FS) to operate in Florida: **NOT APPLICABLE**

(a) **The Florida Secretary of State fictitious name registration number:**

12. **If a limited liability partnership**, provide proof of registration to operate in Florida:

(a) **The Florida Secretary of State registration number:** _____

NOT APPLICABLE

13. **If a partnership**, provide name, title and address of all partners and a copy of the partnership agreement. **NOT APPLICABLE**

Name: _____

Title: _____

Address: _____

City/State/Zip: _____

Telephone No.: _____ Fax No.: _____

Internet E-Mail Address: _____

Internet Website Address: _____

14. **If a foreign limited partnership**, provide proof of compliance with the foreign limited partnership statute (Chapter 620.169, FS), if applicable. **NOT APPLICABLE**

(a) **The Florida registration number:** _____

15. Provide **F.E.I. Number** (if applicable): 0980204749

16. Provide the following (if applicable):

(a) Will the name of your company appear on the bill for your services?
() Yes (x) No See below.

(b) If not, who will bill for your services?

Name: _____

Title: _____

Address: _____

City/State/Zip: _____

Telephone No.: _____ Fax No.: _____

At present, ePHONE intends to offer only prepaid intrastate long distance services in the State of Arizona. In accordance with its proposed tariff, ePHONE does not require advanced deposits or security for prepaid services. The Company reserves the right to ask Customers of post-paid services for deposits in the event it offers such services.

(c) How is this information provided?

NOT APPLICABLE

17. Who will receive the bills for your service?

- Residential Customers Business Customers
 PATs providers PATs station end-users
 Hotels & motels Hotel & motel guests
 Universities Universities dormitory residents
 Other: (specify) NOT APPLICABLE
PLEASE REFER TO EXPLANATION ON PREVIOUS PAGE.

18. Who will serve as liaison to the Commission with regard to the following?

(a) The application:

Name: Cheryl Lynn Schneider Telecom Legal Services International, Inc.

Title: Counsel to ePHONE Telecom, Inc.

Address: 1776 I Street, N.W. - 9th Floor

City/State/Zip: Washington, D.C. 20006

Telephone No.: (202) 756-4833 Fax No.: (202) 756-1513

Internet E-Mail Address: cschneider@telecom-legal.com

Internet Website Address: www.telecom-legal.com

(b) Official point of contact for the ongoing operations of the company:

Name: Kevin Trax

Title: VP Finance

Address: 1145 Herndon Parkway

City/State/Zip: Herndon, VA 20170

Telephone No.: (703) 787-7000 Fax No.: (703) 787-7007

Internet E-Mail Address: www.ephonecard@ephonetelecom-com

Internet Website Address: www.ephonetelecom.com

(c) Complaints/Inquiries from customers:

Name: Robert Case

Title: VP Customer Service

Address: 1145 Herndon Parkway

City/State/Zip: Herndon, VA 20170

Telephone No.: (703) 787-7000 Fax No.: (703) 787-7007

Internet E-Mail Address: www.ephonecard@ephoneteleco-1com

Internet Website Address: www.ephonetelecom.com

19. List the states in which the applicant:

(a) has operated as an interexchange telecommunications company.

Colorado, Idaho, Michigan, Montana, New Mexico, New York,

Ohio, Oregon, Texas, Washington, District of Columbia, Wyoming, Maryland

(b) has applications pending to be certificated as an interexchange telecommunications company.

Illinois, Maine, Minnesota, South Dakota, Arizona

(c) is certificated to operate as an interexchange telecommunications company.

Colorado, Idaho, Michigan, Montana, New Mexico, New York, Ohio,
Oregon, Texas, Washington, District of Columbia, Wyoming, Maryland

(d) has been denied authority to operate as an interexchange telecommunications company and the circumstances involved.

NONE

(e) has had regulatory penalties imposed for violations of telecommunications statutes and the circumstances involved.

(f) has been involved in civil court proceedings with an interexchange carrier, local exchange company or other telecommunications entity, and the circumstances involved.

NONE

20. Indicate if any of the officers, directors, or any of the ten largest stockholders have previously been:

(a) adjudged bankrupt, mentally incompetent, or found guilty of any felony or of any crime, or whether such actions may result from pending proceedings. If so, please explain.

No officer, director, or any of the ten largest stockholders have previously been adjudged bankrupt, mentally incompetent, or found guilty of any felony or of any crime.

(b) an officer, director, partner or stockholder in any other Florida certificated telephone company. If yes, give name of company and relationship. If no longer associated with company, give reason why not.

No officer, director, or any of the ten largest stockholders have previously been an officer, director, partner or stockholder in any other Florida certificated telephone company.

21. The applicant will provide the following interexchange carrier services $\sqrt{\quad}$ (check all that apply):

a. _____ MTS with distance sensitive per minute rates

- _____ Method of access is FGA
- _____ Method of access is FGB
- _____ Method of access is FGD
- _____ Method of access is 800

b. _____ MTS with route specific rates per minute

- _____ Method of access is FGA
- _____ Method of access is FGB
- _____ Method of access is FGD
- _____ Method of access is 800

c. _____ MTS with statewide flat rates per minute (i.e. not distance sensitive)

- Method of access is FGA
- Method of access is FGB
- Method of access is FGD
- Method of access is 800

d. **MTS for pay telephone service providers**

e. **Block-of-time calling plan (Reach Out Florida, Ring America, etc.).**

f. **800 service (toll free)**

g. **WATS type service (bulk or volume discount)**

- Method of access is via dedicated facilities
- Method of access is via switched facilities

h. **Private line services (Channel Services)**
(For ex. 1.544 mbs., DS-3, etc.)

i. **Travel service**

- Method of access is 950
- Method of access is 800

j. **900 service**

k. **Operator services**

- Available to presubscribed customers
- Available to non presubscribed customers (for example, to patrons of hotels, students in universities, patients in hospitals).
- Available to inmates

1. **Services included are:**

- _____ Station assistance
- _____ Person-to-person assistance
- _____ Directory assistance
- _____ Operator verify and interrupt
- _____ Conference calling

22. Submit the proposed tariff under which the company plans to begin operation. Use the format required by Commission Rule 25-24.485 (example enclosed).

23. Submit the following: **SEE ATTACHMENT A**

A. Managerial capability; give resumes of employees/officers of the company that would indicate sufficient managerial experiences of each.

B. Technical capability; give resumes of employees/officers of the company that would indicate sufficient technical experiences or indicate what company has been contracted to conduct technical maintenance.

C. Financial capability. **SEE ATTACHMENT B**

The application **should contain** the applicant's audited financial statements for the most recent 3 years. If the applicant does not have audited financial statements, it shall so be stated.

The unaudited financial statements should be signed by the applicant's chief executive officer and chief financial officer **affirming that the financial statements are true and correct** and should include:

1. the balance sheet;
2. income statement; and
3. statement of retained earnings.

NOTE: *This documentation may include, but is not limited to, financial statements, a projected profit and loss statement, credit references, credit bureau reports, and descriptions of business relationships with financial institutions.*

Further, the following (which includes supporting documentation) should be provided:

SEE ATTACHMENT B

1. **A written explanation** that the applicant has sufficient financial capability to provide the requested service in the geographic area proposed to be served.
2. **A written explanation** that the applicant has sufficient financial capability to maintain the requested service.
3. **A written explanation** that the applicant has sufficient financial capability to meet its lease or ownership obligations.

THIS PAGE MUST BE COMPLETED AND SIGNED

APPLICANT ACKNOWLEDGMENT STATEMENT

1. **REGULATORY ASSESSMENT FEE:** I understand that all telephone companies must pay a regulatory assessment fee in the amount of .15 of one percent of its gross operating revenue derived from intrastate business. Regardless of the gross operating revenue of a company, a minimum annual assessment fee of \$50 is required.
2. **GROSS RECEIPTS TAX:** I understand that all telephone companies must pay a gross receipts tax of two and one-half percent on all intra and interstate business.
3. **SALES TAX:** I understand that a seven percent sales tax must be paid on intra and interstate revenues.
4. **APPLICATION FEE:** I understand that a non-refundable application fee of \$250.00 must be submitted with the application.

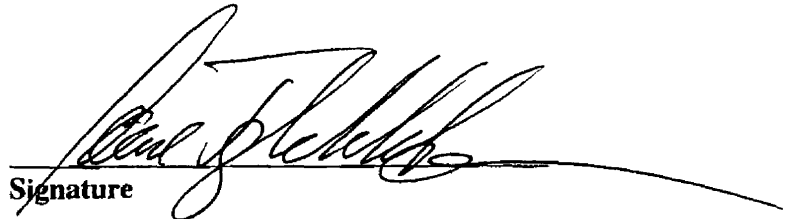
UTILITY OFFICIAL:

Carmine Tagliatela, Jr.
Print Name

President + CEO
Title

(703) 787-7000 (703) 787-7007
Telephone No. Fax No.

Address: 1145 Herndon Parkway
Herndon, VA 20170


Signature
July 31, 2002
Date

THIS PAGE MUST BE COMPLETED AND SIGNED

CUSTOMER DEPOSITS AND ADVANCE PAYMENTS

A statement of how the Commission can be assured of the security of the customer's deposits and advance payments may be provided in one of the following ways (applicant, please check one):

- () The applicant will **not** collect deposits nor will it collect payments for service more than one month in advance.

- () The applicant intends to collect deposits and/or advance payments for more than one month's service and will file and maintain a surety bond with the Commission in an amount equal to the current balance of deposits and advance payments in excess of one month.
(The bond must accompany the application.)

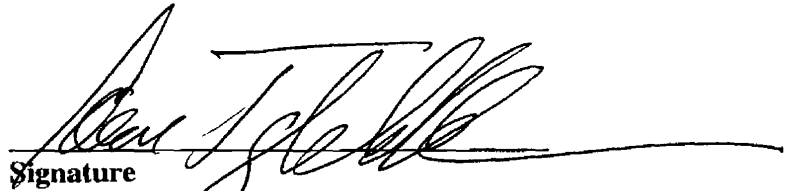
UTILITY OFFICIAL:

Carmine Tugliatela, Jr.
Print Name

President & CEO
Title

(703) 787-7000
Telephone No.

Address: 1145 Herndon Parkway
Herndon, VA 20170


Signature

July 31, 2002
Date

(703) 787-7007
Fax No.

THIS PAGE MUST BE COMPLETED AND SIGNED

AFFIDAVIT

By my signature below, I, the undersigned officer, attest to the accuracy of the information contained in this application and attached documents and that the applicant has the technical expertise, managerial ability, and financial capability to provide interexchange telecommunications service in the State of Florida. I have read the foregoing and declare that, to the best of my knowledge and belief, the information is true and correct. I attest that I have the authority to sign on behalf of my company and agree to comply, now and in the future, with all applicable Commission rules and orders.

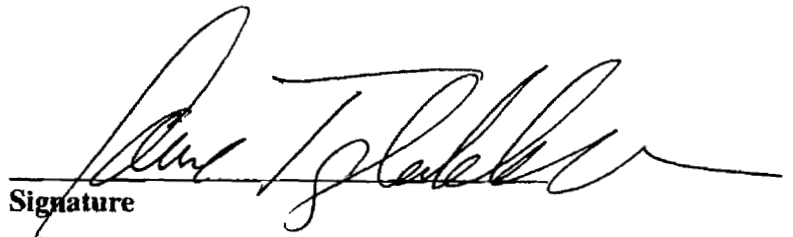
Further, I am aware that, pursuant to Chapter 837.06, Florida Statutes, "Whoever knowingly makes a false statement in writing with the intent to mislead a public servant in the performance of his official duty shall be guilty of a misdemeanor of the second degree, punishable as provided in s. 775.082 and s. 775.083."

UTILITY OFFICIAL:

Carmine Tagliakatela, Jr.
Print Name

President & CEO
Title

(703) 787-7000
Telephone No.


Signature

July 31, 2002
Date

(703) 787-7007
Fax No.

Address: 1145 Herndon Parkway
Herndon, VA 20170

CURRENT FLORIDA INTRASTATE SERVICES

Applicant **has** () or **has not** (X) previously provided intrastate telecommunications in Florida.

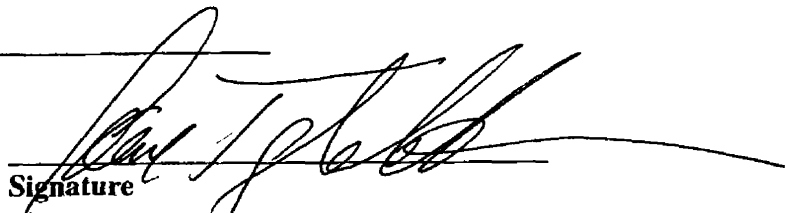
If the answer is has, fully describe the following:

a) What services have been provided and when did these services begin?

b) If the services are not currently offered, when were they discontinued?

UTILITY OFFICIAL:

Carmine Tagliatela, Jr.
Print Name


Signature

President & CEO
Title

July 31, 2002
Date

(703) 787-7000
Telephone No.

(703) 787-7007
Fax No.

Address: 1145 Herndon Parkway
Herndon, VA 20170

CERTIFICATE TRANSFER, OR ASSIGNMENT STATEMENT

I, (Name) _____,

(Title) _____ of
_____ (Name of Company)

and current holder of Florida Public Service Commission Certificate Number

_____, have reviewed this application and join in the petitioner's request for a:

() transfer

**THIS IS AN ORIGINAL APPLICATION AND THEREFORE
THIS SECTION DOES NOT APPLY.**

() assignment

of the above-mentioned certificate.

UTILITY OFFICIAL:

Print Name

Signature

Title

Date

Telephone No.

Fax No.

Address:

ATTACHMENT A

MANAGERIAL CAPABILITY

TECHNICAL CAPABILITY

ePHONE TELECOM, INC.

KEY MANAGEMENT RESUMES

Carmine Tagliatela Jr. - President and Chief Executive Officer.

Prior to joining ePHONE, Mr. Tagliatela was President and Chief Operating Officer of TELRON Communications and was responsible for the day-to-day operations of the company, the development of service offerings, and the expansion of services into new markets. Mr. Tagliatela has also held Executive Vice President positions at TELRON and CompassRose International, Inc., a boutique international telecommunications consulting firm. He served as Director, International Public Policy and Regulatory Affairs at MCI Telecommunications Corporation where he developed and implemented MCI's regulatory and business strategy for access to international markets. He was a member of an expansion team devoted to broadening MCI's presence in the global market. At ePHONE, Mr. Tagliatela is responsible for the day-to-day operations of the company, formulating its strategic direction and implementing new partnerships.

Charlie Rodriguez - Director, Chief Financial Officer, and Vice President, Corporate Affairs. Mr. Rodriguez previously served as Vice President of Corporate Affairs and Corporate Secretary of ePHONE Telecom from June 1999 to April 16, 2000. Before his return to ePHONE, Mr. Rodriguez was appointed Vice President, Corporate Affairs of 7bridge Systems of Hong Kong and President of 7bridge Systems America, Inc. He is also a Director with Management Services of Arizona, a business consulting company specializing in mergers, acquisitions, and financing. Prior to MSA, he served as Chief Financial Officer for Zephyr Technologies, Inc., a biometrics and smartcard software integration company. From January to November 1997, Mr. Rodriguez served as a member of the board of directors with Wave Rider Communications, Inc., a wireless communication company, and as President and Chief Executive Officer from May 1995 to January 1997. Mr. Rodriguez has a Masters in Business Administration.

Sonny Souvannavong - Chief Technology Officer. Mr.

Souvannavong will be responsible for directing ePHONE's global technology development and deployment. Prior to joining ePHONE, Mr. Souvannavong was Vice-President of Technology at Ecom Telecommunication, where he successfully designed, procured and rolled out a global multi-service network with presence in North

America, Europe and Asia. Additionally, at Ecocom he implemented Operational Support System tools, a Global Network Management Center, a global billing system and IT systems that were compatible with most major vendor software. From 1995-1999 Mr.

Souvannavong held senior level positions with Facilicom International and Birch & Davis Associates, where he served as Director of Information Services and Division Director of Information Technology respectively. In both environments he was charged with managing sizable teams of developers, engineers and programmers. Mr. Souvannavong brings with him a diverse range of education including an MBA and advanced Networks certifications from Microsoft, Cisco, Checkpoint and Novell.

Robert D. Case - Vice President, Operations and Customer Service.

Mr. Case is responsible for the planning, deployment, operation, and management of ePHONE's global VoIP network. Previously, Mr. Case was Chief Information Officer with The Capital Markets Company, overseeing the company's Information Technology, Enterprise Resource Planning, and IP-based systems. Prior to that, Mr. Case was Director, Internet Systems with Global TeleSystems Group (GTS) in London, UK, where he was involved in GTS's Internet strategy, CLEC IP business development, vendor trials of IP telephony platforms, and managed the negotiations of international private line leased circuits. Mr. Case started his career with the Space Shuttle Program and was involved in payload program management and training. Mr. Case has a Bachelors of Science in Aerospace Engineering from the University of Virginia and is currently pursuing an Executive MBA program at the Georgetown University.

TECHNICAL

ePHONE offers enhanced IP telephony services via its owned-and-operated IP gateways located in: New York, New York; Los Angeles, California; and Miami, Florida. These IP gateways are managed by ePHONE through its state of the art network operations center (NOC) located at the company headquarters in Herndon, Virginia. ePHONE employs a variety of proprietary systems in its network and recently enhanced its network performance through the addition of Cisco and Sun Microsystems components.

ePHONE intends to utilize traditional telephony connections, as well as the Internet, to provide intrastate interexchange service to customers in Florida. ePHONE is interconnected with a variety of carriers authorized to provide facilities-based or resold services within Florida, such as Global Crossing. ePHONE has no plans to build, locate, expand or acquire facilities in Florida.

As an initial matter, ePHONE intends to offer a variety of prepaid IP telephony services through either a monthly calling plan, where customers are billed in advance for service via a credit card or direct debit, or through prepaid calling cards. Customers may obtain these services without changing their presubscribed interexchange carrier and may utilize these services from any touch-tone phone. These services are described in full in the ePHONE proposed tariff, which has been submitted with this Petition. In the future, ePHONE may expand its portfolio of services to include post-paid VOIP services, internet access and e-mail services.

ATTACHMENT B

FINANCIAL CAPABILITY STATEMENT

2001 10-K

2002 10-Q

FINANCIAL CAPABILITY OF THE APPLICANT

ePHONE Telecom, Inc. possesses the financial capability necessary to provide and maintain the intrastate services outlined in its proposed tariff and to meet its lease obligations in the state of Florida. As is stated in the ePHONE's SEC Form 10-QSB for the period ending March 31, 2002 (see Attachment B-2), the Company achieved revenue of \$4,062,000 during the first quarter of 2002. ePHONE also reported a decrease in operating expenses. This represented significant growth over the previous quarter and a vast improvement over ePHONE's performance during all of 2001. (See Attachment B-1; ePHONE SEC Form 10-K.) ePHONE expects to report similar revenue figures in its SEC Form 10-QSB for the period ending June 30, 2002. ePHONE believes that this continued trend of revenue growth and operational efficiency will enable it to maintain service in Florida in a manner consistent with the Commission's requirements for competitive intrastate long distance service providers.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549-0001
FORM 10-KSB

(MARK ONE)

- ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 2001
- TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from _____ to _____

Commission File Number 0-27669

ePHONE Telecom, Inc.
(Name of small business issuer in its charter)

Florida
(State or other jurisdiction of
incorporation or organization)

98-0204749
(I.R.S. Employer
Identification Number)

1145 Herndon Parkway, Suite 100
Herndon Virginia
(Address of principal executive offices)

20170
(Zip Code)

(703)-787-7000
Issuer's telephone number

Securities registered under Section 12(b) of the Exchange Act:

None
(Title of each Class)

None
(Name of each exchange
on which registered)

Securities registered under Section 12(g) of the Exchange Act:

COMMON STOCK, \$0.001 PAR VALUE

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will 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-KSB or any amendment to this Form 10-KSB.

Issuer's revenues for the year ended December 31, 2001 were \$3,589,840. Aggregate market value of voting stock held by non-affiliates of 32,920,713 shares outstanding at December 31, 2001 was approximately \$6,255,000. Amount was computed using the average bid and ask price as of December 31, 2001, which was \$0.19. As of December 31, 2001, a total of 32,987,381 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE - None

Transitional Small Business Disclosure Format (check one): Yes No

ePHONE TELECOM, INC.

FORM 10-KSB

INDEX

		<u>Page</u>
Part I		
Item 1.	Description of Business.....	4
Item 2.	Description of Properties.....	12
Item 3.	Legal Proceedings	13
Item 4.	Submission of Matters to a Vote of Security Holders	14
Part II		
Item 5.	Market for Common Equity and Related Stockholder Matters	14
Item 6.	Management's Discussion and Analysis of Financial Condition and Results of Operations	16
Item 7.	Financial Statements.....	23
Item 8.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.....	23
Part III		
Item 9.	Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act.....	23
Item 10.	Executive Compensation	26
Item 11.	Security Ownership of Certain Beneficial Owners and Management.....	28
Item 12.	Certain Relationships and Related Transactions	30
Item 13.	Exhibits and Reports on Form 8-K.....	31
Registrant Signatures		32

FORWARD LOOKING STATEMENTS

Certain information in this report including statements made in “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, “Description of Business” and elsewhere contain “forward-looking statements”. All statements other than statements of historical fact are “forward-looking statements”, including any projections of earnings, revenues or other financial items, any statements of the plans and objectives of management for future operations, any statements concerning proposed new products or services, any statements regarding future economic conditions or performance, and any statements of assumptions underlying any of the foregoing. In some cases, forward-looking statements can be identified by the use of terminology such as “may”, “will”, “expects”, “plans”, “anticipates”, “estimates”, “potential”, or “continue”, or the negative thereof or other comparable terminology. Although ePHONE believes that the expectations reflected in its forward-looking statements are reasonable, it can give no assurance that such expectations or any of its forward-looking statements will prove to be correct, and actual results could differ materially from those projected or assumed in these forward-looking statements.

Forward-looking statements include but are not limited to:

- Expectations and estimates as to completion dates of the Network of Regional gateways ePHONE is installing and the Network;
- ePHONE’s ability to implement successfully ePHONE’s operating strategy as described in the business plan of ePHONE;
- Future financial performance as estimated in ePHONE’s financial projections;
- ePHONE’s forecasts of customer or market demand;
- Highly competitive market conditions;
- Changes in or developments under laws, regulations and licensing requirements in regions ePHONE is installing gateways; and
- Changes in telecommunications technology.

This list of categories of forward-looking statements should not be construed as exhaustive. ePHONE will not update or revise any forward-looking statements.

Certain factors that could cause ePHONE’s forward-looking statements not to be correct and cause ePHONE’s actual results to materially vary from projections made in forward-looking statements are set forth in Section E (Risk Factors) of Item 6 below.

PART I

ITEM 1. DESCRIPTION OF BUSINESS

A. Overview

ePHONE was incorporated pursuant to the laws of the State of Florida, effective May 3, 1996, as IRA Fund Brokers Corp., changed its name to IFB Corp. on April 6, 1998 and on March 22, 1999, IFB Corp changed its name to ePHONE Telecom, Inc.

The development of ePHONE's current business plan essentially commenced as of June 2001. From the date of incorporation until November, 1998 ePHONE did no business and made no attempt to develop any business. From November 1998 until December 31, 1999, ePHONE focused its efforts on the review of business opportunities and from January 1, 2000 to June of 2001 focused on the development of the business model that was a precursor to the current business plan.

On March 31, 2000, ePHONE entered into a Strategic Alliance Agreement and License Agreement with Comdial Corporation ("Comdial") and Array Telecom Corporation ("Array Telecom"), a wholly owned subsidiary of Comdial. In connection with these agreements ePHONE acquired certain fixed assets from Array Telecom and obtained an exclusive license for all Voice over Internet Protocol technology that had been developed by Array Telecom for a period of five years.

The Array Telecom business model that was proved to be based on a technology that could not be economically implemented. This technology consisted of proprietary Voice Over Internet Protocol (VOIP) gateways, calling card and network management software that was intended to be used with customer premises equipment (CPE) VOIP gateways. Several contracts had been signed and the network was deployed in several European cities by the third quarter of 2000. After extensive testing was conducted, ePHONE concluded that the network provided inadequate quality and functionality. The system did not have an integrated billing capability. The third party billing solution being bridged to the proprietary system was too cumbersome to support the necessary day-to-day activities of billing, PIN generation and reporting. Further, no provision in the system could be made for the management of a network of CPE devices, which had needed to be managed as a separate billing entity. Furthermore, it was determined that the equipment supported a very limited set of telecommunications protocols, making it difficult or impossible to interconnect with other carriers.

ePHONE underwent an evaluation of alternatives, costs involved, probabilities of success and determined that it would be in the company's best interests to transition to state of the art technologies that were in production and could be deployed rapidly. In this regard, ePHONE made a strategic decision that the Array Technology systems should be integrated with Cisco and Sun Microsystems products with a Mind CTI billing system. The combination of cutting edge technology would immediately broaden the range of services that could be provided and allow ePHONE to compete in the retail and wholesale market. A new strategy was developed to overcome the deficiencies of the Array Telecom system and implementation commenced in May of 2001. The new network was then built in seventy -five (75) days and was generating revenue in 90 days.

Due to ongoing integration and migration issues, the viability of the Array technology as well as ePHONE's original strategy was questioned. The respective time and effort spent on the implementation of the two networks led management quickly to the conclusion that the Array network should be abandoned and to commit fully to a network based on Cisco equipment.

ePHONE commenced commercial operations utilizing the new strategy of a Cisco network in August of 2001 and has generated revenues of over \$3.5 million in 2001.

B. STRATEGIC PLAN

ePHONE's strategy is to become a next generation global facilities based marketing and sales oriented telecommunications carrier providing a full complement of telecommunications and data services utilizing the efficiency and reliability of new generation VOIP based telecommunication technologies. This entails operating as a wholesale carrier, interexchange carrier and as a retail services provider. Using a private Internet Protocol ("IP") network, the public Internet and the public switched telephone network ("PSTN"), ePHONE has developed the capability to provide voice and data transmission and other telephony features at high quality and

low cost. ePHONE's role as an Interexchange Carrier allows ePHONE to capitalize on inexpensive wholesale termination rates, which can be further leveraged into retail products in order to increase overall margins.

ePHONE has developed this strategy to take advantage of the current market conditions while positioning itself to accommodate future developments and trends. The key elements are simple individually but require the technology, management expertise and experience to take advantage of them. ePHONE believes it has gained a significant competitive advantage through its ability to:

- Capitalize on the oversupply of bandwidth to continually build out and improve its network by utilizing leased lines to provide a reliable, high quality transmission facility. This is achieved with slightly higher cost than the cost of using the Internet as the transport medium while providing a managed network environment with superior call quality.
- Utilize the latest standards based technologies to deploy a network capable of interfacing to both legacy networks (traditional telephone networks) and the variety of VOIP networks being deployed.
- Introduce higher margin retail products such as ePHONE's Unlimited Domestic Calling Program, reseller program, proprietary products to enhance and provide ease of customer calling on the ePHONE network, DSL reseller program, 1+ dialing services and prepaid calling cards.
- Build traffic volume through wholesaling minutes to other carriers.
- Aggregate traffic to increase volumes to certain geographic destinations which results in decreased cost per minute.
- Open new markets while decreasing termination costs. A distinct advantage of ePHONE's technology is the ability to rapidly and inexpensively deploy nodes or Points of Presence (POPs), which decrease the cost of terminating traffic as well as providing the opportunity to originate traffic.

ePHONE has developed a strategy that builds one element upon the other to decrease the company's costs of providing service while increasing market penetration. ePHONE also employs a channel distribution model based on the development of partnerships both domestically and internationally. ePHONE's philosophy is to create and sustain ePHONE as a facilities based marketing and sales oriented telecommunications company.

C. BUSINESS PLAN

ePHONE's plan is to become a global telecommunications carrier providing a full complement of telecommunications services, including a variety of retail services, wholesale arbitrage and data services, using Voice over Internet Protocol ("VOIP") technology over both the Internet and private leased circuits. ePHONE believes it can differentiate itself from the competition through innovative marketing approaches and techniques while utilizing state of the art technologies to provide a comprehensive array of competitive service offerings.

ePHONE's planned approach has four components:

- Utilization of high quality fiber lines provided by leased circuits and use of the Internet where appropriate to carry telecommunications traffic and to link nodes in the network.
- Deliver a range of innovative products and services using its network.
- Compete as an interexchange carrier to ensure the most competitive rates are available for the retail products.
- Develop direct international connections to further enhance our ability to compete in the wholesale market while further improving margins on retail products.

As of the end of fiscal year 2001 ePHONE had deployed two network nodes, New York and Herndon, and is supporting six revenue generating retail programs as well as wholesale arbitrage traffic. ePHONE is interconnected with 18 carriers for origination of revenue generating traffic and termination of traffic both domestically and internationally. The six retail programs consist of five calling card programs targeted at the US, Mexico, the Philippines, Israel and Africa and the "Unlimited" Program. The Unlimited Program is a telemarketing driven domestic calling program providing unlimited continental US calling for \$54.90 per month.

ePHONE's revenues for the fiscal year ending December 31, 2001 were \$3,589,840. With the exception of approximately \$500,000 generated from the sale of equipment in the first quarter of 2001, the revenue was generated from the new core business between August and the end of December.

ePHONE plans to introduce a new product in early Q2 of 2002 named eTRANSPORT ("eTRANSPORT"). The eTRANSPORT is a piece of equipment that is installed between the phone and the incoming phone line at the customer premises (CPE or Customer Premises Equipment). ePHONE's service to the customer is virtually the same as the 1+ long distance service, however it is prepaid with the added benefit of portability. The device is a transportable 1+ prepaid long distance service from phone to phone which allows call costs to be charged to the same prepaid service.

ePHONE has worked closely with the designer and manufacturer of eTRANSPORT and has integrated the device with our network. ePHONE has secured the exclusive rights to the version of the device that works with our network, which provides functionality and has a speed of connection that is faster than previous versions of the device. ePHONE is working with marketing entities to introduce the product to market through home shopping TV channels and large retail chains that are the after market distribution channels for products marketed "As Seen on TV".

ePHONE plans to position the service so the end user may save as much as 70% off their equal access based 1+ service. Currently, competitive long distance services are offered by service providers, who require the customer to sign an agreement in which the service provider then uses as authorization to order the carrier providing the actual circuits to the customer's premises to route all long distance calls to that service provider. The approach ePHONE is taking does not require any inter carrier or service provider coordination. The customer can use ePHONE's service regardless of which long distance carrier they are currently using, and they do not need to change carriers or inform them that they are using the ePHONE service.

ePHONE believes its aggressive approach to marketing and sales is as important as the technologies being employed. ePHONE has assembled a management team with diverse telecommunications experience and expertise. ePHONE is committed to staying at the leading edge of telecommunications and information technologies but believes its real competitive advantage will be sustained through a creative and innovative approach to acquiring and maintaining customers and channel distribution partners.

ePHONE plans for 2002 and beyond are to continue to build its network capacity, geographic coverage and utility while continuing to introduce new products and services. ePHONE's wholesale activities are focused on two fronts: increasing the support of different telecommunications protocols and pursuing international direct interconnections. Direct interconnections are located either over the Internet, or where economically feasible, over leased circuits to ePHONE's or a partner's equipment located in other countries. ePHONE believes the termination rates obtained through "directs" will lower termination costs which in turn will increase margins on both wholesale and retail programs. The development of direct interconnections is the focus of the franchise program wherein partners are solicited to install equipment in their own country but the equipment becomes a part of the ePHONE network and the revenues generated by the equipment are shared.

D. NETWORK

ePHONE believes the development of IP telephony as a viable technology for providing telecommunications services is significant not only because of the reduction in costs, but also because of the enhanced services that it facilitates. Unlike legacy telecommunication systems, which are currently used by most providers of telecommunications services, IP telephony systems are open, and thereby, allow the integration of numerous services on a single platform. This integration provides significant cost advantages. Inherent in the conversion of voice to data over an IP network is an effective and efficient compression of the conversation. Effectively this means an increase in utilization of bandwidth or capacity, which translates into a decreased cost.

ePHONE's plan is for their network to be deployed worldwide, and it will consist of the following main elements:

- The use of a high quality IP backbone provided by a combination of leased lines and the Internet to carry telecommunications traffic and to link nodes in the network.
- Strategically placing nodes in the network that interface with end-users and provide the actual services ePHONE will offer Points of Presence (POPs) .

- Co-location of Nodes in special facilities to allow low cost interconnection to a variety of PSTN and IP network providers.
- Global Network Management Center (GNMC). From this centralized point of command, ePHONE's technical staff will use their best efforts to ensure uninterrupted operation of ePHONE's network and services. The GNMC will also serve as a collection point for billing information used in invoicing for services rendered.

1. IP Backbone

In order to deliver high quality voice services that are comparable to traditional public telephone services, ePHONE requires a high quality IP backbone to carry traffic between its POPs. Currently, ePHONE is utilizing a 100 megabit per second dedicated IP bandwidth from Cogent between POPs.

The technology ePHONE employs allows the use of international and domestic private leased circuits until a more economical transport mechanism is available and provides the flexibility to move to new technologies as they evolve and become practical. Because of a VOIP technology called Real Time Protocol "RTP" header compression, the use of private leased circuits allows ePHONE to double the amount of traffic ePHONE can carry over a given bandwidth of circuit. This technology enables ePHONE to realize even more savings in the transport of traffic than an Internet only competitive carrier.

2. Points of Presence (POPs)

In each region where ePHONE establishes a presence, equipment will be deployed. Each POP will interface to the IP Backbone in order to provide the numerous services that ePHONE intends to offer. The key components of each of our POPs will be the following:

- Network routers used to connect the POP as a whole to the IP backbone. These routers will allow access to our IP backbone by any device that is part of the company network. Such devices include gateways, and other sub-components of our switch.
- The PSTN/IP gateway that serves as the interface between the local PSTN (or other traditional telecommunications provider) and our IP backbone. This VOIP gateway is the bridge between our network and the existing public telephone network.

Application servers are used to deliver actual services to the end user. Similar to a web server, application servers will be used to host the applications that end users interact with. These servers are centrally located and accessed by the POPs either over the Internet or via the ePHONE network.

ePHONE proposes to deploy 4 more POPs during the course of 2002, Los Angeles (installed during Q1) Miami, London and Frankfurt. These six POPs will form the core of ePHONE's network. A second tier of POPs placed under the auspices of the franchise program is intended to provide direct termination to and access from various countries where the placement of such POPs are technically feasible and economically profitable. ePHONE expects to be able to place an additional 15 local access POPs per year under its Franchise and Partnership program.(Section J: Partnership Programs)

3. Global Network Management Center (GNMC)

The GNMC is the centralized command center from which ePHONE's technical staff manages the various components of the network, as well as all other services being provided. The GNMC is staffed 24 hours a day, 7 days a week. The GNMC, which is connected to the network via a high-speed dedicated IP connection, will provide the following services:

- Real-time collection of call detail record (CDR) information from all ePHONE POPs.
- Consolidation of all billing information generated by ePHONE POPs located throughout the network.
- Back office functions such as account setup, management, termination, and billing.
- IP network monitoring, to ensure, to the extent possible, that the IP backbone delivers consistently high quality performance and results.
- Monitoring of each POP in the network to ensure availability. Such monitoring will not be limited to monitoring on the IP network, but also PSTN availability of a given ePHONE POP.

- Monitoring carrier interconnects to ensure adequate quality of service and availability of termination to the contracted destinations.
- Deployment of new services to ePHONE POPs.
- Bandwidth monitoring and planning activities to determine the appropriate timing and structure of improvements to our network infrastructure.
- Coordination of the deployment of new ePHONE POPs, and extensions of the IP backbone to include new regions.

The GNMC is fully established and operational and is located in ePHONE's corporate headquarters in Herndon, Virginia.

E. MARKETING

ePHONE plans to offer a wide range of telecommunications services to carriers and end users throughout the world. The fundamental service that ePHONE will provide is the ability to reduce telecommunications costs through the use of IP telephony technology. In order to provide such services economically, ePHONE will utilize a worldwide IP network that will be used to transmit calls. ePHONE's network will handle long distance traffic, both for carrier customers, and for calls between our retail customers and the larger population connected to the public switched telephone network (PSTN).

ePHONE believes companies such as ITXC, iBasis, and Net2Phone have demonstrated the viability of selling long distance telephone services using IP telephony technology. However, ePHONE plans to offer significantly differentiated retail products and services. We believe there are three broad categories in which ePHONE delivers services that are more compelling than the straightforward long distance calling services being offered currently by IP telephony carriers.

These categories are:

- **Marketing differentiated services.**
These products are differentiated more by how they are distributed and sold than the underlying technologies. Moving telephony services into mass marketing channels and adapting the products either technically or commercially to offer an innovative product tailored to the specific distribution channel is what distinguishes these products from other offerings. Examples of this are the Unlimited Program and the soon to be launched eTRANSPORT program.
- **Enhanced services.**
Through integration of IP telephony products based on open standards, ePHONE plans to provide a significantly greater depth of services beyond simple long distance calling, including services such as international roaming, roaming 1+ dialing, online billing and verification. Because of the open architecture, ePHONE is also positioned to add services such as unified messaging, "Follow Me" and "Find Me" services in the very near term..
- **Access technology.**
At present, the only means provided by IP telephony carriers to access their networks, is an access number that must be manually dialed. While companies using IP telephony products enjoy one-stage dialing, they are required to deploy their own networks in order to do so, and as a result, can typically only call between area codes where they have Points of Presence (POPs). ePHONE, in conjunction with our partners, has developed the capacity for access devices to be used in addition to the normal PSTN-based access methods. These devices will allow ePHONE to deliver services providing an ease of use only seen with 1+ service.

F. PRODUCTS AND SERVICES

- **Specialty Products**

These services are customized to the requirements of a specific distribution channel or marketing program. Examples of these programs are the Unlimited Program and the soon to be launched eTRANSPORT product. These products are driven by the marketing approach rather than technology. The underlying technologies are

standard prepaid services, however, the marketing approach or channel differentiates the product and thereby creates a competitive advantage resulting in high margins.

For example, eTRANSPORT, an exclusive patented device with a microchip that does not require a separate power source, is used to produce a product that works for all practical purposes the same as a 1+ dialing program. In addition, the product is mobile since it can be used from almost any 1 or 2 line phone in the domestic US.

As the network is expanded ePHONE believes these products can be exported to international markets thus leveraging the development effort that has gone into the definition and launch of the product in the US.

- **1+ and ISDN services**

ePHONE is currently developing these products for introduction in Q3 of 2002. They require ePHONE to become licensed as a CLEC (Competitive Local Exchange Carrier) in order to provide services in specific geographies. ePHONE intends to develop a true retail base that can be developed as a market for other value added products. The resale of another service provider's fixed network services allows us to "own" the customer as ePHONE becomes responsible for monthly billing and customer service.

- **Prepaid Calling Cards**

Since each POP is capable of providing interactive voice response ("IVR"), balance announcements, real-time billing with automatic cutoff and other key features, no additional investment is required in order to use the network to provide prepaid calling card services.

Prepaid calling cards offer a range of products targeted at different markets and distribution channels. Competitive rates and extensive distribution channels allow cards to be tailored to each of these markets:

- **Local Community Cards**

Targeted at local community calling groups with specific calling destinations distributed through small retail stores or neighborhood contacts.

- **Promotional Cards**

Cards sold to a corporate entity to promote their product as a promotional item.

- **Travel Cards**

These cards allow a consumer to make calls from a number of specified countries at rates that are lower than the consumer would otherwise be required to pay.

- **NPO – non profit organization products**

These products are tailored to the "affinity" market. They provide an alternative revenue source for non-profit organizations.

- **International Cards**

As second tier local access POPs are put in place, franchise partners are able to market their own prepaid products in the call originating country.

- **Customized Online Billing**

Because ePHONE's network is built on Internet Protocol (IP) technology, it is able to deliver transactional and e-commerce applications identical to those used by web-based retailers. Since all POPs collect billing information in real-time, with immediate transmission of billing information to the GNMC, ePHONE is able to provide online services, such as, allowing a customer to review their bills, sign up for new plans and services, or make changes to existing services. This service also provides immediate feedback to end users on the benefits and savings.

This service has been further extended with the addition of an IVR (Interactive Voice Response system) that provides similar services for users over the phone, allowing them to sign up for new services and providing information on the status of their accounts.

G. INTEREXCHANGE CARRIER AND DIRECTS

ePHONE believes the provision of competitive retail products is dependant on its ability to obtain competitive rates from suppliers. ePHONE believes it can obtain these competitive rates by positioning itself as a wholesale service provider and an interexchange carrier. ePHONE buys from carriers and sells to other carriers with the intent of making a margin on the transaction.

Providing these services allows ePHONE to increase traffic volumes as well as making bilateral arrangements for both the origination and termination of traffic with a specific carrier, thereby, reducing the financial exposure in both directions. ePHONE believes this also increases the number of carriers with whom ePHONE can contract.

ePHONE has established relationships with a base of carriers who provide services ranging from local access, 800 access and international terminations. ePHONE has established contractual relationships with Global Crossing Bandwith, Inc., Teleglobe U.S.A., Bell South Long Distance, Encore Telecommunications Inc. (Vonova), Intelco Communication (Cescom), MCI-Worldcom, and several other carriers. The relationship with other carriers is very dynamic and requires an ongoing presence in the market to track rates and develop relationships as new routes or more competitive rates become available.

The interconnection with other carriers is being done at our facilities in New York and Los Angeles. ePHONE is located in a carrier hotel that provides local access to a number of carriers and inexpensive access to local loops in New York and Los Angeles that can be used to interconnect with virtually any carrier located in the city. These interconnections are done via leased lines between switches. ePHONE is also using the Internet to connect to some carriers whose switches are not located in New York or Los Angeles.

ePHONE has established a network of interconnections that is sufficient for the current business plan purposes and can increase its capacity within days. ePHONE can terminate calls to any destination in the world and has very competitive rates through contracted carriers for access and egress in the domestic US. ePHONE is able to offer competitive products in the retail market and to terminate traffic on behalf of other carriers competitively.

A number of the larger carriers (tier 1 carriers) were not available during 2001 as prospective customers because ePHONE did not support SS7. SS7 is a signaling protocol that has been adopted as a standard by many of the larger carriers and all suppliers to large carriers have to support SS7. ePHONE purchased the SS7 equipment and software needed to support SS7 and completed installation during the second quarter of 2002. This has opened to ePHONE a more lucrative market since may tier 1 carriers require the support of SS7 with carriers they interconnect to.

ePHONE believes it can further improve its rates to international destinations by interconnecting with carriers or service providers in those international locations. This is the focus of ePHONE's franchise program. It encourages companies in international locations to install compatible equipment and provide access to the local telephone network (PSTN) and to become part of the ePHONE network. These "directs" bypass intermediaries and allow ePHONE to benefit from lower termination rates as well as providing access for retail products in that location.

H. SUPPLIERS

A significant amount of technology and management experience was required to create the network and deliver services to end-users. Although ePHONE may need to find the technical expertise to create some systems, its strategy is to enhance the current technology team by partnering with other companies that provide the required technology and can meet ePHONE's requirements. A list of the partners and suppliers that ePHONE uses are:

- Cisco Systems, Inc.

The equipment used in ePHONE's POPs is virtually all Cisco manufactured. Cisco offers an extensive array of VOIP products, IP routers and switches. These products can be combined in a variety of different ways to provide the desired network functionality. ePHONE's technology team believes they have developed an architecture that provides superior functionality and flexibility. This architecture has been propagated throughout ePHONE's core network.

- Mind CTI, LTD

Mind CTI is an Israeli company that has developed a billing system used in both data and voice applications. It also provides access control, authorization and configuration capabilities. It allows ePHONE to define a hierarchy of relationships between carriers, distributors, service providers and anyone else with whom ePHONE deals with to provide services, either as a customer or provider. The Cisco equipment handles the routing and sending of traffic while the Mind CTI system keeps track of what happened throughout the network and what the cost was and who should be charged.

- Immix Telecom, Inc.

Immix is a Florida corporation selling autodialers and other access devices. Immix produces the device being used for the eTRANSPORT program. ePHONE has developed a very close working relationship with Immex that has allowed ePHONE to closely integrate the eTRANSPORT with the ePHONE network to provide seamless customer access. ePHONE's contract with Immix provides for an exclusive right to distribute the specific device ePHONE has developed in conjunction with Immix.

- Switch and Data

ePHONE has contracted with Switch and Data to provide co-location facilities in New York, Miami and Los Angeles. Switch and Data operates "Carrier Hotels" which are facilities set up to provide a location to house telecommunications switches. They possess all the attributes required in the form of security, uninterruptible power, air conditioning and proximity to other carriers and telecommunications facilities.

- Carriers

As an interexchange carrier ePHONE interconnects with a number of other carriers. These relationships are fluid, depending on where ePHONE can obtain the best rates and to whom ePHONE can sell rates at any given point in time. Though other carriers as a group are extremely important to ePHONE, no one carrier is in a position to be considered critical to ePHONE's success.

I. COMPETITION

The market for Internet voice, fax and other value-added services is competitive. Internet protocol and Internet telephony service providers, such as ITXC Corp., route traffic to destinations worldwide and compete directly with ePHONE, along with Internet telephony service providers Net2Phone. In addition, major telecommunications carriers, such as AT&T, Deutsche Telekom, MCI WorldCom and Qwest Communications, have all entered or announced plans to enter the Internet telephony market. Many of these companies are larger than ePHONE and have substantially greater managerial and financial resources than we do. Competition in ePHONE's markets can be expected to continue and may adversely affect our profitability. ePHONE cannot assure that we will be able to compete successfully against competitors and may lose customers or fail to grow our business as a result of this competition.

For the present, the following companies focusing on the use of VoIP technology are our main competitors:

- The Internet Telephone Exchange Carrier (ITXC)

ITXC is a clearinghouse for Internet telephony service providers and operates ITXC.net. Since April of 1998, ITXC has been used to provide traditional carriers' international call completion with sufficient quality for carriers to serve their phone-to-phone customers. ITXC has reportedly installed 167 POPs in 45 countries and 101 cities.

- iBasis

iBasis was founded in 1996 to provide Internet Protocol (IP) telephony service to telecommunication carriers around the globe. The company has POPs in Asia, Europe, the Middle East, and the Americas. iBasis is in wholesale Internet telephony service.

- Net2Phone

Net2Phone began as a subsidiary of IDT Corporation and is a provider of voice over public Internet communications services. Net2Phone enables its customers to place telephone calls from their computers, telephones, or fax machines to any telephone or fax machine in the world. By routing calls via the public Internet, Net2Phone enables users to save money on their international phone rates. Net2Phone developed a proprietary Gateway technology for IP voice services offered by the company.

Net2Phone's product offerings include PC-to-phone service, IP telephony service for phone or fax and Real-time PC-to-fax solution. Its network currently reaches 30 countries and expects to be operational in 25 additional countries by the end of 2002.

- **DeltaThree**

Founded in 1996, DeltaThree manages a network dedicated to the transmission of voice over IP. Its services include PC-to-phone, unified messaging, global access calling cards, and voice greetings accessible from the company's communications portal. DeltaThree currently operates a network of 37 international POPs.

J. PARTNERSHIP PROGRAMS

A key element in our overall ePHONE strategy is the Partnership Program. ePHONE's Partnership Program is designed to facilitate the rapid deployment and sales of products and services with a minimum capital investment by ePHONE. There are two elements to our Partnership Program, the Franchise Partner Program and the Sales Agent Program.

- **Franchise Partner Program**

The Franchise partner program focuses on the rapid expansion of our network. The program is designed to allow interested parties to participate in the deployment of ePHONE's network by providing capital used to locate an ePHONE POP in a given area. Once that POP is deployed, ePHONE's Franchise Partner then performs marketing of our services, taking a share of any profits generated by that ePHONE switch.

- **Sales Partner Program**

Under this program, ePHONE recruits resellers who make no capital investment but specialize in selling services. Sales Partners are required to commit to minimum sales targets for each of our services that they sell. However, Sales Partners will be paid a commission based on sales.

K. GOVERNMENT APPROVALS AND REGULATIONS

ePHONE is currently in possession of a Federal Communications Commission 214 license which allows ePHONE to provide telecommunications services in the United States and as an international carrier. ePHONE has obtained, has filed for, or is in the process of filing for licenses with the individual states within the domestic US for provision of intrastate services.

ePHONE's need for licenses in other countries will depend on whether ePHONE operates as a foreign company in those locations or whether ePHONE partners with licensed local partners.

L. PATENTS, TRADEMARKS AND ROYALTY AGREEMENTS

ePHONE does not have any patents, trademarks, licenses or protective agreements. ePHONE has trademarked its logo in Canada.

M. RESEARCH & DEVELOPMENT ACTIVITIES

ePHONE is not undertaking any pure research and development. ePHONE's activities in this respect consist of working with the products ePHONE has purchased and licensed from suppliers in order to integrate them into a network and back office. In this effort ePHONE has found it necessary to develop tools and processes for its own use in the administration and management of the Network. These activities will continue as its business requirements grow and change.

N. EMPLOYEES

As of December 31, 2001, ePHONE had 20 full-time employees in the Virginia office, including 2 in Development, 7 in Network Operations, 5 in Marketing and 6 in Administrative and Accounting. In addition, ePHONE had 9 part-time employees and 1 individual providing service to us as independent consultant. As ePHONE's business and development efforts expand, additional personnel will be engaged, either as employees or as contract service suppliers.

ITEM 2. DESCRIPTION OF PROPERTIES

ePHONE leases approximately 7,400 square feet for the principal executive offices, which are located at 1145 Herndon Parkway; Suite 100, Herndon, Virginia 20170. Base rent for the current premises is approximately \$14,500 per month subject to annual increases of three percent. The lease requires ePHONE to pay a portion of the property taxes and certain operating expenses. Management believes that the current and anticipated facilities are suitable and adequate for operations.

ITEM 3. LEGAL PROCEEDINGS

Litigation with former officer

Mr. Charles Yang joined ePHONE in July 1999, as President and Chief Operating Officer in part due to Mr. Yang's strong representations that he could bring to ePHONE extensive business connections, and that those connections could be converted into sales for ePHONE. The Board subsequently concluded that Mr. Yang did not have the potential that they originally believed he had - which is part of the reason for the breakdown of the relationship with Mr. Yang. For further information regarding ePHONE's relationship with Mr. Yang, see Section B of Item 12 below.

Mr. Yang ceased providing services to ePHONE as of January 31, 2000. Mr. Yang's positions as President and Chief Operating Officer of ePHONE were formally terminated March 9, 2000.

During 1999, ePHONE accrued a liability totaling \$300,000 in connection with a settlement offer made to Mr. Yang to resolve this matter. On March 23, 2001, the Company entered into a Settlement Agreement and Mutual General Release (the "Settlement Agreement") with Mr. Yang to resolve all claims and disputes between the Company and Mr. Yang, including all claims relating to Mr. Yang's employment by and separation from the Company. Pursuant to the terms of the Settlement Agreement, the Company agreed to pay Mr. Yang \$400,000 in cash in installments by July 23, 2001, and issue Mr. Yang 400,000 shares of the Company's common stock.

ePHONE did not make the required cash payments by July 23, 2001 and the balance due Mr. Yang was \$150,000 at December 31, 2001. Effective January 29, 2002, we entered into a Modification Agreement of the original Settlement Agreement and were required to pay Mr. Yang an additional \$75,000 and issue an additional 100,000 shares of our common stock. The \$225,000 due Mr. Yang as of December 31, 2001 will be paid in 30 monthly installments of \$7,500, beginning in 2002.

Comdial Arbitration

During the third quarter of 2001, we filed for arbitration against Comdial seeking rescission of the Array Telecom License Agreement, return of the \$2.65 million paid to Comdial, and compensatory and punitive damages of \$10,000,000 due to what we believe to have been violations by Comdial of the Array Telecom License Agreement. Comdial initially responded to our arbitration demand with a counterclaim seeking relief from all of our claims and the payment of \$215,000 in accrued royalties plus interest. Subsequently, Comdial has also added an additional counterclaim alleging that the agreement is still valid and is seeking the value of the future royalty payments which were to be made under the agreement. We have given back the licensed products to Comdial, and consequently, do not believe that we have an obligation for any additional future royalties based upon the use of the licensed products. We believe the \$215,000 plus accrued interest of approximately \$11,000 is our maximum exposure in the event of an unfavorable outcome and have recorded these amounts as accrued liabilities at December 31, 2001. Arbitration is scheduled to occur in Washington D.C. beginning on May 29, 2002.

Other than disclosed above, ePHONE is not involved in, nor has knowledge of, any threatened or pending legal proceedings against it.

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

The Company held its annual meeting of shareholders on December 12, 2001. There were two agenda items submitted to a vote of security holders:

1. Election of Mr. Shelly Kamins to the Board of Directors and reelection of Mr. Robert Clarke, John Fraser, Charlie Rodriguez and Carmine Tagliatela to the Board of Directors.
2. Proposal to ratify Grant Thornton, LLP as ePHONE's independent public accountants for fiscal year 2001.

The result of the voting stockholders were as follows:

1. <u>Directors</u>	<u>Clarke</u>	<u>Fraser</u>	<u>Rodriguez</u>	<u>Tagliatela</u>	<u>Kamins</u>
Against	1,000	3,000	0	800	0
For	17,251,827	17,249,827	17,252,827	17,252,027	17,252,827
Abstain	22,550	22,550	22,550	22,550	22,550
2. <u>Proposal</u>	<u>For</u>	<u>Against</u>	<u>Abstain</u>		
	17,262,177	5,200	8,000		

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Since June 12, 2000 and prior to December 15, 1999, the common shares did trade and currently trades on the OTC Bulletin Board - under the symbol "EPHO". From December 15, 1999 until June 11, 2000, the common shares traded on the National Quotation Bureau's Electronic Quotation Service (the "Pink Sheets") under the symbol "EPHO". Shares of the common stock do not trade on any stock exchange or any other market.

The following table sets forth the closing high and low bid prices of the common stock for each quarter within the last two years as reported by publicly available sources to which ePHONE has access. The quotations reflect inter-dealer prices and do not represent retail mark-ups, markdowns, commissions, and may not reflect active transactions.

Market Information

<u>2000:</u>	<u>High</u>	<u>Low</u>
First Quarter	4.00	0.75
Second Quarter	2.93	1.09
Third Quarter	1.66	0.91
Fourth Quarter	0.94	0.25
<u>2001:</u>		
First Quarter	0.44	0.16
Second Quarter	0.41	0.12
Third Quarter	0.22	0.08
Fourth Quarter	0.35	0.14

As of December 31, 2001 there were 204 holders of record of the common stock. This does not reflect persons or entities that hold stock in "Street" name or through various brokerage firms.

ePHONE has not paid any cash dividends on common stock and at present does not intend to pay cash dividends in the foreseeable future. ePHONE plans to retain earnings, if any, to use in the operation of the business and to fund future growth.

Unregistered Securities

During February 2002, ePHONE issued 10,000 shares to Rudy Ryckewaert in exchange for consulting services rendered valued at \$2,200.

During March 2001 and January 2002, ePHONE issued 500,000 shares of common stock to Mr. Charles Yang in connection with a settlement agreement further described in legal proceedings.

During November 2001 and January 2002, ePHONE issued 200,000 shares of common stock to Mr. Kuba Farbiarz in exchange for marketing consulting services rendered.

During November 2001, ePHONE issued 538,973 shares to PITRFA, Inc, in connection with a marketing and distribution agreement.

The issuances were made pursuant to available exemptions from the registration provisions of the Securities Act of 1933, as amended (specifically, Section 4(2) of the Securities Act) and relevant Blue Sky statutes.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Fiscal Year 2001 was one of transition for us. Management's decision in the second quarter to introduce Cisco equipment and to begin implementing a private network, as opposed to exclusively using the Internet for transport, proved to be fundamental to the generation of our telephony based revenues. We began carrying production traffic, both wholesale and retail in the third quarter of 2001. This major milestone marked the first time we have produced revenue from the provision of telecommunications services in our history.

Our core strategy had been to deploy and manage a global Internet telephony services network using the Array series of products and customer premises equipment (Business Direct and Business Connect services). The Array network, after more than 12 months of effort was not able to support production traffic. This called into question the viability of the Array technology as well as our original strategy. The respective time and effort spent on the implementation of the network led management quickly to the conclusion that the Array network must be integrated and a migration strategy developed for a network based on Cisco equipment.

Our decision to deploy the new network was based on several underlying factors described in Part I Item I Business, that were seen as providing a broader based business strategy and one that worked in conjunction with our original plan. It also surpassed the Array network in areas where it was deficient, primarily carrier interconnectivity and billing functionality. Our new network has provided supplemental revenues by allowing wholesale arbitrage and increasingly competitive rates for the retail programs being deployed.

Our new network was deployed and brought into production in 75 days.

Results of Operations - Years ended December 31, 2001 and 2000

Our net loss and net loss per share were (\$7,021,000) and (\$0.28) and (\$13,701,000) and (\$0.94) and for the years ended December 31, 2001 and 2000, respectively.

During the third quarter in 2001, we began recognizing revenue under our "Unlimited Program" telecommunications program and our wholesale strategy. This coupled with the significant reduction of non-

cash general and administrative costs during 2001 compared to 2000 were the primary reasons for the significant decrease in our net loss

Revenues

Revenues increased from \$590,000 in 2000 to \$3,590,000 in 2001. The majority of the increase is attributed to the Company's "Unlimited Access" Program and our wholesale strategy, which began in mid August. These programs accounted for 86% of ePHONE's revenue for the year ended December 31, 2001 and did not account for any revenue during 2000. During December 2001, cash collections of \$367,000 were considered pre-paid and are reflected in the Current Liability section of the Balance Sheet as "Deferred Revenue". As ePHONE continues to focus on retail and wholesale offerings, sales of equipment are not expected to be significant in the future. The \$513,000 revenue from the sales of equipment in Q1 of 2001 is not likely to reoccur.

Cost of Revenues

Cost of Revenues increased from \$412,000 in 2000 to \$2,501,000 in 2001. For the year ended December 31, 2001, cost of goods sold represented commissions, activation fees and processing charges related to our telecommunications services program. Prior to the third quarter of fiscal year 2001, cost of goods sold was related to telecommunications equipment sales. Gross margin for the year ended December 31, 2001 and 2000 was 30%. Our gross margin percentage will likely fluctuate higher in the future due to changes in our sales mix.

Sales and marketing

Sales and marketing expense decreased from \$1,853,000 in 2000 to \$1,212,000 in 2001. During 2000, our sales and marketing expenses included compensation paid to consultants for market studies and competitive intelligence of the Internet telephony market place in several countries where we were deploying our network. There were no similar expenditures incurred during 2001. Currently, sales and marketing expense consists primarily of marketing commissions and salaries.

General and administrative

General and administrative expense increased from \$4,787,000 in 2000 to \$5,485,000 in 2001. We expect general and administrative expenses to level off or decrease in the future. Due to our changes in the business plan, non-recurring expenses related to the write off of the Array Telecom license in the amount of \$1,180,000 were incurred in 2001.

Write-off of Array Telecom License

In March 2000, we entered into a Strategic Alliance Agreement and a License Agreement with Comdial Corporation ("Comdial") and Array Telecom Corporation ("Array Telecom"), a wholly owned subsidiary of Comdial. In connection with the Agreement and the License, we made an initial payment to Comdial of \$2.65 million and received the fixed assets of Array Telecom, assumed the lease of Array Telecom's Herndon, Virginia facility and an exclusive license for all Voice over Internet Protocol (VoIP) technology that had been developed by Array Telecom for a period of five years. The License Agreement required us to pay additional minimum royalty fees for the VoIP technology over a five-year period.

During the fourth quarter of 2000, we determined that due to the rapidly changing technology in the VOIP industry, a shorter amortization life for the License Agreement was appropriate and shortened the expected life to three years. The shortened life gave rise to a deferred royalty obligation representing the difference between the straight-line expense over the shortened three-year life of the License Agreement and the actual royalty payments, which were scheduled to be made over a five-year period.

During the third quarter of 2001, we filed for arbitration against Comdial seeking rescission of the Array Telecom License Agreement, return of the \$2.65 million paid to Comdial, and compensatory and punitive damages due to what we believe to have been violations by Comdial of the Array Telecom License Agreement.

Comdial has responded to our arbitration demand with a counterclaim seeking relief from all of our claims and the payment of \$215,000 accrued royalties plus interest. We believe the \$215,000 plus accrued interest of approximately \$11,000 is our maximum exposure in the event of an unfavorable outcome and have recorded these amounts as accrued liabilities at December 31, 2001. Arbitration is scheduled to occur in Washington D.C. beginning on May 29, 2002. Since Comdial has terminated the License Agreement, we have reversed the previously recorded deferred royalty obligation of \$603,000 during the year ended December 31, 2001.

We have also decided to discontinue use of the Array Telecom technology and therefore, have written off the remaining balance of the Array Telecom License and related assets and liabilities of \$1,180,000 at December 31, 2001.

Income taxes

There was no provision for federal or state income taxes for the period from our inception due to our operating losses. At December 31, 2001, we had net operating loss carryforwards for income tax purposes. A valuation allowance has been established and, accordingly, no benefit has been recognized for our net operating losses and other deferred tax assets.

Results of Operations - Years ended December 31, 2000 and 1999

Revenues

During fiscal year 2000, ePHONE introduced its Array Series 3000 gateway to the market. The Company earned \$590,000 in revenue from the sale of these gateways to equipment customers during 2000. One customer purchased approximately 90% of the gateways ePHONE sold in 2000. ePHONE had no revenue during 1999.

Cost of Revenues

The cost of the Array gateways sold during 2000 totaled \$412,000, which represents a gross margin of 30%.

Sales and Marketing

Sales and marketing expense increased \$1,631,000, from \$219,000 in 1999 to \$1,853,000 in 2000. This increase in selling and marketing expenses is attributed to the introduction of the Array Series 3000 gateway to the marketplace and costs incurred by ePHONE in its preparation for the deployment of its global Internet telephony network. Such costs included cash amounts paid to consultants of \$1,050,000 for market studies and competitive intelligence of the Internet telephony marketplace in several countries in which ePHONE is deploying its network. The Company also issued stock options and warrants with a value of \$903,000 to these consultants and have included this amount as an expense in the statement of operations as non-cash compensation.

General and Administrative

General and administrative expenses increased \$3,818,000 from \$969,000 in 1999 to \$4,787,000 in 2000. The increase is attributable to increased costs incurred on research and development associated with the development of ePHONE's network, software support and development fees, royalties associated with the Array Technology license agreement, and increased legal and accounting fees associated with raising capital to fund operations. General and administrative costs for 2000 included \$666,000 of amortization and depreciation expenses related to amortization of the Array technology and depreciation of equipment. Also included in 2000 general and administrative costs is \$1,030,000 of one-time costs incurred in connection with signing bonuses that it paid to certain employees of Comdial when it acquired the Array technology totaling \$350,000 and a payment of \$680,000 to ePHONE Technologies, Inc., a company formed by the certain executive officers which were terminated in December 2000.

Non-Cash Compensation

Non cash compensation represents the value assigned to equity securities issued to employees and non-employees in exchange for services as follows.

Stock options and warrants issued to consultants (see "Sales and Marketing")	\$	903,000
Stock options issued to executive officers		(1)2,864,000
Stock issued to former executive officers and consultants		(2)3,666,000
	\$	<u>7,433,000</u>

- (1) During 2000, ePHONE granted options to two executive officers which vested on the date of grant and had a fair market value on that date of \$2,864,000. These two officers terminated their employment with the Company during late 2000, and the stock awards were cancelled as provided in their separation agreements.
- (2) ePHONE issued 3,666,488 shares of its common stock to former executive officers and consultants of the Company who would have been eligible to receive shares of common stock under the performance share plan that was cancelled by the Company.

Liquidity And Capital Resources

Since December 31, 2001, we have raised \$690,000 from the exercise warrants we had issued in connection with the sale of special warrants in 1999 for the purchase of 3,448,913 shares of our common stock. On March 30, 2002, the warrants for the purchase of 9,115,161 shares of our common stock expired unexercised. The proceeds from the exercise of these warrants, along with our operations during the first quarter 2002 increased our cash from \$36,000 at December 31, 2001 to \$684,000 at March 31, 2002, and improved our working capital deficiency from \$1,621,000 at December 31, 2001 to a working capital surplus of \$570,000 including subscription receivables from the exercise of warrants of \$388,000 at March 31, 2002.

Since we commenced commercial operations utilizing our new strategy based upon a Cisco-based network in August of 2001 we have generated service revenue of over \$3,000,000 from August to December 2001. In the first quarter of 2002, we billed and collected approximately \$4,900,000. Our liquidity continues to improve and as of April 11, 2002 we had a total of \$1,273,000 of cash on hand. We plan to expand our current products and services in 2002 and introduce new products and services. We have been successful in generating net income from operations since we deployed our new Cisco-based network in August 2001. Our anticipated future cash flows from operations is largely dependent upon our ability to achieve our revenue and gross profit objectives from our current products and services and introduction of new products we plan to launch in 2002. We believe that based on our current level of operations, the cash flows we are generating from operations together with the \$690,000 we received from the exercise of warrants described above is sufficient for our current operations.

It is important to point out that since our inception, we have accumulated a deficit of \$22,341,000, and that we funded our operations, prior to our generating service revenues beginning in August 2001, primarily with the proceeds we raised in our special warrant offering in 2000, from the exercise of warrants during 2001 of \$305,000, and from limited equipment sales. We do not currently have a line of credit or any other credit facility available to us.

While our service revenue sales continues to increase during the first quarter of 2002, and while management anticipates that growth in service revenue will continue in 2002, we cannot assure you that this will happen. Future prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in the telecommunications industry. To address these risks and achieve profitability and increased sales levels, we must, among other things, continue to establish and increase market acceptance of our products,

respond effectively to competitive pressures, offer high quality customer service and support, and successfully introduce, on a timely basis, new products and enhancements of our existing products.

We anticipate, based on our present plans and assumptions, that our current cash balances and projected level of 2002 operations will be sufficient to enable us to sustain our current and planned operations for at least the next 12 months, and will not need to raise additional funding. However, we cannot assure you that this will hold true.

For the year ended December 31, 2001, we used \$3,747,000 of cash for our operating activities. The principal differences between the cash we used in operations and our 2001 net loss of \$7,021,000 were (i) reduction for non-cash expenses including depreciation and amortization and stock issued for compensation; (ii) increases in our accounts payable and deferred revenue balances; and (iii) the write-off of our Array Telecom License and the disposal of obsolete inventory and equipment in December 31, 2001.

For the year ended December 31, 2001, investing activities provided \$1,960,000 of cash as a result of the redemption of \$2,194,000 of marketable securities and release of \$520,000 of restricted cash, offset by payments to purchase fixed assets. Our financing activities generating \$305,000 in cash from the exercise of stock purchase warrants for the purchase of 848,243 shares of our common stock.

For the year ended December 31, 2001, we had a net decrease in cash from operating, investing and financing activities of \$1,490,000. At December 31, 2001, we had \$36,000 of cash and a working capital deficit of \$1,621,000.

We have one equipment commitment totaling \$46,000 for a Sun Microsystems server which expires in July 2003.

On April 20, 2000, we closed an offering of Special Warrants, receiving net proceeds of approximately \$12,205,000. The total number of Special Warrants we sold in that offering was 13,780,837. The special warrant agreements contained certain penalties in the event that we did not meet the prescribed deadlines for registration of common stock to be issued on the exercise of the special warrants in both Canada and the United States. We failed to meet these deadlines, and consequently each special warrant holder was entitled to exercise their right to have 12.5% of their original investment returned to them and reduce the number of special warrants they held by the same percentage ("Redemption Right"). In addition, each special warrant holder received an additional 10% of their original investment in shares of our common stock upon the exercise of the special warrants. As of March 31, 2001, all special warrant holders exercised their Redemption Rights, and we returned \$1,895,000 to these investors. We completed the registration of our common stock in Canada, and our investors exercised their special warrants causing us to issue 13,436,317 shares of our common stock and warrants to purchase 13,436,317 shares of our common stock for \$1.60 per share.

During the year ended December 31, 2001, we raised \$305,000 from the exercise of warrants for the purchase of 848,243 shares of our common stock.

During the third quarter of 2001, we decided to provide our warrant holders with an enticement to exercise their warrants by reducing the exercise price of the warrants we issued on the exercise of the special warrants and for all other outstanding warrants from exercise prices ranging between \$1.60 - \$0.50 per share to \$0.35 per share. We further reduced the exercise price of the warrants to \$0.20 in 2002 to better reflect the market price of our common stock. As noted above, during 2002 warrant holders exercised warrants for the purchase of 3,448,913 shares of our common stock for \$690,000.

Stock Compensation Activity During 2001

On February 14, 2001, the Board of Directors approved the issuance of 250,000 stock options to a consultant in an exchange for services rendered under a consulting agreement. The stock options have an exercise price of \$0.50, vested immediately and expire in three years. The market value of our common stock at the grant date

was \$0.23. The fair value associated with these options totaled \$42,500 and was recorded as non-cash compensation during the quarter ended March 31, 2001.

As further described in Legal Proceedings, we entered into a Settlement agreement with Charles Yang on March 23, 2001. Pursuant to the terms of the agreement, we agreed to pay Mr. Yang \$400,000 in cash in installments by July 23, 2001, and issue Mr. Yang 400,000 shares of our common stock. We recorded \$180,000 in expense related to this settlement during the three months ended March 31, 2001. The fair value of the stock issued was \$80,000 and is recorded as non-cash compensation in the statement of operations. We did not make the required payments to Mr. Yang by July 23, 2001 and therefore were required to issue an additional 100,000 shares of our common stock in accordance with a Modification of the original Settlement Agreement entered into between us and Mr. Yang. The fair value of the additional shares totaled \$30,000 and is recorded as non-cash compensation in the December 31, 2001 statement of operations.

On September 12, 2001 our Board of Directors approved a resolution to reduce from \$0.50 to \$0.35 the exercise price of 3,900,000 stock options held by certain Board members, executive officers and former employees.

During October and November 2001, we issued 200,000 shares of our common stock and 200,000 options to purchase shares of our common stock to a consultant as consideration for marketing and business development consulting services rendered. The fair value of these shares of common stock totaled \$49,000 and is recorded as non-cash compensation expense as of December 31, 2001. The options have an exercise price of \$0.50 and vest immediately. The fair value associated with these options was \$48,045 and is recorded as non-cash compensation expense during the year ended December 31, 2001. During 2002, under the terms of a consulting agreement, we may be required to issue this consultant 200,000 shares of our common stock and 200,000 options to purchase shares of our common stock subject to mutually agreed upon performance goals.

On November 29, 2001, we entered into an exclusive Marketing and Distribution Agreement (“Agreement”) with PITRFA Inc., a Florida based sales, marketing and distribution company. As defined in the Agreement, PITRFA will market and distribute ePHONE’s prepaid 1+ long distance service for a period of three years. Upon signing the Agreement, we issued PITRFA 538,973 shares of our common stock. The fair value associated with these shares of common stock totaled \$97,015 and is recorded as non-cash compensation expense in our December 31, 2001 Statement of Operations. The Agreement also contains a provision for the issuance of additional shares of our common stock if our common stock reaches certain price levels in the future as follows: a) if the price of our common stock reaches \$2.50 per share we will be required to issue PITRFA a second tranche of 538,973 shares and; b) if the price of our common stock subsequently reaches \$5.00 per share, we will be required to issue PITRFA a third tranche of 538,973 shares. The maximum amount of shares that would be issued if all milestones are met is 1,616,919, which represents 5% of our common stock outstanding at the signing of the Agreement.

On December 17, 2001, our Board of Directors approved a resolution to extend the expiration date of a former officer’s stock option agreement from March 31, 2002 to October 1, 2002.

Stock Compensation Activity During 2000

On May 5, 2000, the Board of Directors adopted the 2000 Long-Term Incentive Plan and reserved 6,000,000 shares of common stock for issuance under the Plan. During 2000, ePHONE granted 1,500,000 stock options to two officers of ePHONE, which vested on the grant date with the exercise price less than the market price at grant date. In accordance with APB 25, ePHONE recorded compensation expense totaling \$2,865,000. These two officers terminated employment with ePHONE in December 2000 and a total of 6,747,307 stock options were cancelled as provided for in the officers' Separation Agreements. The balance of 5,247,307 stock options did not vest during the year and hence did not have any impact on the financial statements. On May 9, 2000, ePHONE granted 345,000 shares of common stock to Cornwall Management Ltd. as partial consideration for services rendered under a consulting agreement. The fair value of the shares totaled \$604,000 and was recorded as a non-cash compensation expense for the year ended December 31, 2000.

On May 24, 2000, for a detailed analysis of Internet Protocol development and market opportunities in various major countries, ePHONE granted Sobois-Livert Investment Corporation warrants to purchase 250,000 shares of common stock at \$0.60 per share and, as agreed to, upon completion of the consulting engagement and delivery of certain reports, additional warrants to purchase 488,833 shares of common stock at \$1.10 per share. Both sets of warrants expire on May 24, 2002. The fair value of these warrants totaled \$299,000 and has been recorded by ePHONE as non-cash compensation included in general and administrative expense during 2000.

On July 12, 2000, ePHONE `s Board of Directors voted to rescind a performance share plan previously adopted in 1999 pursuant to which up to 15,000,000 shares of ePHONE common stock would have been issued. Concurrently, the Board of Directors agreed to grant for no additional consideration a total of 3,666,448 shares of ePHONE common stock in consideration to certain individuals who would have been eligible to receive shares of common stock under the performance share plan. ePHONE recorded a \$3,700,000 charge related to the granting of these shares of common stock.

Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, Business Combinations. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. This statement is effective for all business combinations initiated after June 30, 2001.

In July 2001, the FASB issued SFAS No. 142, Goodwill And Other Intangible Assets. This statement applies to goodwill and intangible assets acquired after June 30, 2001, as well as goodwill and intangible assets previously acquired. Under this statement goodwill as well as certain other intangible assets, determined to have an infinite life, will no longer be amortized; instead these assets will be reviewed for impairment on a periodic basis. This statement is effective for the Company beginning January 1, 2002. The adoption of this standard is not expected to have a material impact on our financial position or results of operations.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 supersedes previous guidelines for financial accounting and reporting for the impairment or disposal of long-lived assets and for segments of a business to be disposed of. The adoption of SFAS No. 144 on January 1, 2002 is not expected to have a material impact on our financial position or results of operations.

Risk Factors

The risks and uncertainties described below are not the only ones facing the company. Additional risks not presently known or that ePHONE currently considers insignificant may also impair ePHONE`s business operations in the future. ePHONE`s business, financial condition and plan of operations could be materially adversely affected by any of the following risks. The trading price of shares of ePHONE`s common stock could decline due to any of these risks.

- The market for ePHONE`s common stock is limited

There is currently only a limited trading market for ePHONE`s common stock. ePHONE common stock trades on the OTC Bulletin Board under the symbol "EPHO," which is a limited market in comparison to the NASDAQ National Market, the American Stock Exchange and other national securities exchanges.

ePHONE cannot assure investors that the common stock will ever qualify for inclusion on the NASDAQ National Market or that more than a limited market will ever develop for the common stock.

- Penny stock rules limit the liquidity of ePHONE`s common stock

ePHONE's common stock may now and in the future be subject to the penny stock rules under the Securities Exchange Act of 1934, as amended (referred to herein as the Exchange Act). These rules regulate broker-dealer practices for transactions in "penny stocks." Penny stocks generally are equity securities with a price of less than \$5.00. The penny stock rules require broker-dealers to deliver a standardized risk disclosure document that provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer must also provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson and monthly account statements showing the market value of each penny stock held in the customer's account. The bid and offer quotations and the broker-dealer and salesperson compensation information must be given to the customer orally or in writing prior to completing the transaction and must be given to the customer in writing before or with the customer's confirmation.

In addition, the penny stock rules require that prior to a transaction, the broker and/or dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. These additional penny stock disclosure requirements are burdensome and may reduce the trading activity in the market for ePHONE's common stock. As long as the common stock is subject to the penny stock rules, holders of such ePHONE common stock may find it more difficult to sell their securities.

- An investment in ePHONE may be diluted

ePHONE may issue a substantial number of shares of ePHONE common stock without investor approval. Any such issuance of ePHONE securities in the future could reduce an investor's ownership percentage and voting rights in ePHONE and further dilute the value of his or her investment.

In 2001 and 2000, ePHONE incurred net losses of approximately \$7,021,129 and \$13,701,000, respectively. ePHONE's ability to achieve and sustain profitable operations depends on many circumstances. If ePHONE does not achieve and sustain profitability, its ability to respond effectively to market conditions, to make capital expenditures and to take advantage of business opportunities could be affected. In addition, ePHONE's prospects must be considered in light of the risks encountered by companies like ours developing products and services in new and rapidly evolving markets. ePHONE's failure to perform in these areas could have a material adverse effect on the business, plan of operations and financial condition.

- ePHONE's failure to acquire, integrate and operate new technology could harm their competitive position

The telecommunications industry is characterized by rapid and significant technological advancements and the related introduction of new products and services. ePHONE does not possess significant intellectual property rights with respect to the technologies we use, and we are dependent on third parties for the development of and access to new technology. The effect of technological changes on ePHONE's business plan cannot be predicted. In addition, it is impossible for ePHONE to predict with any certainty whether demand for VoIP services in the future markets will develop or will prove to be an economical and efficient technology that is capable of attracting customer usage. Failure by ePHONE to obtain and adapt to new technology in the future markets could have a material adverse effect on their business and plan of operations.

- ePHONE does not presently intend to pay dividends on our common stock

ePHONE has never paid dividends on our common stock and does not presently intend to pay cash dividends on our common stock. Any future decisions as to the payment of dividends will be at the discretion of ePHONE's Board of Directors, subject to applicable law. See "Dividend Policy."

- Telecommunications related stock prices have been especially volatile and this volatility may depress ePHONE's stock price

The stock market has from time to time experienced significant price and volume fluctuations which have particularly affected the market prices of the stocks of high technology and Telecommunications-related companies, including companies like ePHONE, and which may be unrelated or disproportionate to the operating

performance of particular companies. Factors such as quarterly variations in actual or anticipated operating results, changes in earnings estimates by analysts, market conditions in the industry, analysts' reports, announcements by competitors, regulatory actions or other events or factors, including the risk factors described in this annual report and general economic conditions may have a significant effect on the market price of ePHONE's common stock. This broad market and industry volatility may reduce the value of ePHONE's common stock, regardless of ePHONE's operating performance. Due to this volatility, the value of ePHONE's common stock could decrease.

- ePHONE's articles of incorporation provide their officers and directors with certain indemnification.

ePHONE's Articles of Incorporation provide that our directors and officers will not be personally liable to ePHONE or its shareholders for money damages for breach of the fiduciary duty of care as a director or officer.

Thus, under certain circumstances, neither ePHONE nor the shareholders would be able to recover damages even if directors take actions that harm ePHONE.

ITEM 7. FINANCIAL STATEMENTS

The information required hereunder in this report is set forth in the "Index to the Financial Statements" on F-1.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

Directors and Executive Officers

The directors and executive officers, their ages and positions held as of March 1, 2002 are listed below. Each director serves until the next annual meeting of the stockholders or unless they resign earlier. The Board of Directors elects officers and their terms of office are at the discretion of the Board of Directors.

<u>Name</u>	<u>Age</u>	<u>Position Held</u>
Robert G. Clarke	57	Chairman of the Board of Directors
Carmine Tagliatela Jr.	54	President and Chief Executive Officer, Director
Charlie Rodriguez	56	Chief Financial Officer and Director
James Meadows	49	Chief Operating Officer
Sonny Souvannavong	34	Chief Technology Officer
John Fraser	54	Director
Sheldon Kamins	54	Director
Larry Codacovi	68	Director

The following describes the business experience during the past five years of ePHONE's Directors and Executive Officers, including for each director, other directorships held in reporting companies.

Robert G. Clarke. On December 12, 2001, Mr. Clarke was reelected as Chairman of the Board of Directors and President and Chief Executive Officer and served in both of those capacities until Carmine Tagliatela Jr. was appointed President and Chief Executive Officer on July 1, 2001. During the last five years, Mr. Clarke

has served as a Director and as President and Chief Executive Officer at various times, including serving as the Chairman of the Board of Directors from August 9, 1999 to a meeting of the Board of Directors on July 21, 2000, and from December 1, 2000 to December 12, 2001. Mr. Clarke also served as the President and Chief Executive Officer from December 1, 2000 to April 1, 2001, March 9, 2000 until April 1, 2000 and from June 3, 1999 to August 8, 1999.

Mr. Clarke has also acted an independent business consultant, assisting high technology start-up companies with public and private financings, business planning, assembling management teams and business opportunity assessments. Mr. Clarke holds a Bachelor of Commerce degree from Memorial University and Master of Business Administration from the University of Western Ontario.

Carmine Tagliatalata, Jr. On April 1, 2001 Mr. Tagliatalata was appointed President and Chief Operating Officer of ePHONE and elected to the Board of Directors. Effective July 1, 2001, Mr. Tagliatalata was appointed Chief Executive Officer of ePHONE. Prior to joining ePHONE Mr. Tagliatalata was President and Chief Operating Officer of TELRON Communications, responsible for the day-to-day operations of the company and the development of service offerings and expansion of services into new markets. Mr. Tagliatalata has also held executive Vice President positions at TELRON and CompassRose International Inc. At CompassRose he managed a team of professionals on a variety of client assignments requiring extensive international telecommunications experience and expertise in strategic business development, public policy and regulatory matters. Mr. Tagliatalata has secured, on behalf of clients, service authorizations in off shore markets and advised senior management on courses of action for the development of their telecommunications business. Between 1989-1997 he was Director International Public Policy and Regulatory Affairs at MCI Telecommunications Corporation where he developed and implemented MCI's regulatory and business strategy for access to international markets and was a member of an expansion team devoted to expanding MCI's presence in the global market. Mr. Tagliatalata holds a BA Economics from Hunter College, City University of New York and a MBA Finance/Marketing from Fordham University.

Charlie Rodriguez. On December 1, 2000, Mr. Rodriguez was elected as a Director and appointed as Chief Financial Officer and Vice President - Corporate Affairs. Mr. Rodriguez previously served as Vice-President of Corporate Affairs and Corporate Secretary from June 1999 to April 2000. Mr. Rodriguez is also the President of Management Services of Arizona, a business consulting company specializing in mergers, acquisitions and financing. Prior to joining ePHONE, Mr. Rodriguez served as the Chief Financial Officer for Zephyr Technologies, Inc., biometrics and smartcard software integration companies. Mr. Rodriguez was a member of the board of directors of Wave Rider Communications, Inc. (WAYC - otc.bb), a wireless communication company, from January to November 1997, and served as its President and Chief Executive Officer from May 1995 to January 1997. Mr. Rodriguez holds a Bachelor of Science in Accounting and Masters in Business Administration Accounting from the University of Arizona.

James Meadows. James R. Meadows, Jr. was appointed Chief Operating Officer & Executive Vice President on February 1, 2002. Prior to joining ePHONE, Mr. Meadows served as President of PrimeTec International, Inc. from September 1999 to June 2000 where he previously was the Executive Vice President since February 1997. From September 1989 to February 1997 Mr. Meadows was the former Director of Government Affairs, Capital Network System, Inc. Currently, Mr. Meadows is a member of the Board of Directors for Versatel Telecom (VSVA – NASDAQ), a facilities based integrated telecommunications company in the Netherlands and a member of the Advisory Board of Ashely Laurent, of Austin, TX, an integrated network security software company. Historically, Mr. Meadows served as a Board Member of Comptel, the largest competitive telecommunications trade association in the USA, and was the former President and Board Member of America's Carriers Telecommunications Association.

Sonny Souvannavong. Sonny Souvannavong was hired as Chief Technology Officer on April 16, 2001. Prior to joining ePHONE, Mr. Souvannavong was the Vice President of Technology for Ecom from January 2000 to April 2001. Mr. Souvannavong also served as the Director of Information Services for Facilicom International from October 1997 to January 2000. From February 1995 to October 1997, Mr. Souvannavong was the Division Director of Information Technology for Birch & Davis Associates. Mr. Souvannavong also was a Professor of Computer Information Systems and Networking at the Strayer University in Washington,

D.C. from January 2000 to December 2000. Mr. Souvannavong holds a Bachelor of Science in Marketing from Virginia Commonwealth University in Richmond Virginia and a MBA from Strayer University in Washington DC and is certified in Microsoft, Cisco, Novell, and Sun Systems.

John G. Fraser. Mr. Fraser has been a director of ePHONE since June 1999. Prior to joining ePHONE, Mr. Fraser was Vice-Chairman of KPMG Canada, Chartered Accountants. Mr. Fraser held various positions within KPMG Canada from November 1976 until February 1998. Mr. Fraser has a Masters in Business Administration from University of Pittsburgh and a Bachelor of Commerce and Administration from Victoria University, Wellington, New Zealand.

Sheldon Kamins. Mr. Kamins was appointed as a member of the Board of Directors on October 11, 2001. Mr. Kamins has been a real estate developer in the greater metropolitan Washington, D.C. area and a venture capitalist assisting technology and other companies with public and private financing. Mr. Kamins holds a Juris Doctor degree from the Georgetown University Law Center.

Larry M. Codacovi. Mr. Codacovi was appointed as a member of the Board of Directors on January 1, 2002. Prior to joining ePHONE, Mr. Codacovi was Chairman of Pangea Ltd., a pan-European fiber optic network spanning northern Europe from 1999 to 2002. From 1988 to 1999, Mr. Codacovi served as Senior Vice President International Services for MCI WorldCom with the responsibility for expanding MCI's global reach. Mr. Codacovi previously served as Executive Vice President and a Board Member with RCA Global Communications. From 1980 to 1988, Mr. Codacovi continued in that position under the GE acquisition of RCA.

Other Matters

On April 1, 2001 ePHONE accepted the resignation from former board member Fariborz Ghadar. On August 27, 2001, ePHONE accepted resignations from former board members Anthony Balingier and Walter Pickering.

Roy Olmsted, ePHONE's former Executive Vice President and General Manager, resigned effective December 31, 2001.

B. Compliance with Section 16(a) of the Exchange Act

Section 16(a) of the Securities Exchange Act of 1934, as amended (the "1934 Act") requires officers and directors of a company with securities registered pursuant to Section 12 of the 1934 Act, and persons who own more than 10% of the registered class of such company's equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission (the "SEC"). Officers, directors and greater than 10% stockholders are required by SEC regulation to furnish the subject company with copies of all Section 16(a) forms filed. Not all reports required to be filed under Section 16 have been filed.

ITEM 10. EXECUTIVE COMPENSATION

Name and Principal Position at Fiscal Year End	Year	Annual Compensation			Long Term Compensation	
		Salary (\$)	Bonus (\$)	Other Annual Compensation (\$)	Awards Options (Shares)	All Other Compensation (\$)
Robert Clarke Chairman of the Board of Directors and former Chief Executive Officer	2001	(1)--	--	--	(1)1,350,000	--
	2000	(1)--	--	--	1,000,000	--
	1999	(1)--	--	--	--	--
Carmine Tagliatela President and Chief Executive Officer	2001	(2)185,000	50,000	--	(2)1,600,000	--
Charlie Rodriguez Chief Financial Officer	2001	(3)137,000	--	--	(3)1,350,000	--
	2000	(3)19,000	--	--	--	--
	1999	--	--	--	250,000	--
Roy Olmsted Former Executive Officer and General Manager	2001	141,000	--	--	(4)333,333	--
Sonny Souvannavong Chief Technology Officer	2001	(5)87,000	--	--	275,000	--

- (1) Mr. Clarke served as Chief Executive Officer and President at various times during 2001, 2000 and 1999. While serving as an executive officer, Mr. Clarke received no cash compensation. However, a company in which he has a controlling interest, received consulting payments totaling \$25,000, \$68,000 and \$48,000 in 2001, 2000 and 1999, respectively. Included in the total options awarded to Mr. Clarke during 2001 are 1,000,000 stock options that were originally granted to Mr. Clarke in 2000. The exercise price of these stock options was reduced from \$0.50 to \$0.35 in September 2001. Due to the repricing, the options are being characterized as an additional 2001 grant for purposes of this presentation.
- (2) Mr. Carmine Tagliatela was appointed President and Chief Operating Officer and began employment with ePHONE on April 1, 2001. Mr. Tagliatela was appointed Chief Executive Officer on July 1, 2002. The amounts paid to Mr. Tagliatela from April through December are based on an annual salary of \$200,000. Of the total stock options issued to Mr. Tagliatela, 600,000 were issued in April 2001 with an exercise price of \$0.50 and were subsequently repriced to \$0.35.
- (3) Mr. Charlie Rodriguez began as ePHONE's Chief Financial Officer in December 2000. The amounts paid to Mr. Rodriguez are based on an annual salary of \$145,000. In 2000, ePHONE paid \$36,000 in consulting payments to a Company controlled by Mr. Rodriguez prior to his employment with ePHONE. Included in the total options awarded to Mr. Rodriguez during 2001 are 250,000 stock options that were originally granted in 1999 in consideration for consulting services rendered to the Company. The exercise price of these options was reduced in the current year from \$0.50 to \$0.35.

- (4) Mr. Olmsted ceased employment with the Company effective December 31, 2001. During December 2001, ePHONE extended the expiration date of Mr. Olmsted's stock options, which have an exercise price of \$0.50, from March 31, 2001 to October 1, 2001.
- (5) Mr. Souvannavong began as ePHONE's Chief Technology Officer during April 2001. The amounts paid to Mr. Souvannavong are based on an annual salary of \$125,000.

Option Grants for Fiscal 2001

The following table sets forth as to each of the named Executive Officers information with respect to option grants during the last fiscal year.

Name	Number of Securities Underlying Options/SARs Granted (#)	% of Total Options/SARs Granted to Employees in Fiscal Year	Exercise or Base Price (\$/Sh)	Expiration Date
Robert Clarke	(1)1,000,000	(1)10.90%	0.35	6/30/02
Robert Clark	350,000	3.81%	0.35	2/14/11
Carmine Tagliatela Jr.	1,600,000	17.45%	0.35	4/1/11 – 12/17/11
Charlie Rodriguez	(1)250,000	(1)2.72%	0.35	6/30/02
Charlie Rodriguez	1,100,000	11.99%	0.35	2/14/11 – 12/17/11
Roy Olmsted	333,333	3.63%	0.50	10/1/02
Sonny Souvannavong	275,000	2.99%	0.50	5/16/11

- (1) These options were repriced as previously described. For purposes of this presentation, the percentage of total options issued to each executive officer is based on the proportion that the number of options granted to each executive bears to the total number of options granted to all employees during the fiscal year plus the sum of all repriced options or 9,168,693 (5,268,693 options granted to all employees plus 3,900,000 repriced options).

Option Exercises and Values for Fiscal 2001

The following table sets forth as to each of the named Executive Officers information with respect to option exercises during Fiscal 2001 and the status of their options on December 31, 2001.

Name	Number of Securities Underlying Unexercised Options at Fiscal Year End		Value of Unexercised In-The-Money Options at Fiscal Year End (\$)	
	Exercisable	Unexercisable	Exercisable	Unexercisable
Robert Clarke	1,350,000	--	--	--
Carmine Tagliatela	1,240,000	360,000	--	--
Charlie Rodriguez	1,350,000	--	--	--
Roy Olmsted	333,333	--	--	--
Sonny Sovannavong	75,000	200,000	--	--

Compensation of Directors

Non-employee directors received no cash compensation during 2001 and were paid \$8,000 in 2000. With the exception of Mr. Fraser who received 350,000 stock options with an exercise price of \$0.35, directors received 50,000 stock options with an exercise price of \$0.35 during 2001. Directors are reimbursed for expenses they incur in attending meetings at the board or any board committee.

In addition to making the consulting payments to a companies controlled by Mr. Clarke and Mr. Rodriquez as mentioned above, ePHONE made consulting payments of \$43,000 and \$36,000 to a company controlled by Mr. John Fraser during 2001 and 2000, respectively.

Employment Agreements

At December 31, 2000, ePHONE was not party to employment agreements with any of its officers or employees.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following tables set forth information, as of December 31, 2001, with respect to the beneficial owners of our common stock for:

- each person or group of persons, who we know beneficially own more than 5% of any class of our outstanding stock;
- each of our executive officers named in the Summary Compensation Table;
- each of our directors; and
- all executive officers and directors as a group.

In general, under the SEC's rules, a person is deemed to be a "beneficial owner" of a security if that person has or shares the power to vote or direct the voting of such security or has the power to dispose or direct the disposition of such security. A person is also deemed to be the beneficial owner of any securities of which the person has the right to acquire beneficial ownership within 60 days.

Name and Address of Holder	Shares of common stock beneficially owned	Percent of outstanding shares of common stock beneficially owned
Robert Clarke C-2, Bayview Court 49 Mount Davis Road Hong Kong Chairman of the Board	1,416,668(1)	4.12%
Carmine Tagliatela 10430 Deerfoot Drive Great Falls, VA 22060 President and Chief Executive Officer	1,240,000(2)	3.62%
Charlie Rodriguez 1662 W. Petunia Place Tucson, Arizona 85737 Director, Chief Financial Officer	1,350,000(2)	3.93%
John Fraser 104 Elm Avenue Toronto, Ontario M4W 1P2 Director	666,668(3)	1.98%
Sonny Souvannavong 2230 George C. Marshall Drive, #1001 Falls Church, Virginia 22043 Chief Technology Officer	75,000(2)	0.23%
Roy Olmsted 13 Plainsman Road Mississauga, Ontario L5N 1C4 Former Chief Operation Officer	333,333(2)	1.00%
Executive Officers and Directors as a Group of 6	5,081,669	13.37%
Desjardins Securities Inc. 2 Complex Desjardins E Tower Montreal, Quebec H5B1J	1,740,248	5.28%
Brouillette Charpentier 1100 Rene-Levesque Blvd. West Montreal, Quebec H3B 5C9	2,773,295(4)	8.05%
Kinked Investments 625 Rene Levesque Blvd., Suite 205 Montreal, Quebec H3B 1R2	2,175,520(5)	6.19%

- (1) Includes 33,334 shares of common stock, warrants to acquire 33,334 shares of common stock, and options to acquire 1,350,000 shares of common stock.
- (2) Consists of options to acquire shares of common stock.
- (3) Includes 33,334 shares of common stock, warrants to acquire 33,334 shares of common stock, and options to acquire 600,000 shares of common stock.
- (4) Consists of 1,329,545 shares of common stock and 1,443,750 warrants to purchase shares of common stock.
- (5) Consists of warrants to purchase shares of common stock.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

For the years ended 2001, 2000 and 1999, ePHONE paid \$25,000, \$68,000 and \$48,000, respectively, for management services provided by a company in which Chairman of the Board of Directors Robert Clarke has a controlling interest. During 2000, \$56,000 of sales was made to a company in which Mr. Clarke has an interest.

As described under Executive Compensation, ePHONE made consulting payments to companies controlled by Mr. Fraser and Mr. Rodriguez. The payments to Mr. Rodriguez were made in 2000 before his employment with the Company as Chief Financial Officer.

During 2001, we paid \$100,000 as provided for in a Service and Development Agreement with 7bridge Systems, LTD. Mr. Clarke, John Fraser and Charlie Rodriguez have an interest in 7Bridge Capital Limited which owns 7Bridge Systems, LTD.

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

The following documents are filed as part of this Form 10-KSB:

A. Exhibits

Exhibit No.	Description
3.1.....	Articles of Incorporation (1)
3.2.....	Amendment to Articles of Incorporation (1)
3.3.....	Bylaws (1)
3.4.....	Amended and Restated Articles of Incorporation (2)
10.1.....	Specimen of form of Option Incentive Agreement (1)
10.2.....	Agency Agreement dated as of March 16, 2000 between ePHONE and Groome Capital.com, Inc. (3)
10.3.....	ePHONE Telecom, Inc. 2000 Long-Term Incentive Plan (4)
10.4.....	Employment Agreement with James Meadows, Chief Operating Officer (filed herewith)
10.5.....	Employment Agreement with Carmine Tagliatela, President and Chief Executive officer (filed herewith)
24.....	Powers of Attorney (filed herewith)
99.1.....	Settlement Agreement and Mutual General Release between Charlie Yang and ePHONE Telecom, Inc., dated March 23, 2001 (5)
99.2.....	Modification to Settlement Agreement and Mutual General Release between Charlie Yang and ePHONE Telecom, Inc., dated March 23, 2001 (filed herewith)
99.3.....	Press release, dated April 3, 2001, issued in connection with appointment of Carmine Tagliatela Jr. as President and Chief Operating Officer. (6)

(1) Previously filed as an exhibit to ePHONE's Form 10-SB, filed with the Securities and Exchange Commission on October 15, 1999.

(2) Previously filed as an exhibit to Amendment No. 2 to ePHONE's Form 10-SB, filed with the Securities and Exchange Commission on January 5, 2000.

(3) Previously filed as an exhibit to Amendment No. 5 to ePHONE's Form 10-SB, filed with the Securities Exchange Commission on June 5, 2000.

(4) Previously filed as an exhibit to ePHONE's form SB-2 filed with the Securities and Exchange Commission.

(5) Previously filed as an exhibit to ePHONE's form 8-K, filed with the Securities and Exchange Commission on April 16, 2001.

(6) Previously filed as an exhibit to ePHONE's form 8-K, filed with the Securities and Exchange Commission on April 13, 2001.

B. Reports on Form 8-K:

On April 13, 2001, ePHONE filed with the Commission a current report on 8-K related to the Settlement Agreement entered into by and between Mr. Charles Yang and ePHONE Telecom, Inc., dated March 23, 2001.

On April 16, 2001, ePHONE filed with the Commission a current report on 8-K related to the appointment of Carmine Tagliatela Jr. as President and Chief Executive Officer.

SIGNATURE PAGE

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized.

ePHONE Telecom, Inc.
(Registrant)

By /s/ Carmine Tagliatela, Jr.
(Carmine Tagliatela, Jr., CEO)

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Date</u>
<u>By /s/ Carmine Tagliatela, Jr.</u> (Carmine Tagliatela, Jr., CEO, Director) (Principal Executive Officer)	April 12, 2002
<u>By /s/ Charlie Rodriguez</u> (Charlie Rodriguez, Chief Financial Officer) (Principal Financial and Accounting Officer)	April 12, 2002
<u>By /s/ Robert G. Clarke*</u> (Robert G. Clarke, Chairman)	April 12, 2002
<u>By /s/ John Fraser*</u> (John Fraser, Director)	April 12, 2002
<u>By /s/ Shelly Kamins*</u> (Shelly Kamins, Director)	April 12, 2002
<u>By /s/ Larry Codacovi*</u> (Larry Codacovi, Director)	April 12, 2002

*By: Charlie Rodriguez
Attorney-In-Fact

Index to Financial Statements	Page
Report of Independent Certified Public Accountants	F-2
Balance Sheets as of December 31, 2001 and 2000	F-3
Statements of Operations for the Two Years Ended December 31, 2001 and 2000.....	F-4
Statements of Stockholders' (Deficit) Equity and Comprehensive Income (Loss) for the Years Ended December 31, 2001 and 2000	F-5
Statements of Cash Flows for the Years Ended December 31, 2001 and 2000.....	F-6
Notes to Financial Statements	F-7 – F-19

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors and
Stockholders of ePHONE Telecom, Inc.

We have audited the accompanying balance sheets of ePHONE Telecom, Inc. as of December 31, 2001 and 2000, and the related statements of operations, stockholders' equity (deficit) and comprehensive income (loss), and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 financial position of ePHONE Telecom, Inc. as of December 31, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Grant Thornton LLP

Vienna, Virginia
February 15, 2002 (except for notes 2 and 13 as to which the date is April 11, 2002)

ePHONE Telecom, Inc.

Balance Sheets

	December 31,	
	2001	2000
Current Assets:		
Cash and cash equivalents	\$ 35,970	\$ 1,525,978
Investment in marketable securities	—	2,170,908
Restricted cash	—	579,435
Accounts receivable, net of allowance for returns of \$116,405 at December 31, 2001	155,759	39,200
Inventory	16,500	553,218
Other receivables	65,481	18,893
Total Current Assets	<u>273,710</u>	<u>4,887,632</u>
Property and equipment, net	1,296,561	999,902
Array Telecom Lease, net	—	1,663,942
Other Assets	18,043	287,543
Total Assets	<u>\$ 1,588,314</u>	<u>\$ 7,839,019</u>
Liabilities and Stockholders' (Deficit) Equity:		
Current Liabilities:		
Accounts payable	\$ 850,179	\$ 309,258
Accrued liabilities	654,765	1,169,244
Deferred revenue	367,009	—
Capital lease obligation, current portion	22,663	—
Customer advances	—	25,853
Total Current Liabilities	<u>1,894,616</u>	<u>1,504,355</u>
Deferred royalty obligation	—	410,000
Capital lease obligation, net of current portion	15,839	—
Other long term obligation, net of current portion	142,500	—
Commitments and Contingencies	—	—
Stockholders' (Deficit) Equity:		
Common stock, par value \$0.001:		
150,000,000 shares authorized, 32,987,381 and 17,453,848 issued and outstanding at December 31, 2001 and 2000, respectively.	32,987	17,454
Additional paid-in capital	21,843,199	21,204,687
Accumulated other comprehensive income	—	22,221
Accumulated deficit	<u>(22,340,827)</u>	<u>(15,319,698)</u>
Total Stockholders' (Deficit) Equity	<u>(464,641)</u>	<u>5,924,664</u>
Total Liabilities and Stockholders' (Deficit) Equity	<u>\$ 1,588,314</u>	<u>\$ 7,839,019</u>

See accompanying notes to financial statements

cPHONE Telecom, Inc.

Statements of Operations

	Years ended December 31,	
	2001	2000
Service revenue	\$ 3,077,050	\$ —
Product revenue	<u>512,790</u>	<u>589,823</u>
Total revenues	3,589,840	589,823
Operating expenses		
Cost of service revenue	2,025,207	—
Cost of product revenue	475,826	411,550
Sales and marketing	1,212,026	1,852,970
General and administrative	5,484,191	4,786,660
Non-cash compensation	348,760	7,433,445
Write off of Array Telecom license and disposal of obsolete inventory and equipment, net	<u>1,188,383</u>	<u>—</u>
Total operating expenses	<u>10,734,393</u>	<u>14,484,625</u>
Loss from operations	(7,144,553)	(13,894,802)
Interest and other (income), net	<u>(123,424)</u>	<u>(193,702)</u>
Net loss	<u>\$ (7,021,129)</u>	<u>\$ (13,701,100)</u>
Loss per share—(basic and diluted)	<u>\$ (0.28)</u>	<u>\$ (0.94)</u>
Weighted average number of common shares outstanding	<u>24,910,425</u>	<u>14,573,105</u>

See accompanying notes to financial statements

EPHONE Telecom, Inc.

Statements of Stockholders' Equity (Deficit) and Other Comprehensive Income (Loss)

	Common Shares		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
	Shares	Amount				
Balance,						
December 31, 1999	13,170,667	\$ 13,171	\$ 1,375,954	\$ —	\$ (1,618,598)	(229,473)
Common stock issued for cash	179,333	179	134,321	—	—	134,500
Exercise of stock purchase warrants	92,400	92	115,408	—	—	115,500
Sale of special warrants for cash, net	—	—	12,149,571	—	—	12,149,571
Stock and warrants issued in exchange for services	4,011,448	4,012	4,565,267	—	—	4,569,279
Employee stock options	—	—	2,864,166	—	—	2,864,166
Net loss	—	—	—	—	(13,701,100)	(13,701,100)
Change in unrealized gain	—	—	—	22,221	—	22,221
Total comprehensive loss	—	—	—	—	—	(13,678,879)
Balance,						
December 31, 2000	17,453,848	17,454	21,204,687	22,221	(15,319,698)	5,924,664
Stock options issued in exchange for services	—	—	90,545	—	—	90,545
Common stock issued in legal settlement	500,000	500	109,500	—	—	110,000
Common stock issued in exchange for services	748,973	749	147,466	—	—	148,215
Proceeds from issuance of common stock	848,243	848	304,437	—	—	305,285
Conversion of Special Warrants	13,436,317	13,436	(13,436)	—	—	—
Net Loss	—	—	—	—	(7,021,129)	(7,021,129)
Change in unrealized gain	—	—	—	(22,221)	—	(22,221)
Total comprehensive loss	—	—	—	—	—	(7,043,350)
Balance,						
December 31, 2001	<u>32,987,381</u>	<u>\$ 32,987</u>	<u>\$ 21,843,199</u>	<u>\$ —</u>	<u>\$ (22,340,827)</u>	<u>(464,641)</u>

See accompanying notes to financial statements

ePHONE Telecom, Inc.

Statements of Cash Flows

	Years ended December 31,	
	2001	2000
Cash Flows from Operating Activities:		
Net loss	\$ (7,021,129)	\$ (13,701,100)
Adjustments to reconcile net loss to net cash flows from operating activities:		
Depreciation and amortization	785,575	665,195
Stock issued for services rendered	258,215	4,569,279
Stock option benefits charged to operations	90,545	2,864,166
Allowance for sales returns	116,405	—
Deferred royalty expense	193,334	410,000
Realized gain	(45,470)	—
Inventory reserve	108,900	—
Write down of investment in ePHONE Technologies, Inc.	184,000	—
Write off of Array Telecom license and the disposal of obsolete inventory and equipment	1,188,383	—
Changes in operating assets and liabilities:		
Accounts receivable and other receivables	(135,661)	(58,093)
Inventory	78,175	(553,218)
Other assets	85,500	166,657
Accounts payable	540,921	26,360
Accrued liabilities	(371,979)	837,244
Deferred revenue	223,118	—
Due to related parties	—	(91,995)
Customer deposits	(25,853)	25,853
Net Cash Flows Used in Operating Activities	<u>(3,747,021)</u>	<u>(4,839,652)</u>
Cash flows from investing activities:		
Purchase of fixed assets	(813,857)	(999,977)
Purchase of Array Telecom license	—	(2,218,589)
Purchase of investments	—	(2,798,687)
Redemption of marketable securities	2,194,157	650,000
Deposit to restricted cash, net	579,435	(579,435)
Investment in ePHONE Technologies, Inc.	—	(170,000)
Net cash flows provided by (used in) investing activities	<u>1,959,735</u>	<u>(6,116,688)</u>
Cash flows provided by financing activities:		
Proceeds from issuance of common stock	305,285	250,000
Proceeds from issuance of special warrants, net	—	12,149,571
Repayments on capital lease	(8,007)	—
Net cash flows provided by financing activities	<u>297,278</u>	<u>12,399,571</u>
Net (decrease) increase in cash and cash equivalents	(1,490,008)	1,443,231
Cash and cash equivalents, beginning of year	<u>1,525,978</u>	<u>82,747</u>
Cash and cash equivalents, end of year	<u>\$ 35,970</u>	<u>\$ 1,525,978</u>

See accompanying notes to financial statements

NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

ePHONE Telecom, Inc. ("ePHONE") was incorporated in 1996 under the laws of the State of Florida, and is traded on the OTC Electronic Bulletin Board operated by the National Association of Securities Dealers, Inc. under the trading symbol "EPHO". We were a development stage company, as defined in Statement of Financial Accounting Standard No. 7 until we began generating revenues from our principal business activities during August 2001.

We provide telecommunication services to retail and wholesale customers. Our vision is to become a global telecommunications carrier providing a full complement of telecommunications services, including phone-to-phone one-step dialing, using Voice over Internet Protocol ("VoIP") technology. Using a call origination approach that involves its own Customer Premise Equipment ("CPE"), and a combination of its own dedicated Internet Protocol ("IP") network, the public Internet and the public switched telephone network ("PSTN"), we plan to develop the capacity to provide voice and fax transmission and other telephony features at high quality and low cost.

USE OF ESTIMATES

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

CASH AND CASH EQUIVALENTS

We consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

SUPPLEMENTAL CASH FLOW INFORMATION AND NON CASH INVESTING AND FINANCING ACTIVITIES

For the years ended December 31, 2001 and 2000, we paid no income taxes or interest. During the year ended December 31, 2001, we entered into capital lease obligations totaling \$46,509.

INVENTORY

Inventory consists primarily of component parts held for resale and is stated at the lower of cost, utilizing the weighted average method, or market.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets, generally 5 to 7 years. Routine repairs and maintenance are expensed as incurred.

INVESTMENTS IN MARKETABLE SECURITIES

We classify marketable securities as available for sale. The securities consist of debt securities, which are stated at fair value, with net unrealized gains or losses on the securities recorded as accumulated other comprehensive income (loss) in stockholders' equity. Realized gains and losses are included in earnings and are derived using the specific identification method for determining the cost of the securities. Realized gains were \$45,470 in 2001. There were no realized gains in 2000.

INVESTMENT IN EPHONE TECHNOLOGIES, INC.

Our investment in 20% of the outstanding common stock of ePHONE Technologies, Inc. (ePHONE Tech) is accounted for using the cost method. We do not exercise significant influence over ePHONE Tech's operating or financial activities.

IMPAIRMENT OF LONG-LIVED ASSETS

We review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to the expected future net cash flows generated by the assets. If the assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. During the years ended December 31, 2001 and 2000, our analyses indicated that there was an impairment of long lived assets associated with the Array Telecom License, as described in Note 6, and our investment in ePHONE Tech, as described in Note 7.

REVENUE RECOGNITION

We recognize telecommunication services revenues over the period services are provided. Monthly recurring telecommunications services are billed in advance. Any portion of our services that is billed for which we have not yet provided services is recorded as deferred revenue.

Product sales are recognized upon shipment. Typical terms of sale do not provide the customer with the right of return except for defective products, which are covered by the warranty of the original equipment manufacturer. The Company also generated revenues from product licenses and services. Product license revenues were generally recognized upon product shipment provided that no significant post-delivery obligations existed and payment was due within one year. Advance payments of product licenses and services were reported as unearned revenue until all conditions for revenue recognition are met. The majority of our customers prepay for their services. We establish an allowance for doubtful accounts based upon factors, which include historical trends and other information.

STOCK-BASED COMPENSATION

We account for stock-based employee compensation arrangements in accordance with provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations, and comply with the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation". Under APB No. 25, compensation expense is based on the difference, if any, on the date of the grant, between the fair value of the our common stock and the exercise price.

We account for non-employee stock-based awards in which services are the consideration received for the equity instruments issued based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measured. We determined the value of stock grants made to both employees and non-employees based on the quoted market price of our common stock on the date of grant. We determine the fair value of warrants and options we granted to non-employees using the Black-Scholes option pricing model.

Deferred income taxes result primarily from temporary differences between financial and income tax reporting. Deferred tax assets and liabilities are determined based on the differences between the financial statement bases and tax bases of assets and liabilities using enacted tax rates. A valuation allowance is recorded to reduce the deferred tax asset to that portion that is expected to more likely than not be realized.

NET LOSS PER SHARE

We report basic and diluted loss per share. Basic loss per share is computed by dividing net loss by the weighted average number of outstanding shares of common stock. Diluted earnings per share is computed by dividing net loss by the weighted average number of shares adjusted for the potential dilution that could occur if stock options, warrants and other convertible securities were exercised or converted into common stock.

For the years ended December 31, 2001 and 2000, options and warrants to purchase 24,661,540 and 9,654,377 shares of common stock, respectively, were outstanding but were not included in the computation of diluted earnings per share because the effect would have been anti-dilutive.

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, Business Combinations. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. This statement is effective for all business combinations initiated after June 30, 2001.

In July 2001, the FASB issued SFAS No. 142, Goodwill And Other Intangible Assets. This statement applies to goodwill and intangible assets acquired after June 30, 2001, as well as goodwill and intangible assets previously acquired. Under this statement goodwill as well as certain other intangible assets, determined to have an infinite life, will no longer be amortized; instead these assets will be reviewed for impairment on a periodic basis. This statement is effective for the Company beginning January 1, 2002. The adoption of this standard is not expected to have a material impact on our financial position or results of operations.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 supersedes previous guidelines for financial accounting and reporting for the impairment or disposal of long-lived assets and for segments of a business to be disposed of. The adoption of SFAS No. 144 on January 1, 2002 is not expected to have a material impact on our financial position or results of operations.

RECLASSIFICATIONS

Certain 2000 balances and disclosures have been reclassified to conform to the 2001 presentation.

NOTE 2 – OPERATIONS

As shown in the accompanying financial statements, we have incurred operating losses since our inception, and have accumulated a deficit of \$22,341,000 at December 31, 2001. Our continued existence is dependent upon our ability to develop profitable operations, continue to successfully introduce our products to market and if necessary, obtain additional financing to fund future operations. As described in Note 13, in March 2002, existing investors in the Company exercised outstanding warrants, purchasing 3,448,913 shares of the Company's common stock for \$690,000.

Management believes that together with our cash on hand, proceeds from the warrants exercised in 2002, and cash flow from our planned level of 2002 operations that we have sufficient resources to enable us to sustain our current and planned level of operations for at least the next 12 months without the need for additional investment capital.

During the three months ended March 31, 2002, we received cash payments from customers totaling \$4,063,000. At March 31, 2002 we had a working capital surplus of \$570,000 including subscription receivables from the exercise of warrants of \$388,000 as described in Note 13.

NOTE 3 - RELATED PARTY TRANSACTIONS

During the year ended December 31, 2001 and 2000 we incurred costs for management services provided by companies in which certain directors of ours have a controlling interest and incurred consulting fees to certain directors of ours totaling \$74,000 and \$110,000, respectively.

During the year ended December 31, 2001, we paid \$248,000 to ePHONE Technologies, Inc., a company we hold a 20% equity interest in, for consulting services. We also paid \$25,000 in consulting fees to one of our officers, and paid \$100,000 as provided for in a Service and Deployment Agreement with 7bridge Systems, LTD, a related party, a company in which our Chairman of the Board and Chief Financial Officer have an interest in.

NOTE 4 - MARKETABLE INVESTMENTS

Our available for sale investments consisted of debt instruments issued by federal and state government agencies. During the year ended December 31, 2001, we redeemed the remaining \$2,194,000 of available-for-sale debt securities. During the year ended December 31, 2000, we redeemed \$650,000 of available for sale debt securities. Contractual maturities were as follows at December 31, 2000:

December 31, 2000	Cost	Market Value	Unrealized Gain (Loss)
Mature within one year.....	\$1,557,131	\$1,588,929	\$ 31,798
Mature within one to five years.....	<u>591,556</u>	<u>581,979</u>	<u>(9,577)</u>
Total available-for-sale securities.....	<u>\$2,148,687</u>	<u>\$2,170,908</u>	<u>\$ 22,221</u>

NOTE 5 - PROPERTY AND EQUIPMENT AND CAPITAL LEASE OBLIGATION

At December 31, 2001 and 2000, property and equipment consisted of the following:

	December 31, 2001	December 31, 2000
Computer equipment	\$ 198,785	\$ 119,739
Furniture and fixtures	340,986	535,143
Telecommunications equipment	322,303	106,863
Other equipment	<u>711,022</u>	<u>380,777</u>
	1,573,096	1,142,522
Less: accumulated depreciation	<u>(276,535)</u>	<u>(142,620)</u>
Property and equipment, net	<u>\$1,296,561</u>	<u>\$ 999,902</u>

Property and equipment includes a capitalized lease asset and accumulated depreciation on the capitalized lease asset of \$46,509 and \$7,306, respectively, at December 31, 2001. There were no capitalized lease assets as of December 31, 2000. Payments for the capital lease obligation by fiscal year are as follows:

Year ending December 31,

2002.....	\$ 29,295
2003.....	<u>17,089</u>
Total gross payments.....	46,393
Less amount representing interest.....	<u>(7,891)</u>
	38,502
Less current portion.....	<u>(22,663)</u>
Long-term portion of capitalized lease obligation	<u>\$ 15,839</u>

Depreciation expense (including depreciation on the capitalized lease asset during 2001) was \$230,928 and \$110,548 for the years ended December 31, 2001 and 2000, respectively.

NOTE 6 - ARRAY TELECOM LICENSE AND DEFERRED ROYALTY OBLIGATION

In March 2000, we entered into a Strategic Alliance Agreement and a License Agreement with Comdial Corporation ("Comdial") and Array Telecom Corporation ("Array Telecom"), a wholly owned subsidiary of Comdial. In connection with the Agreement and the License, we made an initial payment to Comdial of \$2.65 million and received the fixed assets of Array Telecom, assumed the lease of Array Telecom's Herndon, Virginia facility and an exclusive license for all Voice over Internet Protocol (VoIP) technology that had been developed by Array Telecom for a period of five years. The License Agreement required that we pay additional minimum royalty fees of \$2,180,000 for the VoIP technology over a five-year period.

During the fourth quarter of 2000, we determined that due to the rapidly changing technology in the VOIP industry, a shorter amortization life for the License Agreement was appropriate and shortened the expected life to three years. The shortened life gave rise to a deferred royalty obligation representing the difference between the straight-line expense over the shortened three-year life of the License Agreement and the actual royalty payments which were scheduled to be made over a five-year period.

During the third quarter of 2001, we filed for arbitration against Comdial as further described in Note 10. We had made royalty payments of \$90,000 and had remaining future minimum royalty payments of \$2,090,000 at the time of the License Agreement termination. We have accrued royalty fees of \$225,000, which represents the unpaid royalty fees up to the License Agreement termination date. Since Comdial has terminated the License Agreement, we have reversed the previously recorded deferred royalty obligation of \$603,000 (\$410,000 at December 31, 2000) during the year ended December 31, 2001. We have also decided to discontinue use of the Array Telecom technology and therefore, have written off the remaining balance of the Array Telecom License of \$1,109,295 at December 31, 2001. We have presented the net effect of the write off of the Array License and the reversal of the deferred royalty obligation along with a write-off of other Array Telecom technology assets in the statement of operations.

NOTE 7 – TRANSACTION WITH AND INVESTMENT IN EPHONE TECHNOLOGIES, INC.

On December 1, 2000, in connection with the termination of certain executive officers of our Company, we entered into a Support and Development Agreement with ePHONE Technologies, Inc (ePHONE Tech), a company formed by the terminated executive officers in December 2000. Under this Agreement, ePHONE Tech provided us with Internet telephony technology support and development services at an hourly rate plus reimbursements for certain support services, as defined in the agreement. The term of the agreement was one year and included renewal options for consecutive one-year terms, which we have elected not to exercise.

As provided for in the agreement, we purchased a 20% equity interest in ePHONE Tech. Since the agreement contained a provision, allowing ePHONE Tech to repurchase our equity interest for \$185,000 at any time prior to the third anniversary of the agreement, we recorded the equity investment in ePHONE Tech at \$185,000. The remaining portion of the \$880,000 (which consisted of \$865,000 in cash and \$15,000 in equipment) or \$695,000, we incurred in connection with the termination of these executive officers was included in general and administrative expense for the year ended December 31, 2000.

At December 31, 2001, we recognized an impairment write-down of substantially all of the remaining carrying value of this investment. The write-down totaled \$184,000 and is recorded as general and administrative expense in the Statement of Operations at December 31, 2001. The remaining carrying value of this investment is \$1,000 and is recorded as a non-current other asset at December 31, 2001.

NOTE 8 - ACCRUED LIABILITIES AND LONG TERM OBLIGATION

Accrued expenses consist of the following:

	December 31,	
	2001	2000
Accrued vacation.....	\$ 32,411	\$ 15,412
Accrued compensation.....	35,443	--
Redeemable special warrants.....	--	579,435
Accrued legal fees.....	147,300	212,000
Other obligation, current portion.....	82,500	300,000
Comdial obligation.....	225,576	--
Other.....	<u>131,535</u>	<u>62,397</u>
	<u>\$ 654,765</u>	<u>\$1,169,244</u>

At December 31, 2000, certain special warrant holders had not exercised their right to redeem a portion of their original investment, as described in Note 9. All of these warrant holders subsequently exercised this right during 2001.

We were involved in arbitration, resulting from the termination of our former President and Chief Operating Officer, Mr. Charles Yang. A breakdown in the relationship between Mr. Yang and us developed in early 2000 and he ceased providing any services to us on January 31, 2000. Mr. Yang was formally terminated on March 9, 2000.

F-12

On March 23, 2001, we entered into a Settlement Agreement and Mutual General Release (the "Settlement Agreement") with Charles Yang to resolve all claims and disputes between ePHONE and Mr. Yang, including all claims relating to Mr. Yang's employment by and separation from ePHONE. Pursuant to the terms of the Settlement Agreement, we agreed to pay Mr. Yang \$400,000 in cash installments by July 23, 2001, and issue Mr. Yang 400,000 shares of our common stock as further described in Note 9. We had previously accrued \$300,000 during 1999, and the additional \$100,000 liability related to the settlement was accrued during the year ended December 31, 2001.

We did not make the required cash payments by July 23, 2001 and the balance due Mr. Yang was \$150,000 at December 31, 2001. Effective January 29, 2002, we entered into a Modification Agreement of the original Settlement Agreement and were required to issue Mr. Yang an additional 100,000 shares of our common stock, as further described in Note 9, and pay an additional \$75,000, which is recorded as a general and administrative expense as of December 31, 2001. The total amount due Mr. Yang of \$225,000 will be repaid in 30 monthly installments of \$7,500 beginning in 2002. Payments by fiscal year are as follows:

Year ending December 31,

2002.....	\$ 82,500
2003.....	90,000
2004.....	<u>52,500</u>
	225,000
Current portion included in accrued liabilities..	<u>(82,500)</u>
Long-term obligation.....	<u>\$ 142,500</u>

NOTE 9 - STOCKHOLDERS' EQUITY

COMMON STOCK

Beginning in November 1999 and ending in February 2000, we sold a total of 1,350,000 "units" for \$0.75 a unit to investors outside the United States pursuant to Regulation S under the Securities Act of 1933, as amended (referred to herein as the Securities Act). Each "unit" consisted of one share of our common stock and one warrant to purchase an additional share of common stock at \$1.25. On September 12, 2001, our Board of Directors approved a resolution to reduce the exercise price of the warrant included with each unit to \$0.35 and effective February 23, 2002 further reduced the exercise price to \$0.20 to reflect the market price and provide an inducement for the warrant holders to exercise the warrants. During the year ended December 31, 2001 and 2000, investors exercised warrants for the purchase of 848,243 and 92,400 shares of our common stock, respectively. We received \$134,500 and \$878,000 for the sale of the units during 2000 and 1999, respectively, and \$296,885 and \$115,500 for the exercise of the warrants in 2001 and 2000, respectively. During December 2001, we also received \$8,400 for the exercise of warrants for which shares of common stock will be issued in 2002. The warrants expire March 30, 2002.

During May 2000, the Company issued 345,000 shares of stock to a consultant as further described under non-employee stock compensation.

On July 12, 2000, our Board of Directors voted to rescind a performance share plan previously adopted in 1999 pursuant to which up to 15,000,000 shares of Company common stock would have been issued for no additional consideration if we were to meet certain performance objectives by the end of fiscal year 2002. The performance share plan was rescinded because of changes in our business plan since the adoption of the performance share plan. Concurrently with rescinding the performance share plan, the Board of Directors agreed to grant for no additional consideration a total of 3,666,448 shares of our common stock to four individuals who are former executive officers and consultants who would have been eligible to receive shares of common stock under the performance share plan. Our stockholders approved the issuance of these shares and an amendment to our Articles of Incorporation, increasing the number of authorized shares of common stock from 50,000,000 to 150,000,000 at the Annual Meeting of Stockholders on August 23, 2000. The shares of common stock were granted in consideration for services rendered to us during the period from the fourth quarter of 1998 through the first quarter of 2000. We recorded a \$3,700,000 charge during 2000 related to the granting of these shares of common stock.

On March 23, 2001, we entered into a Settlement Agreement with Charles Yang, which was subsequently modified in January 2002 as described in Note 8. In accordance with the Settlement Agreement and subsequent Modification Agreement, we issued a total of 500,000 shares of our common stock to Mr. Yang. The fair value of these shares totaled \$110,000 and is recorded as non-cash compensation expense as of December 31, 2001.

During August 2001, 13,436,317 Special Warrants were converted into 13,436,317 shares of our common stock as described under Special Warrants below.

During October and November 2001, we issued 200,000 shares of our common stock to a consultant who provided marketing and business development services to ePHONE as further described under non-employee stock compensation below.

During November 2001, we issued 538,973 shares of our common stock to PITRFA, Inc., a marketing and distribution company, as further described under non-employee stock compensation below.

During February 2002, we negotiated a settlement agreement with a former consultant in which we were required to issue 10,000 shares of common stock in exchange for past services rendered. The fair value of the common stock was \$2,200 and is recorded as general and administrative expense as of December 31, 2001.

SPECIAL WARRANTS

In early 2000, we sold a total of 13,780,837 special warrants to investors outside of the United States pursuant to Regulation S under the Securities Act. Each special warrant was purchased for \$1.10, and each special warrant when exercised entitled the holder to one share of common stock for no additional consideration and one purchase warrant to purchase an additional share of common stock for \$1.60. Holders of special warrants were originally entitled to receive up to 13,780,837 shares of common stock in the aggregate upon exercise of the special warrants and up to an additional 13,780,837 shares of common stock in the aggregate upon exercise of the purchase warrants. The purchase warrants expire on March 30, 2002.

In connection with the sale of special warrants described above, we granted GroomeCapital.com, Inc., which served as our agent in the sale of the special warrants, compensation warrants to purchase 889,251 units exercisable into 889,251 shares of common stock and 889,251 warrants at \$1.10 per unit. The warrant received with each unit is exercisable into a share of common stock at \$1.60 per share. We also issued options to purchase 250,000 shares of common stock at \$0.60 per share. The compensation warrants and options expire on March 30, 2002.

F-14

The special warrant agreements contained certain penalties in the event that we did not meet the prescribed deadlines for registration of common stock to be issued on the exercise of the special warrants in both Canada and the United States. We failed to meet these deadlines, and consequently, each special warrant holder was entitled to exercise

their right to have 12.5% of their original investment returned to them and reduce the number of special warrants they are holding by the same percentage ("Redemption Right"). In addition, each special warrant holder had the right to receive an additional 10% of their original investment in shares of our common stock upon the exercise of the special warrants. As of December 31, 2001, all special warrant holders exercised their Redemption Right and we returned \$1,894,865 to these investors.

On August 13, 2001 final receipts from the regulators of the British Columbia, Alberta, Ontario and Quebec provinces in Canada were received for the registration prospectus dated August 7, 2001. Each Special Warrant was then deemed converted, as provided for in the special warrant agreement, into one share of common stock and a warrant to purchase one share of common stock at an exercise price of \$1.60 per share expiring on March 30, 2002, for no additional consideration. Upon exercise of the special warrants, taking into consideration the exercise of Redemption Rights by all the investors, and the issuance of additional shares of our common stock equal to 10% of the special warrant holders initial investment, we issued a total of 13,436,317 shares of common stock and stock purchase warrants for the purchase of up to 13,436,317 shares of our common stock for \$1.60 per share to these investors. On September 26, 2001, our Board of Directors approved a resolution to reduce the price of the stock purchase warrants to \$0.35 and effective February 23, 2002 further reduced the exercise price to \$0.20 to reflect the market price and provide an inducement for the warrant holders to exercise the warrants. Proceeds from the Special Warrant offering totaled \$12,149,571, net of \$1,114,485 in offering costs and \$1,894,865 returned to shareholders upon the exercise of their Redemption Right. Certain warrant holders exercised their warrants in 2002 as described under subsequent events below.

NON-EMPLOYEE STOCK COMPENSATION ISSUED IN EXCHANGE FOR SERVICES RECEIVED

As partial consideration for services rendered under a consulting agreement entered into on May 24, 2000, for a detailed analysis of Internet Protocol development and market opportunities in various major countries, we granted Sobois-Livert Investment Corporation warrants to purchase 250,000 shares of common stock at \$0.60 per share and, as agreed to, upon completion of the consulting engagement and delivery of certain reports, additional warrants to purchase 488,833 shares of common stock at \$1.10 per share. Both sets of warrants expire on May 24, 2002. The fair value of these warrants totaled \$299,000 and was recorded as non-cash compensation during the year ended December 31, 2000.

On May 9, 2000, we granted 345,000 shares of common stock to Cornwall Management Ltd. as partial consideration for services rendered under a consulting agreement. The fair value of the shares totaled \$604,000 and was recorded as a non-cash compensation expense for the year ended December 31, 2000.

On February 14, 2001, our Board of Directors approved the issuance of 250,000 stock options to a consultant in an exchange for services rendered. The stock options have an exercise price of \$0.50, vest immediately and expire in three years. The market value of the our common stock at the grant date was \$0.23. The fair value associated with these options totaled \$42,500 and was recorded as non-cash compensation during the year ended December 31, 2001.

During October and November 2001, we issued 200,000 shares of our common stock and 200,000 options to purchase shares of our common stock to a consultant as consideration for marketing and business development consulting services rendered. The fair value of these shares of common stock totaled \$49,000 and is recorded as non-cash compensation expense as of December 31, 2001. The options have an exercise price of \$0.50 and vest immediately. The fair value associated with these options was \$48,045 and is recorded as non-cash compensation expense during the year ended December 31, 2001. During 2002, under the terms of a consulting agreement, we may be required to issue this consultant 200,000 shares of our common stock and 200,000 options to purchase shares of our common stock subject to mutually agreed upon performance goals.

F-15

On November 29, 2001, we entered into an exclusive Marketing and Distribution Agreement "Agreement" with PITRFA Inc., a Florida based sales, marketing and distribution company. As defined in the agreement, PITRFA will market and distribute ePHONE's prepaid 1+ long distance service for a period of three years. Upon signing the Agreement, we issued PITRFA 538,973 shares of our common stock. The fair value associated with these shares of

common stock totaled \$97,015 and is recorded as non-cash compensation expense in our December 31, 2001 Statement of Operations. The Agreement also contains a provision for the issuance of additional shares of our common stock if our common stock reaches certain price levels in the future as follows: a) if the price of our common stock reaches \$2.50 per share we will be required to issue PITRFA a second tranche of 538,973 shares and; b) if the price of our common stock subsequently reaches \$5.00 per share, we will be required to issue PITRFA a third tranche of 538,973 shares. The maximum amount of shares that would be issued if all milestones are met is 1,616,919, which represents 5% of our common stock outstanding at the signing of this Agreement.

The following table summarizes information for non-employee stock options and stock purchase warrants granted for services, and issued in connection with private placements we have completed:

	Year Ended December 31, 2001		Year Ended December 31, 2000	
	Number of Shares	Weighted Average Price Per Share	Number of Shares	Weighted Average Price Per Share
Beginning balance	4,385,684	\$0.91	2,420,667	\$0.86
Granted (including Special Warrant Conversion in 2001)	13,886,317	\$0.35	2,057,417	\$0.99
Exercised	(848,243)	\$0.35	(92,400)	\$1.25
Cancelled	--	--	--	--
Ending balance	<u>17,423,758</u>	<u>\$0.42</u>	<u>4,385,684</u>	<u>\$0.91</u>

EMPLOYEE STOCK COMPENSATION

During 1999, we granted 2,250,000 options to purchase common stock at \$.50 per share to certain directors and officers.

On May 5, 2000, our Board of Directors adopted the 2000 Long-Term Incentive Plan (the "Plan") and reserved 6,000,000 shares of common stock for issuance under the Plan. The Plan provides for grants and awards of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock and incentive shares to officers, key employees, directors, persons hired to be employees, and who the Board determines will be officers or key employees upon commencement of employment, and consultants or independent contractors for rendering key services. The Board will determine the exercise price per share of the Common Stock purchasable under a stock option and the options will have various vesting schedules ranging from immediate vesting to vesting on specified dates and over various periods of time. In general, options granted under this plan will expire in ten years from the date of grant.

During 2000, we granted 1,500,000 stock options to two officers, which vested on the grant date with the exercise price less than the market price at grant date. In accordance with APB 25, we recorded compensation expense totaling \$2,865,000. These two officers terminated employment with us in December 2000 and a total of 6,747,307 in accumulated stock option awards were canceled as provided for in their Separation Agreements.

In connection with the termination of these two officers, all other outstanding unvested stock options became immediately vested pursuant to a provision in the Plan.

On September 12, 2001 our Board of Directors approved a resolution to reduce from \$0.50 to \$0.35 the exercise price of 3,900,000 stock options held by certain Board members, executive officers and former employees. Since the repricing we have accounted for these options using variable accounting. We have not recorded any compensation expense in connection with this repricing since the new exercise price has been higher than or equal to the market price.

On December 17, 2001, our Board of Directors approved a resolution to extend the expiration date of a former officer's stock option agreement from March 31, 2002 to October 1, 2002.

The following table summarizes information concerning our stock options:

	Years Ended December 31,			
	2001		2000	
	Number of Shares	Weighted Average Price Per Share	Number of Shares	Weighted Average Price Per Share
Beginning balance	5,268,963	\$0.81	2,250,000	\$0.50
Granted	5,713,333	0.41	9,776,000	\$0.70
Exercised	--	--	--	--
Cancelled	<u>(3,784,244)</u>	<u>0.90</u>	<u>(6,757,307)</u>	<u>\$0.56</u>
Ending balance	<u>7,197,782</u>	<u>\$0.40</u>	<u>5,268,693</u>	<u>\$0.81</u>

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

Range of Exercise Prices	Number of Outstanding	Options Outstanding		Options Exercisable	
		Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
\$0.35 to \$0.35...	5,700,000	6 years	\$0.35	5,340,000	\$0.35
\$0.50 to \$0.50...	1,273,333	9 years	\$0.50	583,333	\$0.50
\$0.60 to \$1.09...	196,449	8 years	\$1.09	196,449	\$1.09
\$1.09 to \$1.59...	<u>28,000</u>	<u>9 years</u>	<u>\$1.44</u>	<u>28,000</u>	<u>\$1.44</u>
	<u>7,197,782</u>	<u>7 years</u>	<u>\$0.40</u>	<u>6,147,782</u>	<u>\$0.39</u>

Had compensation expense for our plan been determined based on the fair value at the grant date for plan awards consistent with the provisions of SFAS No. 123, our net loss and net loss per common share outstanding would have been the pro forma amounts indicated below:

	Year Ended December 31,	
	2001	2000
Net loss -- as reported.....	\$ (7,021,129)	\$ (13,701,100)
Net loss -- pro forma.....	\$ (7,724,071)	\$ (16,649,035)
Net loss per share -- as reported.....	\$ (0.28)	\$ (0.94)
Net loss per share -- pro forma.....	\$ (0.31)	\$ (1.14)

The weighted-average fair values of each option at the date of grant for 2001 and 2000 was \$0.16 and \$1.04, respectively, and were estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used in 2001 and 2000: dividend yield of 0%; expected volatility of 150% in 2001 and 2000; risk-free interest rate of 4.08% in 2001 and 6.22% in 2000; and expected lives of 3 years.

NOTE 10 – COMMITMENTS AND CONTINGENCIES

Comdial Arbitration

During the third quarter of 2001, we filed for arbitration against Comdial seeking rescission of the Array Telecom License Agreement, return of the \$2.65 million paid to Comdial, and compensatory and punitive damages of \$10,000,000 due to what we believe to have been violations by Comdial of the Array Telecom License Agreement. Comdial initially responded to our arbitration demand with a counterclaim seeking relief from all of our claims and the payment of \$215,000 in accrued royalties plus interest. Subsequently, Comdial has also added an additional counterclaim alleging that the agreement is still valid and is seeking the value of the future royalty payments which were to be made under the agreement. We have given back the licensed products to Comdial, and consequently, do not believe that we have an obligation for any additional future royalties based upon the use of the licensed products. We believe the \$215,000 plus accrued interest of approximately \$11,000 is our maximum exposure in the event of an unfavorable outcome and have recorded these amounts as accrued liabilities at December 31, 2001. Arbitration is scheduled to occur in Washington D.C. beginning on May 29, 2002.

Herndon Office Lease

The following is a schedule of future minimum payments with respect to the Herndon, Virginia office lease:

Year Ending December 31,	
2002.....	179,004
2003.....	184,374
2004.....	<u>62,061</u>

Total future minimum payments..... \$ 425,439

Rent expense was \$165,258 and \$128,527 for the years ended December 31, 2001 and 2000, respectively.

NOTE 11 - INCOME TAXES

As we have incurred losses since our inception, no provision for US federal or state income taxes have been recorded in any period.

Deferred income taxes reflect the net effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the deferred tax assets for federal and state income taxes are as follows:

	Year Ended December 31,	
	2001	2000
Net operating loss carryforwards....	\$6,407,000	\$3,647,000
Excess of book over tax - Array		
Telecom license amortization.....	--	171,000
Non-cash compensation.....	543,000	508,000
Investment write-down	343,000	--
Deferred royalty obligation	--	160,000
Other.....	46,000	8,000
Less valuation allowance.....	<u>(7,339,000)</u>	<u>(4,494,000)</u>
Net deferred tax asset	<u>\$ --</u>	<u>\$ --</u>

Realization of deferred tax assets is dependent upon future earnings, if any. We have recorded a full valuation allowance against our deferred tax assets since we believe it is more likely than not that these assets will not be realized. No income tax benefit has been recorded for all periods presented because of the valuation allowance.

At December 31, 2001, we have available, for U.S. income tax purposes, net operating loss carryforwards of approximately \$16,428,000 which can be used to offset future taxable income through 2019. There can be no assurance that we will realize the benefit of the net operating loss carryforward. In addition, our utilization of our net operating loss carryforward may be limited pursuant to Internal Revenue Code Section 382, due to cumulative changes in ownership in excess of 50% within a three year period.

NOTE 12 SIGNIFICANT CUSTOMER

For the year ended December 31, 2001 and 2000, 11% and 90% of sales, respectively, were to one customer. As of December 31, 2000, 97% of accounts receivable was from this same customer. We did not have accounts receivable with this customer as of December 31, 2001.

NOTE 13 SUBSEQUENT EVENT

In late March 2002, the Company received approximately \$690,000 for the exercise of warrants for the purchase of 3,450,000 shares of common stock which had been issued in connection with the sale of Special Warrants described in Note 9. On March 31, 2002, the remaining warrants for the purchase of 9,115,000 shares of common stock expired unexercised.

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

FORM 10-QSB

(MARK ONE)

- QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2002

- TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF EXCHANGE ACT

Commission File Number 000-27699

ePHONE Telecom, Inc.

(Name of small business issuer as specified in its charter)

Florida
(State or other jurisdiction of
incorporation or organization)

98-020-4749
(IRS Employer
Identification No.)

**1145 Herndon Parkway
Herndon, Virginia 20170-5535**
(Address of principal executive offices)

(703) 787-7000
(Issuer's telephone number)

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

As of March 31, 2002 there were 34,622,902 shares of Common Stock issued and outstanding.

Transitional Small Business Disclosure Format (check one): Yes No

ePHONE Telecom, INC.

FORM 10-QSB

INDEX

Part I – Financial Information		<u>Page</u>
Item 1.	Financial Statements (Unaudited)	
	Balance Sheets as of March 31, 2002 and December 31, 2001	1
	Statements of Operations for the Three Months Ended	
	March 31, 2002 and 2001	2
	Statements of Cash Flows for the Three Months Ended	
	March 31, 2002 and 2001	3
	Notes to Financial Statements.....	4
Item 2.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	7
 Part II – Other Information		
Item 1.	Legal Proceedings.....	12
Item 2.	Changes in Securities and Use of Proceeds	12
Item 3.	Defaults Upon Senior Securities.....	12
Item 4.	Submission of Matters to a Vote of Security Holders.....	12
Item 5.	Other Information	12
Item 6.	Exhibits and Reports on Form 8-K	12
Signatures	13

ePHONE Telecom, Inc.

Balance Sheets

(unaudited)

	March 31, 2002	December 31, 2001
Current Assets:		
Cash and cash equivalents	\$ 682,872	\$ 35,970
Accounts receivable, net of allowance for returns of \$172,000 and \$116,000 at March 31, 2002 and December 31, 2001, respectively	310,129	155,759
Inventory	—	16,500
Other receivables	37,612	65,481
	<hr/>	<hr/>
Total Current Assets	1,030,613	273,710
Property and equipment, net	1,349,051	1,296,561
Other assets	68,043	18,043
	<hr/>	<hr/>
Total Assets	\$ 2,447,707	\$ 1,588,314
Liabilities and Stockholders' Equity:		
Current Liabilities:		
Accounts payable	\$ 738,546	\$ 850,179
Accrued liabilities	715,020	654,765
Deferred revenue	745,504	367,009
Capital lease obligation, current portion	30,914	22,663
	<hr/>	<hr/>
Total Current Liabilities	2,229,984	1,894,616
Capital lease obligation, net of current portion	25,166	15,839
Other long term obligation, net of current portion	120,000	142,500
Commitments and Contingencies	—	—
Stockholders' Equity (Deficit):		
Common stock, par value \$0.001: 150,000,000 shares authorized, 34,622,902 and 32,987,381 issued and outstanding at March 31, 2002 and December 31, 2001, respectively.	34,622	32,987
Common stock subscription receivable	(388,394)	—
Additional paid-in capital	22,554,062	21,843,199
Accumulated deficit	(22,127,733)	(22,340,827)
	<hr/>	<hr/>
Total Stockholders' Equity (Deficit)	72,557	(464,641)
Total Liabilities and Stockholders' Equity (Deficit)	\$ 2,447,707	\$ 1,588,314

See accompanying notes to financial statements

ePHONE Telecom, Inc.

Statements of Operations

(unaudited)

	Three Months Ended March 31,	
	2002	2001
Service revenue	\$ 4,061,823	\$ —
Product revenue	—	419,200
	<hr/>	<hr/>
Total revenues	4,061,823	419,200
Operating expenses		
Cost of service revenue	2,485,248	—
Cost of product revenue	—	272,392
Sales and marketing	200,408	682,551
General and administrative, including non-cash compensation of \$37,715 and \$122,500 as of March 31, 2002 and 2001, respectively	1,153,655	1,844,323
	<hr/>	<hr/>
Total operating expenses	3,839,311	2,799,266
Income (loss) from operations	222,512	(2,380,066)
Interest and other expense (income), net	9,418	(96,599)
	<hr/>	<hr/>
Income (loss) before taxes	213,094	(2,283,467)
Income tax expense	—	—
	<hr/>	<hr/>
Net income (loss)	\$ 213,094	\$ (2,283,467)
Earnings (loss) per share—(basic and diluted)	\$ 0.01	\$ (0.13)
	<hr/>	<hr/>
Weighted average number of common shares outstanding	33,022,298	17,489,404
	<hr/>	<hr/>

See accompanying notes to financial statements

ePHONE Telecom, Inc.

Statements of Cash Flows

(unaudited)

	Three Months Ended March 31,	
	2002	2001
Cash Flows from Operating Activities:		
Net income (loss)	\$ 213,094	\$ (2,283,467)
Adjustments to reconcile net income (loss) to net cash flows from operating activities:		
Depreciation and amortization	72,622	242,097
Stock issued for services rendered	37,715	122,500
Allowance for returns	56,000	—
Deferred royalty expense	—	136,667
Realized gain	—	(33,757)
Changes in operating assets and liabilities:		
Accounts receivable and other receivables	(891)	(84,271)
Inventory	16,500	20,171
Other assets	(50,000)	(20,000)
Accounts payable	(111,633)	(30,298)
Accrued liabilities	52,755	(424,482)
Deferred revenue	196,885	—
	483,047	(2,354,840)
Net cash flows provided by (used in) operating activities		
Cash flows from investing activities:		
Purchase of fixed assets	(102,347)	(104,408)
Redemption of marketable securities	—	822,982
Deposit to restricted cash, net	—	579,435
	(102,347)	1,298,009
Net cash flows (used in) provided by investing activities		
Cash flows provided by financing activities:		
Proceeds from exercise of warrants	301,389	—
Repayments on long-term obligation	(15,000)	—
Repayment to related party	(15,000)	—
Repayments on capital lease	(5,187)	—
	266,202	—
Net cash flows provided by financing activities		
Net increase (decrease) in cash and cash equivalents	646,902	(1,056,831)
Cash and cash equivalents, beginning of year	35,970	1,525,978
Cash and cash equivalents, end of year	\$ 682,872	\$ 469,147

See accompanying notes to financial statements

NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

ePHONE Telecom, Inc. ("ePHONE") was incorporated in 1996 under the laws of the State of Florida, and is traded on the OTC Electronic Bulletin Board operated by the National Association of Securities Dealers, Inc. under the trading symbol "EPHO".

We provide telecommunication services to retail and wholesale customers. We are a global telecommunications carrier providing a full complement of telecommunications services, including phone-to-phone, one-step dialing, using Voice over Internet Protocol ("VoIP") technology and adaptable to legacy and future technologies.

The Company has prepared the accompanying unaudited financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. These financial statements should be read together with the financial statements and notes in the Company's 2001 Annual Report on Form 10-KSB filed with the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The accompanying financial statements reflect all adjustments and disclosures, which in our opinion are necessary for fair presentation. All such adjustments are of a normal recurring nature. The results of operations for the interim periods are not necessarily indicative of the results of the entire year.

USE OF ESTIMATES

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

REVENUE RECOGNITION

In accordance with generally accepted accounting principles, we recognize prepaid telecommunication services revenues over the period services are provided. We bill monthly recurring telecommunications services in advance and the majority of our customers prepay for their services. Therefore, any portion of our services billed and collected but not yet provided is recorded as a deferred revenue. Of the \$745,000 in deferred revenue at March 31, 2002, \$693,000 will be fully earned during the month of April 2002. We establish an allowance for doubtful accounts based upon factors, which include historical trends and other information.

For the three months ended March 31, 2001, product sales were recognized upon shipment. Typical terms of sale did not provide the customer with the right of return except for defective products, which were covered by the warranty of the original equipment manufacturer. The Company also generated revenues from product licenses and services. Product license revenues were generally recognized upon product shipment provided that no significant post-delivery obligations existed and payment was due within one year. Advance payments of product licenses and services were reported as unearned revenue until all conditions for revenue recognition were met.

INCOME TAXES

We had no income tax expense during the three months ended March 31, 2002 due to the availability of net operating losses for U.S. income tax purposes. There can be no assurance that we will continue to realize the benefit of the net operating loss carryforward.

NET EARNINGS (LOSS) PER SHARE

We report basic and diluted loss per share. Basic loss per share is computed by dividing net loss by the weighted average number of outstanding shares of common stock. Diluted earnings per share is computed by dividing net loss by the weighted average number of shares adjusted for the potential dilution that could occur if stock options, warrants and other convertible securities were exercised or converted into common stock.

For the three months ended March 31, 2002, options and warrants to purchase 8,387,000 shares of common stock were outstanding but were not included in the computation of diluted earnings per share because the exercise price of all outstanding options and warrants exceed the average market price of our stock during this period.

NOTE 2 – OPERATIONS

As shown in the accompanying unaudited financial statements, net income for the three months ended March 31, 2002 of \$214,000 represents the first profitable fiscal quarter in our operating history. Also, of \$745,000 recorded as deferred revenue at March 31, 2002, \$693,000 will be fully earned during April 2002. Our continued success is dependent upon our ability to maintain profitable operations and successfully introduce our products to market. As described in Note 5, in March 2002, existing investors in the Company exercised outstanding warrants, purchasing 3,448,913 shares of the Company's common stock for \$690,000. Since inception we have an accumulated deficit of \$22,128,000, which will be used to offset income taxes related to our current and future earnings.

Management believes that together with our cash on hand, proceeds from the warrants exercised in 2002, and cash flow from our planned level of 2002 operations that we have sufficient resources to enable us to sustain our current and planned level of operations for at least the next 12 months without the need for additional investment capital.

During the three months ended March 31, 2002, we generated net revenues of \$4,062,000 with a gross margin of \$1,577,000 (39%).

NOTE 3 - RELATED PARTY TRANSACTIONS

During the three months ended March 31, 2002 and 2001 we incurred costs for management services provided by companies in which certain directors of ours have a controlling interest and incurred consulting fees to certain directors of ours totaling \$15,000 and \$39,000, respectively. The 2002 expense represents the fair value of 66,668 shares of our common stock issued in lieu of cash payments as further described under Stockholders' Equity.

During the three months ended March 31, 2002, we repaid a \$15,000 amount that was advanced to us during 2001 by our Chairman of the Board, Mr. Robert Clarke.

During the three months ended March 31, 2001, the Company paid \$180,000 to ePHONE Technologies, Inc., a related party, for consulting services.

NOTE 4 - ACCRUED LIABILITIES

Accrued expenses consist of the following:

	March 31, 2002	December 31, 2001
Accrued vacation.....	\$ 46,854	\$ 32,411
Accrued compensation.....	73,932	35,443
Accrued legal fees.....	130,300	147,300
Other obligation, current portion.....	90,000	82,500
Comdial obligation.....	230,951	225,576
Other.....	142,983	131,535
	<u>\$ 715,020</u>	<u>\$ 654,765</u>

NOTE 5 - STOCKHOLDERS' EQUITY

In late March and early April 2002, we received approximately \$690,000 for the exercise of warrants for the purchase of 3,448,913 shares of common stock which had been issued in connection with the sale of Special Warrants originally issued in early 2000. The portion of proceeds received in April was \$388,000 and is recorded as a subscription receivable in the accompanying balance sheet at March 31, 2002. On March 31, 2002, the remaining warrants for the purchase of 9,115,000 shares of common stock expired unexercised.

During March 2002, we issued 171,431 shares to two consultants and two members of our Board of Directors. The fair value of the shares totaled \$38,000 and was recorded based upon the market price of the stock on the date of issuance.

NOTE 6 - COMMITMENTS AND CONTINGENCIES

During the third quarter of 2001, we filed for arbitration against Comdial seeking rescission of the Array Telecom License Agreement, return of the \$2.65 million paid to Comdial, and compensatory and punitive damages of \$10,000,000 due to what we believe to have been violations by Comdial of the Array Telecom License Agreement. Comdial initially responded to our arbitration demand with a counterclaim seeking relief from all of our claims and the payment of \$215,000 in accrued royalties plus interest. Subsequently, Comdial has also added an additional counterclaim alleging that the agreement is still valid and is seeking the value of the future royalty payments which were to be made under the agreement. We have given back the licensed products to Comdial, and consequently, do not believe that we have an obligation for any additional future royalties based upon the use of the licensed products. We believe the \$215,000 plus accrued interest of approximately \$16,000 is our maximum exposure in the event of an unfavorable outcome and have recorded these amounts as accrued liabilities at December 31, 2001. Arbitration is scheduled to occur in Washington D.C. beginning on May 29, 2002.

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

Overview

Our core strategy is to become a next generation global facilities based marketing and sales oriented telecommunications carrier providing a full complement of telecommunications and data services utilizing the efficiency and reliability of new generation VOIP based telecommunication technologies. This entails operating as a wholesale carrier, interexchange carrier and as a retail services provider. Using a private Internet Protocol ("IP") network, the public Internet and the public switched telephone network ("PSTN"), we have developed the capability to provide voice and data transmission and other telephony features at high quality and low cost. Our role as an Interexchange Carrier allows us to capitalize on inexpensive wholesale termination rates, which are further leveraged into retail products in order to increase overall margins.

Since we commenced commercial operations utilizing our new strategy based upon a Cisco-based network in August of 2001 we have generated service revenue of over \$7,000,000 and are continuing to increase service revenue every month. The success of our retail programs and increasing wholesale business has enabled us to attain profitability during the first quarter.

We believe our aggressive approach to marketing and sales is as important as the technologies being employed. We are committed to staying at the leading edge of telecommunications and information technologies but believe our real competitive advantage will be sustained through a creative and innovative approach to acquiring and maintaining customers and channel distribution partners

For example, we plan to introduce a new product in early Q2 of 2002 named eTRANSPORT ("eTRANSPORT"). The eTRANSPORT is a piece of equipment that is installed between the phone and the incoming phone line at the customer premises. Our service to the customer is virtually the same as the 1+ long distance service, however it is prepaid with the added benefit of portability.

We have worked closely with the designer and manufacturer of eTRANSPORT and have integrated the device with our network. We have secured the exclusive rights to the version of the device that works with our network, which provides features and the functionalities that customers desire. We are also working with marketing entities to introduce the product to market through home shopping TV channels and large retail chains that are the after market distribution channels for products marketed "As Seen on TV"..

Results of Operations – Three months ended March 31, 2002 and 2001

Our net income (loss) and net income (loss) per share were \$214,000 and \$0.01 and (\$2,283,000) and (\$0.13) for the three months ended March 31, 2002 and 2001, respectively.

During the three months ended March 31, 2002, increasing business from our retail and wholesale programs that were introduced in Q3 of FY 2001, coupled with the significant reduction of general and administrative and selling and marketing costs were the primary reasons for the overall improvement in operations.

Revenues

Revenues increased from \$419,000 for the three months ended March 31, 2001 to \$4,062,000 for the same period in 2002. The majority of the increase is attributed to the Company's "Unlimited Calling" Program. Prepaid calling card programs and our wholesale strategy also contributed to the increase. These programs accounted for all of ePHONE's revenue for the three months ended March 31, 2002 and did not account for any revenue during the same period in 2001. During March 2002, cash collections of \$745,000 were considered pre-paid and are reflected in the Current Liability section of the Balance Sheet as "Deferred Revenue". Of this amount, \$693,000 will be earned by us during April 2002. As ePHONE continues to focus on retail and wholesale offerings, sales of equipment are not expected to be significant in the future. The \$419,000 of revenue from the sales of equipment in Q1 of 2001 is not likely to reoccur.

Cost of Revenues

Cost of Revenues increased from \$274,000 for the three months ended March 31, 2001 to \$2,485,000 for the same period in 2002. For the three months ended March 31, 2002, cost of goods sold represented commissions, activation fees and processing charges related to our telecommunications services programs. For the three months ended March 31, 2001, cost of goods sold was related to telecommunications equipment sales. Gross margin for the three months ended March 31, 2002 and 2001 was 39% and 35%, respectively. Our gross margin percentage will likely be much higher in the future due to increases in sales volume and sales mix.

Sales and marketing

Sales and marketing expense decreased from \$683,000 for the three months ended March 31, 2001 to \$200,000 for the same period in 2002. During 2001, our sales and marketing expenses included compensation paid to consultants for market studies and competitive intelligence of the Internet telephony market place in several countries where we were deploying our network. There were no similar expenditures incurred during the three months ended March 31, 2002. Currently, sales and marketing expense consists primarily of marketing commissions and salaries.

General and administrative

General and administrative expense decreased from \$1,844,000 for the three months ended March 31, 2001 to \$1,154,000 for the same period in 2002. General and administrative expense included non-cash compensation of \$38,000 and \$123,000 for the three months ended March 31, 2002 and 2001, respectively. The 2002 expense represented the fair value of 171,000 shares of our common stock issued for consulting services to two consultants and to two members of our Board of Directors. A portion of the 2001 non-cash compensation was incurred in connection with a settlement between us and a former officer under which 400,000 shares of common stock with a fair value of \$80,000 were issued to this former officer. The remaining \$43,000 of non-cash compensation in 2001 represents the fair value of 250,000 stock options issued to a consultant in exchange for services rendered. We expect general and administrative expenses to increase in the future in direct proportion to the increase in sales.

Income taxes

There was no provision for federal or state income taxes for the three months ended March 31, 2001 due to the availability of a net operating loss (NOL) for income tax purposes. This NOL was generated from previous operating losses incurred since inception. A valuation allowance has been established and, accordingly, no asset has been recorded for our net operating losses and other deferred tax assets.

Liquidity And Capital Resources

During the three months ended March 31, 2002, we received \$302,000 of the \$690,000 raised from the exercise of warrants we had issued in connection with the sale of special warrants in 2000 for the purchase of 3,448,913 shares of our common stock. On March 30, 2002, the warrants for the purchase of 9,115,161 shares of our common stock expired unexercised. The proceeds from the exercise of these warrants, along with cash generated from our operations during the first quarter 2002 increased our cash from \$36,000 at December 31, 2001 to \$683,000 at March 31, 2002. We received the remaining \$388,000 from the exercise of warrants in early April 2002 and have recorded this amount as a subscription receivable in the balance sheet at March 31, 2002.

For the three months ended March 31, 2002, utilizing our new strategy based upon a Cisco-based network we have generated service revenue of over \$ 4,000,000. Our liquidity continues to improve and as of May 14, 2002 we had a total of \$1,500,000 of cash in the bank. We plan to expand our current products and services in 2002 and introduce new products and services. We have been successful in generating net income from operations since we deployed our new Cisco-based network in August 2001. Our anticipated future cash flows from operations is largely dependent upon our ability to achieve our revenue and gross profit objectives from our current products and services and introduction of new products we plan to launch in 2002. We believe that based on our current level of

operations, the cash flows we are generating from operations together with the \$690,000 we received from the exercise of warrants described above is sufficient for our current operations.

It is important to point out that since our inception, we have accumulated a deficit of \$22,128,000, and that we funded our operations, prior to our generating service revenues beginning in August 2001, primarily with the proceeds we raised in our special warrant offering in 2000, from the exercise of warrants during 2001 of \$305,000, and from limited equipment sales. We do not currently have a line of credit or any other credit facility available to us.

While our service revenue sales continues to increase during the first two quarters of 2002, and while management anticipates that growth in service revenue will continue throughout the remainder of 2002, we cannot assure you that this will happen. Future prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in the telecommunications industry. To address these risks and achieve profitability and increased sales levels, we must, among other things, continue to establish and increase market acceptance of our products, respond effectively to competitive pressures, offer high quality customer service and support, and successfully introduce, on a timely basis, new products and enhancements of our existing products.

We anticipate, based on our present plans and assumptions, that our current cash balances and projected level of 2002 operations will be sufficient to enable us to sustain our current and planned operations for at least the next 12 months, and will not need to raise additional funding. However, we cannot assure you that this will hold true.

For the three months ended March 31, 2002, we generated \$483,000 of cash from our operating activities. The amount of cash provided by operations for the three months ended March 31, 2002 in excess of the \$214,000 net income for that same period is attributed to increases in our deferred revenue balances and depreciation expense partially offset by decreases in our accounts payable balances.

Investing activities used \$102,000 of cash for the purchase of fixed assets and financing activities provided \$266,000 which consisted of \$302,000 received from the exercise of warrants offset by payments on obligations for the three months ended March 31, 2002.

We have two equipment commitments totaling \$56,000 for two Sun Microsystems servers which expire in 2003 and 2004.

On April 20, 2000, we closed an offering of Special Warrants, receiving net proceeds of approximately \$12,205,000. The total number of Special Warrants we sold in that offering was 13,780,837. The special warrant agreements contained certain penalties in the event that we did not meet the prescribed deadlines for registration of common stock to be issued on the exercise of the special warrants in both Canada and the United States. We failed to meet these deadlines, and consequently each special warrant holder was entitled to exercise their right to have 12.5% of their original investment returned to them and reduce the number of special warrants they held by the same percentage ("Redemption Right"). In addition, each special warrant holder received an additional 10% of their original investment in shares of our common stock upon the exercise of the special warrants. As of March 31, 2001, all special warrant holders exercised their Redemption Rights, and we returned \$1,895,000 to these investors. We completed the registration of our common stock in Canada, and our investors exercised their special warrants causing us to issue 13,436,317 shares of our common stock and warrants to purchase 13,436,317 shares of our common stock for \$1.60 per share.

During the year ended December 31, 2001, we raised \$305,000 from the exercise of warrants for the purchase of 848,243 shares of our common stock.

During the third quarter of 2001, we decided to provide our warrant holders with an enticement to exercise their warrants by reducing the exercise price of the warrants we issued on the exercise of the special warrants and for all other outstanding warrants from exercise prices ranging between \$1.60 - \$0.50 per share to \$0.35 per share. We further reduced the exercise price of the warrants to \$0.20 in 2002 to better reflect the market price of our common stock. As noted above, during 2002 warrant holders exercised warrants for the purchase of 3,448,913 shares of our

common stock for \$690,000.

Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, Business Combinations. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. This statement is effective for all business combinations initiated after June 30, 2001.

In July 2001, the FASB issued SFAS No. 142, Goodwill And Other Intangible Assets. This statement applies to goodwill and intangible assets acquired after June 30, 2001, as well as goodwill and intangible assets previously acquired. Under this statement goodwill as well as certain other intangible assets, determined to have an infinite life, will no longer be amortized; instead these assets will be reviewed for impairment on a periodic basis. This statement is effective for the Company beginning January 1, 2002. The adoption of this standard is not expected to have a material impact on our financial position or results of operations.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 supersedes previous guidelines for financial accounting and reporting for the impairment or disposal of long-lived assets and for segments of a business to be disposed of. The adoption of SFAS No. 144 on January 1, 2002 is not expected to have a material impact on our financial position or results of operations.

Risk Factors

The risks and uncertainties described below are not the only ones facing the company. Additional risks not presently known or that ePHONE currently considers insignificant may also impair ePHONE's business operations in the future. ePHONE's business, financial condition and plan of operations could be materially adversely affected by any of the following risks. The trading price of shares of ePHONE's common stock could decline due to any of these risks.

- The market for ePHONE's common stock is limited

There is currently only a limited trading market for ePHONE's common stock. ePHONE common stock trades on the OTC Bulletin Board under the symbol "EPHO," which is a limited market in comparison to the NASDAQ National Market, the American Stock Exchange and other national securities exchanges.

ePHONE cannot assure investors that the common stock will ever qualify for inclusion on the NASDAQ National Market or that more than a limited market will ever develop for the common stock.

- Penny stock rules limit the liquidity of ePHONE's common stock

ePHONE's common stock may now and in the future be subject to the penny stock rules under the Securities Exchange Act of 1934, as amended (referred to herein as the Exchange Act). These rules regulate broker-dealer practices for transactions in "penny stocks." Penny stocks generally are equity securities with a price of less than \$5.00. The penny stock rules require broker-dealers to deliver a standardized risk disclosure document that provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer must also provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson and monthly account statements showing the market value of each penny stock held in the customer's account. The bid and offer quotations and the broker-dealer and salesperson compensation information must be given to the customer orally or in writing prior to completing the transaction and must be given to the customer in writing before or with the customer's confirmation.

In addition, the penny stock rules require that prior to a transaction, the broker and/or dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's

written agreement to the transaction. These additional penny stock disclosure requirements are burdensome and may reduce the trading activity in the market for ePHONE's common stock. As long as the common stock is subject to the penny stock rules, holders of such ePHONE common stock may find it more difficult to sell their securities.

- An investment in ePHONE may be diluted

ePHONE may issue a substantial number of shares of ePHONE common stock without investor approval. Any such issuance of ePHONE securities in the future could reduce an investor's ownership percentage and voting rights in ePHONE and further dilute the value of his or her investment.

In 2001 and 2000, ePHONE incurred net losses of approximately \$7,021,129 and \$13,701,000, respectively. ePHONE's ability to achieve and sustain profitable operations depends on many circumstances. If ePHONE does not achieve and sustain profitability, its ability to respond effectively to market conditions, to make capital expenditures and to take advantage of business opportunities could be affected. In addition, ePHONE's prospects must be considered in light of the risks encountered by companies like ours developing products and services in new and rapidly evolving markets. ePHONE's failure to perform in these areas could have a material adverse effect on the business, plan of operations and financial condition.

- ePHONE's failure to acquire, integrate and operate new technology could harm their competitive position

The telecommunications industry is characterized by rapid and significant technological advancements and the related introduction of new products and services. ePHONE does not possess significant intellectual property rights with respect to the technologies we use, and we are dependent on third parties for the development of and access to new technology. The effect of technological changes on ePHONE's business plan cannot be predicted. In addition, it is impossible for ePHONE to predict with any certainty whether demand for VoIP services in the future markets will develop or will prove to be an economical and efficient technology that is capable of attracting customer usage. Failure by ePHONE to obtain and adapt to new technology in the future markets could have a material adverse effect on their business and plan of operations.

- ePHONE does not presently intend to pay dividends on our common stock

ePHONE has never paid dividends on our common stock and does not presently intend to pay cash dividends on our common stock. Any future decisions as to the payment of dividends will be at the discretion of ePHONE's Board of Directors, subject to applicable law. See "Dividend Policy."

- Telecommunications related stock prices have been especially volatile and this volatility may depress ePHONE's stock price

The stock market has from time to time experienced significant price and volume fluctuations which have particularly affected the market prices of the stocks of high technology and Telecommunications-related companies, including companies like ePHONE, and which may be unrelated or disproportionate to the operating performance of particular companies. Factors such as quarterly variations in actual or anticipated operating results, changes in earnings estimates by analysts, market conditions in the industry, analysts' reports, announcements by competitors, regulatory actions or other events or factors, including the risk factors described in this annual report and general economic conditions may have a significant effect on the market price of ePHONE's common stock. This broad market and industry volatility may reduce the value of ePHONE's common stock, regardless of ePHONE's operating performance. Due to this volatility, the value of ePHONE's common stock could decrease.

- ePHONE's articles of incorporation provide their officers and directors with certain indemnification.

ePHONE's Articles of Incorporation provide that our directors and officers will not be personally liable to ePHONE or its shareholders for money damages for breach of the fiduciary duty of care as a director or officer.

PART II – OTHER INFORMATION

Item 1. Legal proceedings –

During the third quarter of 2001, we filed for arbitration against Comdial seeking rescission of the Array Telecom License Agreement, return of the \$2.65 million paid to Comdial, and compensatory and punitive damages of \$10,000,000 due to what we believe to have been violations by Comdial of the Array Telecom License Agreement. Comdial initially responded to our arbitration demand with a counterclaim seeking relief from all of our claims and the payment of \$215,000 in accrued royalties plus interest. Subsequently, Comdial has also added an additional counterclaim alleging that the agreement is still valid and is seeking the value of the future royalty payments which were to be made under the agreement. We have given back the licensed products to Comdial, and consequently, do not believe that we have an obligation for any additional future royalties based upon the use of the licensed products. We believe the \$215,000 plus accrued interest of approximately \$16,000 is our maximum exposure in the event of an unfavorable outcome and have recorded these amounts as accrued liabilities at December 31, 2001. Arbitration is scheduled to occur in Washington D.C. beginning on May 29, 2002.

- Item 2. Changes in securities and use of proceeds - None.
- Item 3. Defaults upon senior securities
- Item 4. Submission of matters to a vote of security holders - None.
- Item 5. Other information - None.
- Item 6. Exhibits and reports on Form 8-K

A. Exhibits

Exhibit No.	Description
3.1.....	Articles of Incorporation (1)
3.2.....	Amendment to Articles of Incorporation (1)
3.3.....	Bylaws (1)
3.4.....	Amended and Restated Articles of Incorporation (2)
24.....	Powers of Attorney (filed herewith)

(1) Previously filed as an exhibit to ePHONE’s Form 10-SB, filed with the Securities and Exchange Commission on October 15, 1999.

(2) Previously filed as an exhibit to Amendment No. 2 to ePHONE’s Form 10-SB, filed with the Securities and Exchange Commission on January 5, 2000.

B. Reports on Form 8-K: None

SIGNATURE PAGE

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized.

ePHONE Telecom, Inc.

(Registrant)

By /s/ Carmine Tagliatela, Jr.
(Carmine Tagliatela, Jr., CEO)

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Date</u>
<u>By /s/ Carmine Tagliatela, Jr.</u> (Carmine Tagliatela, Jr., CEO, Director) (Principal Executive Officer)	May 14, 2002
<u>By /s/ Charlie Rodriguez</u> (Charlie Rodriguez, Chief Financial Officer) (Principal Financial and Accounting Officer)	May 14, 2002
<u>By /s/ Robert G. Clarke*</u> (Robert G. Clarke, Chairman)	May 14, 2002
<u>By /s/ John Fraser*</u> (John Fraser, Director)	May 14, 2002
<u>By /s/ Shelly Kamins*</u> (Shelly Kamins, Director)	May 14, 2002
<u>By /s/ Larry Codacovi*</u> (Larry Codacovi, Director)	May 14, 2002
<u>By /s/ Eugene A. Sekulow*</u> (Eugene A. Sekulow)	May 14, 2002

*By: Charlie Rodriguez
Attorney-In-Fact

ATTACHMENT C
ARTICLES OF INCORPORATION
BY-LAWS

**AMENDED AND RESTATED
ARTICLES OF INCORPORATION
OF
EPHONE TELECOM, INC.**

FILED
2002 JAN 29 PM 3:36
SECRETARY OF STATE
TALLAHASSEE, FLORIDA

It is hereby certified that:

1. The name of the corporation is ePHONE Telecom, Inc (the "Corporation").
2. Article IV of these Amended and Restated Articles of Incorporation contains an amendment to the Articles of Incorporation of the Corporation originally filed with the Secretary of State of the State of Florida on April 30, 1996 that was required to be approved by the shareholders of the Corporation.
3. Such amendment was approved and adopted at a duly called meeting of the shareholders of the Corporation on August 23, 2000.
4. Such amendment was approved by the affirmative vote of the holders of a sufficient number of shares (i.e., a majority) of the Corporation's outstanding common stock.
5. The following Amended and Restated Articles of Incorporation of ePHONE Telecom, Inc. amends and restates the provisions of and supersedes the Articles of Incorporation originally filed with the Secretary of State of the State of Florida on April 30, 1996 in its entirety:

**ARTICLE I
CORPORATE NAME**

The name of the Corporation is ePHONE Telecom, Inc.

**ARTICLE II
PURPOSE**

The Corporation shall be organized for any and all purposes authorized by the laws of the State of Florida.

**ARTICLE III
PERIOD OF EXISTENCE**

The period during which the Corporation shall continue is perpetual.

**ARTICLE IV
SHARES**

The capital stock of this corporation shall consist of 150,000,000 shares of common stock, \$.001 par value.

**ARTICLE V
DIRECTORS AND OFFICERS**

The business of this corporation shall be managed by its Board of Directors. The number of such directors shall be not be less than one (1) and, subject to such minimum may be increased or decreased from time to time in the manner provided in the By-Laws. The Board of Directors shall be elected by the shareholders of the corporation at such time and in such manner as provided in the By-Laws.

**ARTICLE VI
DENIAL OF PREEMPTIVE RIGHTS**

No shareholder shall have any right to acquire shares or other securities of the Corporation except to the extent such right may be granted by an amendment to these Articles of Incorporation or by a resolution of the Board of Directors.

**ARTICLE VII
AMENDMENT OF BYLAWS**

Anything in these Articles of Incorporation, the By-Laws, or the Florida Corporation Act notwithstanding, bylaws shall not be adopted, modified, amended or repealed by the shareholders of the Corporation except upon the affirmative vote of a simple majority vote of the holders of all the issued and outstanding shares of the corporation entitled to vote thereon.

**ARTICLE VIII
SHAREHOLDERS**

8.1. Inspection of Books The board of directors shall make reasonable rules to determine at what times and places and under what conditions the books of the Corporation shall be open to inspection by shareholders or a duly appointed representative of a shareholder.

8.2. Control Share Acquisition. The provisions relating to any control share acquisition as contained in Florida Statutes now, or hereinafter amended, and any successor provision shall not apply to the Corporation.

8.3. Quorum. The holders of shares entitled to one-third of the votes at a meeting of shareholders shall constitute a quorum.

8.4. Required Vote. Acts of shareholders shall require the approval of holders of 50.01 % of the outstanding votes of shareholders.

**ARTICLE IX
LIABILITY AND INDEMNIFICATION OF DIRECTORS AND OFFICERS**

To the fullest extent permitted by law, no director or officer of the Corporation shall be personally liable to the Corporation or its shareholders for damages for breach of any duty owed to the Corporation or its shareholders. In addition, the Corporation shall have the power, in its By-Laws or in any resolution of its stockholders or directors, to undertake to indemnify the officers and directors of this corporation against any contingency or peril as may be determined to be in the best interests of this corporation, and in conjunction therewith, to procure, at this corporation's expense, policies of insurance.

**ARTICLE X
CONTRACTS**

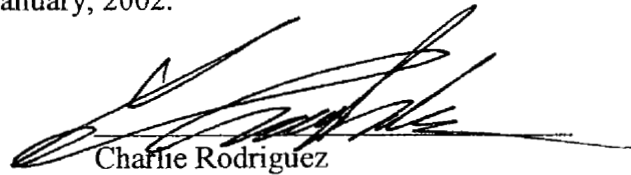
No contract or other transaction between this corporation and any person, firm or corporation shall be affected by the fact that any officer or director of this corporation is such other party or is, or at some time in the future becomes, an officer, director or partner of such other contracting party, or has now or hereafter a direct or indirect interest in such contract.

**ARTICLE XI
RESIDENT AGENT**

The name and address of the resident agent of the Corporation is:

CT Corporation System
1200 South Pine Island Road
Plantation, Florida 33324

IN WITNESS WHEREOF, I have hereunto subscribed to and executed these
Articles of Incorporation on this 3 day of January, 2002.

A handwritten signature in black ink, appearing to read 'Charlie Rodriguez', written over a horizontal line.

Charlie Rodriguez
Vice President—Corporate Affairs
and Secretary

ADOPTED BY
BOARD OF DIRECTORS
ON SEPT 26, 2000

BY-LAWS
OF
ePHONE TELECOM, INC.

A Florida Corporation

ARTICLE I.

Offices

SECTION 1. Registered Office. The registered office of ePHONE Telecom, Inc. (hereinafter called the "Corporation") within the State of Florida shall be c/o CT Corporation System, 1200 South Pine Island Road, Plantation, Florida 33324.

SECTION 2. Other Offices. The Corporation may also have offices at 1145 Herndon Parkway, Herndon, Virginia 20170 and such place or places as the Board of Directors shall from time to time determine or the business of the Corporation may require.

ARTICLE II.

Meetings of Shareholders

SECTION 1. Place of Meetings. All meetings of the shareholders shall be held at any such place, either within or without the State of Florida, as shall be designated from time to time by the Board of Directors and stated in the notice of meeting or in a duly executed waiver thereof.

SECTION 2. Annual Meeting. The annual meeting of the shareholders for the election of directors and for the transaction of such other business as may come before the meeting shall be held at such time and place as shall be determined by the Board of Directors and stated in the notice of the meeting.

SECTION 3. Special Meetings. Special meetings of the shareholders, for any purpose or purposes, unless otherwise prescribed by statute, may be called by the Board or by the Secretary upon the written request of the holders of not less than fifty percent of the outstanding stock of the Corporation entitled to vote at the meeting. *Could be held by Board*

SECTION 4. Notice of Meetings. Notice of meetings of shareholders shall be given as required by applicable law.

SECTION 5. Quorum. ~~One third~~ in voting power of the outstanding shares of the Corporation shall constitute a quorum. When a quorum is once present to organize a meeting of shareholders, it is not broken by the subsequent withdrawal of any shareholders. The holders of a majority of the shares of stock present in person or represented by proxy at any meeting of shareholders, including an adjourned meeting, whether or not a quorum is present, may adjourn such meeting to another time and place.

SECTION 6. Organization. At every meeting of shareholders, the President or, in his absence or inability to act, the person whom the President shall appoint, shall act as chairman of the meeting. The Secretary or, in his absence or inability to act, the person whom the chairman of the meeting shall appoint secretary of the meeting, shall act as secretary of the meeting and keep the minutes thereof.

SECTION 7. Order of Business. The order of business at all meetings of the shareholders shall be as determined by the chairman of the meeting.

SECTION 8. Voting. Unless otherwise provided in the Amended and Restated Articles of Incorporation, every shareholder of record shall be entitled at every meeting of shareholders to one vote for each share of capital stock standing in his name on the record of shareholders. If the Amended and Restated Articles of Incorporation

provides for more or less than one vote for any share, on any matter, every reference in these By-Laws or the Florida Business Corporation Act to a majority or other proportion of stock shall refer to such majority or other proportion of the votes of such stock.

At any meeting of shareholders (at which a quorum was present to organize the meeting), all matters, except as otherwise provided by law or by the Amended and Restated Articles of Incorporation or by these By-Laws, shall be decided by a majority of the votes cast at such meeting by the holders of shares present in person or represented by proxy and entitled to vote thereon, whether or not a quorum is present when the vote is taken. All elections of directors shall be by written ballot unless otherwise provided in the Amended and Restated Articles of Incorporation. In voting on any other question on which a vote by ballot is required by law or is demanded by any shareholder entitled to vote, the voting shall be by ballot. Each ballot shall be signed by the shareholder voting or by his proxy, and shall state the number of shares voted. On all other questions, the voting may be viva voce. Every shareholder entitled to vote at a meeting of shareholders or to express consent or dissent without a meeting may authorize another person or persons to act for him by proxy. The validity and enforceability of any proxy shall be determined in accordance with applicable law.

SECTION 9. Inspectors. The Board of Directors may, in advance of any meeting of shareholders, appoint one or more inspectors to act at such meeting or any adjournment thereof. If any of the inspectors so appointed shall fail to appear or act, the chairman of the meeting shall, or if inspectors shall not have been appointed, the chairman of the meeting may, appoint one or more inspectors. Each inspector, before entering upon the discharge of his duties, shall take and sign an oath faithfully to execute

the duties of inspector at such meeting with strict impartiality and according to the best of his ability. The inspectors shall determine the number of shares of capital stock of the Corporation outstanding and the voting power of each, the number of shares represented at the meeting, the existence of a quorum, the validity and effect of proxies, and shall receive votes, ballots or consents, hear and determine all challenges and questions arising in connection with the right to vote, count and tabulate all votes, ballots or consents, determine the results, and do such acts as are proper to conduct the election or vote with fairness to all shareholders. On request of the chairman of the meeting, the inspectors shall make a report in writing of any challenge, request or matter determined by them and shall execute a certificate of any fact found by them. No director or candidate for the office of director shall act as an inspector of an election of directors. Inspectors need not be shareholders.

SECTION 10. Written Action. Unless otherwise provided in the Amended and Restated Articles of Incorporation, any action required by the Florida Business Corporation Act to be taken at any annual or special meeting of shareholders of the Corporation, or any action which may be taken at any annual or special meeting of such shareholders, may be taken without a meeting/without prior notice and without a vote, if a consent in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. Prompt notice of the taking of the corporate action without a meeting by less than unanimous written consent shall be given to those shareholders who have not consented in writing.

ARTICLE III.

Board of Directors

SECTION 1. General Powers. The business and affairs of the Corporation shall be managed by or under the direction of the Board of Directors.

SECTION 2. Number, Qualifications, Election and Term of Office. The Board shall consist of not less than three nor more than nine members, as determined by the Board by resolution from time to time. Members of the Board need not be residents of the State of Florida and need not be shareholders of the Corporation. Directors shall be elected at the annual meeting of the shareholders and the term of office of each director shall be until the next annual meeting of shareholders and the election and qualification of a successor.

SECTION 3. Place of Meetings. Meetings of the Board of Directors shall be held at such place or places, within or without the State of Florida, as the Board of Directors may from time to time determine or as shall be specified in the notice of any such meeting.

SECTION 4. Annual Meeting. The Board of Directors shall meet for the purpose of organization, the election of officers and the transaction of other business, as soon as practicable after each annual meeting of shareholders, on the same day and at the same place where such annual meeting shall be held. Notice of such meeting need not be given. In the event such annual meeting is not so held, the annual meeting of the Board of Directors may be held at such other time or place (within or without the State of Florida) as shall be specified in a notice thereof given as hereinafter provided in Section 7 of this Article III.

SECTION 5. Regular Meetings. Regular meetings of the Board of Directors shall be held at such time and place as the Board of Directors may fix. Notice of regular meetings of the Board of Directors need not be given except as otherwise required by statute or these By-Laws.

SECTION 6. Special Meetings. Special meetings of the Board of Directors may be called by the President or at the request of a majority of the directors.

SECTION 7. Notice of Meetings. Notice of each special meeting of the Board of Directors (and of each regular meeting for which notice shall be required) shall be given by the Secretary as hereinafter provided in this Section 7, in which notice shall be stated the time and place of the meeting. Except as otherwise required by these By-Laws, such notice need not state the purposes of such meeting. Notice of each such meeting shall be mailed, postage prepaid, to each director, addressed to him at his residence or usual place of business, by first class mail, at least two days before the day on which such meeting is to be held, or shall be sent addressed to him at such place by telegraph, cable, telex, telecopier or other similar means, or be delivered to him personally or be given to him by telephone or other similar means, at least twenty-four hours before the time at which such meeting is to be held. Notice of any such meeting need not be given to any director who shall, either before or after the meeting, submit a signed waiver of notice or who shall attend such meeting, except when he shall attend for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

SECTION 8. Quorum and Manner of Acting. A majority of the entire Board of Directors shall constitute a quorum for the transaction of business at any meeting of

the Board of Directors, and, except as otherwise expressly required by statute or the Amended and Restated Articles of Incorporation or these By-Laws, the act of a majority of the directors present at any meeting at which a quorum is present shall be the act of the Board of Directors. In the absence of a quorum at any meeting of the Board of Directors, a majority of the directors present thereat may adjourn such meeting to another time and place. Notice of the time and place of any such adjourned meeting shall be given to all of the directors unless such time and place were announced at the meeting at which the adjournment was taken, in which case such notice shall only be given to the directors who were not present thereat. At any adjourned meeting at which a quorum is present, any business may be transacted which might have been transacted at the meeting as originally called. The directors shall act only as a Board and the individual directors shall have no power as such.

SECTION 9. Organization. At each meeting of the Board of Directors, the President or, in his absence, another director chosen by a majority of the directors present shall act as chairman of the meeting and preside thereat. The Secretary or, in his absence, any person appointed by the chairman shall act as secretary of the meeting and keep the minutes thereof.

SECTION 10. Resignations. Any director of the Corporation may resign at any time by giving written notice of his resignation to the Corporation. Any such resignation shall take effect at the time specified therein or, if the time when it shall become effective shall not be specified therein, immediately upon its receipt. Unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

SECTION 11. Vacancies. Any vacancy in the Board of Directors, whether arising from death, resignation, removal (with or without cause), an increase in the number of directors or any other cause, may be filled by the vote of a majority of the directors then in office, though less than a quorum, or by the sole remaining director or by the shareholders at the next annual meeting thereof or at a special meeting thereof. Each director so elected shall hold office until his successor shall have been elected and qualified.

SECTION 12. Removal of Directors. Any director may be removed, either with or without cause, at any time, by the holders of at least $66\frac{2}{3}\%$ of the voting power of the issued and outstanding capital stock of the Corporation entitled to vote at an election of directors.

SECTION 13. Compensation. The Board of Directors shall have authority to fix the compensation, including fees and reimbursement of expenses, of directors for services to the Corporation in any capacity.

SECTION 14. Committees. The Board of Directors may, by resolution passed by a majority of the whole Board, designate one or more committees, each committee to consist of one or more of the directors of the Corporation. The Board may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. In the absence or disqualification of a member of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not he or they constitute quorum, may unanimously appoint another member of the Board to act at the meeting in the place of any such absent or disqualified member. Any such committee, to the extent provided in

the resolution of the Board, shall have and may exercise all the powers and authority of the Board in the management of the business and affairs of the Corporation, and may authorize the seal of the Corporation to be affixed to all papers which may require it; but no such committee shall have the power or authority in reference to amending the Amended and Restated Articles of Incorporation, adopting an agreement of merger or consolidation, recommending to the shareholders the sale, lease or exchange of all or substantially all of the Corporation's property and assets, recommending to the shareholders a dissolution of the Corporation or a revocation of a dissolution, or amending these By-Laws of the Corporation; and, unless the resolution designating it expressly so provides, no such committee shall have the power or authority to declare a dividend or to authorize the issuance of stock.

SECTION 15. Action by Consent. Unless restricted by the Amended and Restated Articles of Incorporation, any action required or permitted to be taken by the Board of Directors or any committee thereof may be taken without a meeting if all members of the Board of Directors or such committee, as the case may be, consent thereto in writing, and the writing or writings are filed with the minutes of the proceedings of the Board of Directors or such committee, as the case may be.

SECTION 16. Telephonic Meeting. Unless restricted by the Amended and Restated Articles of Incorporation, any one or more members of the Board of Directors or any committee thereof may participate in a meeting of the Board of Directors or such committee by means of a conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other. Participation by such means shall constitute presence in person at a meeting.

ARTICLE IV.

Officers

SECTION 1. Number and Qualifications. The officers of the Corporation shall be elected by the Board of Directors and shall consist of a President, a Secretary and such Vice Presidents and other officers and assistant officers as the Board of Directors of the Corporation may from time to time appoint, or authorize the President to appoint.

SECTION 2. Tenure. Officers and assistant officers of the Corporation may, but need not, also be members of the Board. Each officer shall hold his office until his successor is elected and qualified or until his earlier death, resignation or removal in the manner specified in this Section 2 of Article IV of these By-Laws. Any officer elected or appointed by the Board may be removed by the Board with or without cause. In addition, however, any officer or assistant officer appointed by the President and, if the President is so authorized by the Board, any officer or assistant officer appointed by the Board of the Corporation, may be removed from office by the President upon such terms as the President may specify in writing to such officer. The removal of an officer without cause shall be without prejudice to his contract rights, if any. The election or appointment of an officer shall not of itself create contract rights. Should any vacancy occur among the officers by reason of any of the specified acts or events, the position shall be filled by appointment made by the Board or by the President, if he is so authorized by the Board. Any individual may be elected to, and may hold, more than one office of the Corporation.

SECTION 3. Duties. The powers and duties of the several officers shall be as provided from time to time by resolution or other directive of the Board. In the absence of such provisions, the respective officers shall have the powers and shall discharge the

duties customarily and usually held and performed by like officers of corporations similar in organization and business purposes to the Corporation.

SECTION 4. Compensation. Officers may be paid such reasonable compensation as the Board may from time to time authorize and direct.

ARTICLE V.

Stock Certificates and Their Transfer

SECTION 1. Stock Certificates. Certificates representing shares of the Corporation shall be in such form (consistent with applicable law) as shall be determined by the Board. All certificates for shares shall be consecutively numbered or otherwise identified. The name and address of the person to whom the shares represented thereby are issued, with the number of shares and date of issue, shall be entered on the stock transfer books of the Corporation. All certificates surrendered to the Corporation for transfer shall be canceled and no new certificate shall be issued until the former certificate for a like number of shares shall have been surrendered and canceled, except that in case of a lost, destroyed, or mutilated certificate a new one may be issued therefor on such terms and indemnity to the Corporation as the Board may prescribe.

SECTION 2. Transfers of Stock. Transfer of shares of the Corporation shall be made in the manner specified in the Uniform Commercial Code. The Corporation shall maintain stock transfer books, and any transfer shall be registered thereon only on request and surrender of the stock certificates representing the transferred shares, duly endorsed. The Corporation shall have the absolute right to recognize as the owner of any shares of stock issued by it, the person or persons in whose the name the certificate representing such shares stands according to the books of the Corporation for all proper

corporate purposes, including the voting of the shares represented by the certificate at a regular or special meeting of shareholders, and the issuance and payment of dividends on such shares.

SECTION 3. Transfer Agents and Registrars. The Board of Directors may appoint, or authorize any officer or officers to appoint, one or more transfer agents and one or more registrars.

SECTION 4. Regulations. The Board of Directors may make such additional rules and regulations, not inconsistent with these By-Laws, as it may deem expedient concerning the issue, transfer and registration of certificates for shares of stock of the Corporation.

SECTION 5. Fixing the Record Date. In order that the Corporation may determine the shareholders entitled to notice of or to vote at any meeting of shareholders or any adjournment thereof, or to express consent to corporate action in writing without a meeting, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or entitled to exercise any rights in respect of any change, conversion or exchange of stock or for the purpose of any other lawful action, the Board of Directors may fix, in advance, a record date, which shall not be more than sixty nor less than ten days before the date of such meeting, nor more than sixty days prior to any other action. A determination of shareholders of record entitled to notice of or to vote at a meeting of shareholders shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

SECTION 6. Registered Shareholders. The Corporation shall be entitled to recognize the exclusive right of a person registered on its records as the owner of shares

of stock to receive dividends and to vote as such owner, shall be entitled to hold liable for calls and assessments a person registered on its records as the owner of shares of stock, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares of stock on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Florida.

ARTICLE VI.

Indemnification

SECTION 1. Indemnification. (1) Each person who was or is made a party or is threatened to be made a party to or is otherwise involved in any action, suit or proceeding, whether civil, criminal, administrative or investigative (hereinafter a "proceeding"), by reason of the fact: (i) that he or she is or was a director or officer of the Corporation, or (ii) that he or she, being at the time a director or officer of the Corporation, is or was serving at the request of the Corporation as a director, trustee, officer, employee or agent of another corporation or of a partnership, joint venture, trust or other enterprise, including service with respect to an employee benefit plan (collectively, "another enterprise"), whether either in case (i) or case (ii) the basis of such proceeding is alleged action or inaction (a) in an official capacity as a director or officer of the Corporation, or as a director, trustee, officer, employee or agent of such other enterprise, or (b) in any other capacity related to the Corporation or such other enterprise while so serving as a director, trustee, officer, employee or agent, shall be indemnified and held harmless by the Corporation to the fullest extent authorized by the Florida Business Corporation Act, as the same exists or may hereafter be amended (but, in the case of any such amendment, only to the extent that such amendment permits the

Corporation to provide broader indemnification rights than permitted prior thereto), against all expense, liability and loss (including without limitation attorneys' fees, judgments, fines, ERISA excise taxes or penalties and amounts paid in settlement) reasonably incurred or suffered by such person in connection therewith. The persons indemnified by this paragraph (1) of this Article VI are hereinafter referred to as "indemnitees." Such indemnification as to such alleged action or inaction shall continue as to an indemnitee who has after such alleged action or inaction ceased to be a director or officer of the Corporation, or director, officer, employee or agent of such other enterprise; and shall inure to the benefit of the indemnitee's heirs, executors and administrators; provided, however, that, except as provided in paragraph (2) of this Article VI with respect to proceedings to enforce rights to indemnification, the Corporation shall indemnify any such indemnitee in connection with a proceeding (or portion thereof) initiated by such indemnitee only if such proceeding (or portion thereof) was authorized by the Board of Directors. The right to indemnification conferred in this Article VI (a) shall be a contract right; (b) shall not be affected adversely to any indemnitee by any amendment of these By-Laws with respect to any action or inaction occurring prior to such amendment; and (c) shall include the right to be paid by the Corporation the expenses incurred in defending any such proceeding in advance of its final disposition (hereinafter an "advancement of expenses"); provided, however, that, if and to the extent the Florida Business Corporation Act requires, an advancement of expenses incurred by an indemnitee shall be made only upon delivery to the Corporation of an undertaking (hereinafter an "undertaking"), by or on behalf of such indemnitee, to repay all amounts so advanced if it shall ultimately be determined by final judicial

decision from which there is no further right to appeal (hereinafter a "final adjudication") that such indemnitee is not entitled to be indemnified for such expenses under this Article VI or otherwise.

(2) If a claim under paragraph (1) of this Article VI is not paid in full by the Corporation within sixty days after it has been received in writing by the Corporation, except in the case of a claim for an advancement of expenses, in which case the applicable period shall be twenty days, the indemnitee may at any time thereafter bring suit against the Corporation to recover the unpaid amount of the claim. If successful in whole or in part in any such suit, or in a suit brought by the Corporation to recover an advancement of expenses pursuant to the terms of an undertaking, the indemnitee shall be entitled to be paid also the expense of prosecuting or defending such suit. In (i) any suit brought by the indemnitee to enforce a right to indemnification hereunder (but not in a suit brought by the indemnitee to enforce a right to an advancement of expenses) it shall be a defense that, and (ii) in any suit by the Corporation to recover an advancement of expenses pursuant to the terms of an undertaking the Corporation shall be entitled to recover such expenses only upon a final adjudication that, the indemnitee has not met the applicable standard of conduct set forth in the Florida Business Corporation Act. Neither the failure of the Corporation (including the Board of Directors, independent legal counsel, or its shareholders) to have made a determination prior to the commencement of such suit that indemnification of the indemnitee is proper in the circumstances because the indemnitee has met the applicable standard of conduct set forth in the Florida Business Corporation Act, nor an actual determination by the Corporation (including the Board of Directors, independent legal

counsel, or its shareholders) that the indemnitee has not met such applicable standard of conduct, shall create a presumption that the indemnitee has not met the applicable standard of conduct or, in the case of such a suit brought by the indemnitee, be a defense to such suit. In any suit brought by the indemnitee to enforce a right to indemnification or to an advancement of expenses hereunder, or by the Corporation to recover an advancement of expenses pursuant to the terms of an undertaking, the burden of proving that the indemnitee is not entitled to be indemnified, or to have or retain such advancement of expenses, under this Article VI or otherwise, shall be on the Corporation.

(3) The rights to indemnification and to the advancement of expenses conferred in this Article VI shall not be exclusive of any other right which any person may have or hereafter acquire under any statute, the Amended and Restated Articles of Incorporation, bylaw, agreement, vote of shareholders or disinterested directors or otherwise.

(4) The Corporation ~~may~~ ^{will} maintain insurance, at its expense, to protect itself and any director, trustee, officer, employee or agent of the Corporation or another enterprise (as defined in paragraph (1) of this Article VI) against any expense, liability or loss, whether or not the Corporation would have the power to indemnify such person against such expense, liability or loss under the Florida Business Corporation Act.

(5) The Corporation may, to the extent authorized from time to time by the Board of Directors, grant rights to indemnification, and to the advancement of expenses, to any employee or agent of the Corporation (or any person serving at the Corporation's request as a director, trustee, officer, employee, or agent of another enterprise) or to persons who are or were a director, officer, employee or agent of a

constituent corporation absorbed by the Corporation in a consolidation or merger or who is or was serving at the request of such constituent corporation as a director, officer, employee or agent of another enterprise, in each case as determined by the Board to the fullest extent of the provisions of this Article VI in cases of the indemnification and advancement of expenses of directors and officers of the Corporation, or to any lesser extent (or greater extent, if permitted by law) determined by the Board of Directors.

ARTICLE VII.

General Provisions

SECTION 1. Dividends. Subject to the provisions of statute and the Amended and Restated Articles of Incorporation, dividends upon the shares of capital stock of the Corporation may be declared by the Board of Directors at any regular or special meeting. Dividends may be paid in cash, in property or in shares of stock of the Corporation, unless otherwise provided by statute or the Amended and Restated Articles of Incorporation.

SECTION 2. Reserves. Before payment of any dividend, there may be set aside out of any funds of the Corporation available for dividends such sum or sums as the Board of Directors may, from time to time, in its absolute discretion, think proper as a reserve or reserves to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the Corporation or for such other purpose as the Board of Directors may think conducive to the interests of the Corporation. The Board of Directors may modify or abolish any such reserves in the manner in which it was created.

SECTION 3. Seal. The seal of the Corporation shall be in such form as shall be approved by the Board of Directors.

SECTION 4. Fiscal Year. The fiscal year of the Corporation shall be fixed, and once fixed, may thereafter be changed, by resolution of the Board of Directors.

SECTION 5. Checks, Notes, Drafts, Etc. All checks, notes, drafts or other orders for the payment of money of the Corporation shall be signed, endorsed or accepted in the name of the Corporation by such officer, officers, person or persons as from time to time may be designated by the Board of Directors or by an officer or officers authorized by the Board of Directors to make such designation.

SECTION 6. Execution of Contracts, Deeds, Etc. The Board may authorize any officer, employee or agent to enter into any contract or execute and deliver any instrument in the name and on behalf of the Corporation. Such authority may be general or confined to specific instances, or otherwise limited, and if the Board so provides may be delegated by the person so authorized.

SECTION 7. Loans. No loans shall be contracted on behalf of the Corporation and no evidence of indebtedness shall be issued in its name unless authorized by a resolution of the Board. Such authority may be general or confined to specific instances and if the Board so provides may be delegated by the person so authorized.

SECTION 8. Voting of Stock in Other Corporations. Unless otherwise provided by resolution of the Board of Directors, the President, from time to time, may (or may appoint one or more attorneys or agents to) cast the votes which the Corporation may be entitled to cast as a shareholder or otherwise in any other corporation, any of whose shares or securities may be held by the Corporation, at meetings of the holders of the shares or other securities of such other corporation. In the event one or more

attorneys or agents are appointed, the President may instruct the person or persons so appointed as to the manner of casting such votes or giving such consent. The President may, or may instruct the attorneys or agents appointed to, execute or cause to be executed in the name and on behalf of the Corporation and under its seal or otherwise, such written proxies, consents, waivers or other instruments as may be necessary or proper in the circumstances.

ARTICLE VIII.

Amendments

These By-Laws may be amended or repealed or new By-Laws adopted (a) by the affirmative vote of the holders of shares having not less than a majority of the voting power of the outstanding shares of the Corporation entitled to vote thereon at any annual or special meeting of shareholders or (b) by the affirmative vote of at least a majority of the members of the Board of Directors at a regular or special meeting thereof as provided by Article III of these By-Laws. Any by-law made by the Board of Directors may be amended or repealed by action of the shareholders at any annual or special meeting of shareholders.

ATTACHMENT D

TARIFF

ePHONE TELECOM, INC.

REGULATIONS AND SCHEDULE OF INTRASTATE CHARGES
APPLYING TO COMMUNICATIONS SERVICES WITHIN
THE STATE OF FLORIDA

Applicable in the State of Florida

Issued in compliance with the Florida Public Utilities Commission

Issued: August 2, 2002

Effective: _____, 2002

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1145 Herndon Parkway
Herndon, VA 20170

CHECK SHEET

Sheets 1 through 35 inclusive of this tariff are effective as of the date shown at the bottom of the respective sheet(s). Original sheets as named below comprise the original tariff and will be in effect as of the date on the bottom of this sheet.

<u>Page:</u>	<u>Number of Revision:</u>	<u>Page:</u>	<u>Number of Revision:</u>
1	Original	28	Original
2	Original	29	Original
3	Original	30	Original
4	Original	31	Original
5	Original	32	Original
6	Original	33	Original
7	Original	34	Original
8	Original	35	Original
9	Original	36	Original
10	Original	37	Original
11	Original	38	Original
12	Original	39	Original
13	Original	40	Original
14	Original	41	Original
15	Original	42	Original
16	Original		
17	Original		
18	Original		
19	Original		
20	Original		
21	Original		
22	Original		
23	Original		
24	Original		
25	Original		
26	Original		
27	Original		

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Effective: _____, 2002

Issued By: Manager Rates and Tariffs
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 Herndon, VA 20170

TABLE OF CONTENTS

<u>INDEX</u>	<u>PAGE</u>
SECTION 1 — APPLICATION OF TARIFF.....	5
SECTION 2 — EXPLANATION OF TERMS.....	7
SECTION 3 — GENERAL RULES AND REGULATIONS	9
SECTION 4 — INTRASTATE TOLL SERVICES.....	20
SECTION 5 — RATES.....	37

Issued: August 2, 2002

Effective: _____, 2002

Issued By: Manager Rates and Tariffs
 1145 Herndon Parkway
 Herndon, VA 20170

EXPLANATION OF NOTES

- (C) Indicates Changed Regulation
- (D) Indicates Discontinued Rate or Regulation
- (I) Indicates Rate Increase
- (M) Indicates Move in Location of Text
- (N) Indicates New Rate or Regulation
- (R) Indicates Rate Reduction
- (T) Indicates Change of Text Only

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Effective: _____, 2002

Issued By: Manager Rates and Tariffs
1145 Herndon Parkway
Herndon, VA 20170

Section 1 – APPLICATION OF TARIFF

CONTENTS

	<u>Page</u>
1.1 APPLICATION OF TARIFF	6
1.1.1 Service Territory.....	6
1.1.2 Availability	6

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Effective: _____, 2002

Issued By: Manager Rates and Tariffs
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Herndon, VA 20170

Section 1 – APPLICATION OF TARIFF (cont'd)

1.1 APPLICATION OF TARIFF

This Tariff sets forth the regulations and rates applicable to services provided by ePHONE Telecom, Inc. (“ePHONE”), with its principal offices at: 1145 Herndon Parkway, Herndon, Virginia 20170, as follows:

The furnishing of intrastate interexchange communications services by virtue of one-way and/or two-way information transmission between points within the State of Florida.

This tariff is on file with the Florida Public Service Commission and copies may be inspected, during normal business hours, at the Company’s principal place of business.

1.1.1 Service Territory

ePHONE will provide service throughout the entire State of Florida.

1.1.2 Availability

Service is available where facilities permit.

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Section 2 – EXPLANATION OF TERMS

Certain terms used generally throughout this Tariff are defined below. The terms defined in this Tariff include the plural as well as the singular. Unless otherwise expressly stated, the words “herein,” “hereof,” “hereunder” and other similar words refer to this Pricing Guide as a whole and not to any particular subsection. The words “include” and “including” shall not be construed as terms of limitation.

Charges: The rates and charges, including but not limited to Usage Charges, Monthly Charges, and Termination Charges, assessed the Customer in accordance with this Tariff.

Company: ePHONE Telecom, Inc.

Commission: The Florida Public Utilities Commission.

Customer: A person, firm, corporation or any other entity that orders Service and is responsible for the payment of Charges and compliance with the Company’s regulations. A person, firm, corporation or any other entity that reasonably appears to be acting with the Customer’s authority shall be deemed to be acting on behalf of the Customer

Flat Rate Service: The type of exchange service provided at a monthly rate with an unlimited number of calls within a specified primary calling area.

Intellectual Property: Patents and patent rights, trademarks and trademark rights, trade names and trade name rights, service marks and service mark rights, service names and service name rights, inventions, copyrights and copyright rights, processes, formulae, logos, trade secrets, industrial models, customer lists, designs, methodologies, computer programs (including all source codes) and related documentation, technical information, manufacturing, engineering and technical drawings, know-how and all pending applications for and registrations of patents, trademarks, service marks and copyrights.

Monthly Charge: A flat charge assessed the Customer each month for the use of the Company’s Service.

Issued: August 2, 2002

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1145 Herndon Parkway
Herndon, VA 20170

Section 2 – EXPLANATION OF TERMS (cont'd)

Operational Service Date: The date when any Service, or any part of it, is first made available to the Customer by the Company or the date when the Customer first starts to use such Service (or any part of it), whichever date is the earlier.

Other Facilities Supplier: An entity other than the Company that provides facilities or services in connection with the Service furnished by the Company under this Pricing Guide, and not as a part of a joint undertaking with the Company to furnish Service under this Pricing Guide.

PIN: Personal Identification Number. The PIN is a unique code assigned to a Customer of Company prepaid calling card services. The PIN is used to access the Company network for the purpose of placing calls through a Company prepaid calling card.

Resale of Service: The subscription to communications service and facilities by one entity and the reoffering of communications service to others (with or without 'adding value') for profit.

Service Order: The submission of a Company order form containing billing, technical and other descriptive information designed to enable the Company to furnish Service to the Customer.

State: The State of Florida.

Telephone Call: A voice connection between two or more telephone stations through the public switched exchange system.

Usage Charge: A charge assessed the Customer for the use of the Company's Service. Usage Charges are assessed per second or minute of use or multiple thereof, as specified in Section 5 of this Tariff.

Issued: August 2, 2002

Effective: _____, 2002

Issued By: Manager Rates and Tariffs
1145 Herndon Parkway
Herndon, VA 20170

Section 3 – GENERAL RULES AND REGULATIONS

CONTENTS

	<u>Page</u>
3.1 UNDERTAKING OF THE COMPANY	10
3.1.1 Scope	10
3.1.2 Availability of Service	10
3.1.3 Liability of the Company	10
3.1.4 Uncompleted Calls	10
3.2 OBLIGATIONS OF THE CUSTOMER	14
3.2.1 Use of Service	14
3.2.2 Use and Ownership of Equipment	14
3.2.3 Minimum Period of Service	14
3.2.4 Payment for Services	15
3.3 SUSPENSION OR TERMINATION OF SERVICE	17
3.3.1 Suspension by the Company	17
3.3.2 Termination by the Company	17
3.3.3 Termination by the Customer	18
3.4 PERFORMANCE CREDITS FOR SERVICE INTERRUPTIONS	19

Issued: August 2, 2002

Effective: _____, 2002

Issued By: Manager Rates and Tariffs
 1145 Herndon Parkway
 Herndon, VA 20170

Section 3 – GENERAL RULES AND REGULATIONS (cont'd)

3.1 UNDERTAKING OF THE COMPANY

3.1.1 Scope

The Company undertakes to provide Service between the points described herein, in accordance with the terms and conditions set forth in this Tariff. The Company shall maintain sole and absolute discretion over the routing of Service furnished hereunder.

3.1.2 Availability of Service

Service is available twenty-four (24) hours per day, seven (7) days per week, subject to the availability of facilities and subject to transmission, atmospheric, topographical and like conditions. The Company may limit or interrupt the use of Service because of (i) the lack of transmission medium capacity, (ii) the need to perform maintenance, modifications, upgrades, relocations, testing or other similar activities necessary for the provision of Service, or (iii) any cause beyond its control. The Company reserves the right, when necessary, to arrange for Service to be furnished through the facilities of Other Facilities Suppliers or other entities or through the use of agents or subcontractors.

3.1.3 Liability of the Company

3.1.3.1 Except as stated in this Section 3.1.3, the Company shall not be liable for damages of any kind, including without limitation consequential, special or indirect damages, arising out of or related to events, acts, rights or privileges contemplated in this Tariff. This Tariff does not limit the liability of the Company for willful misconduct, if established as a result of judicial or administrative proceedings.

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Effective: _____, 2002

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Herndon, VA 20170

Section 3 – GENERAL RULES AND REGULATIONS (cont'd)

3.1 UNDERTAKING OF THE COMPANY (cont'd)

3.1.3 Liability of the Company (cont'd)

3.1.3.2 THE COMPANY MAKES NO WARRANTY, EITHER EXPRESSED OR IMPLIED, BY OPERATION OF LAW OR OTHERWISE, CONCERNING THE COMPANY'S SERVICES, INCLUDING, WITHOUT LIMITATION, WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE. THE COMPANY DOES NOT AUTHORIZE ANYONE, WHETHER A COMPANY EMPLOYEE, AGENT, SUB-CONTRACTOR, OR OTHERWISE, TO MAKE A WARRANTY OF ANY KIND ON ITS BEHALF AND THE CUSTOMER SHOULD NOT RELY ON ANY SUCH STATEMENT. NEITHER THE COMPANY NOR ANY OF ITS SUBCONTRACTORS OR SUPPLIERS WILL BE LIABLE TO THE CUSTOMER FOR LOST REVENUES, LOST PROFITS, LOST DATA, OR OTHER SPECIAL, INCIDENTAL, INDIRECT OR CONSEQUENTIAL DAMAGE OR FOR LOSS, DAMAGE OR EXPENSE DIRECTLY OR INDIRECTLY ARISING FROM THE CUSTOMER'S OR ANY OTHER PARTY'S USE OF OR INABILITY TO USE SERVICES EITHER SEPARATELY OR IN COMBINATION WITH OTHER EQUIPMENT OR FOR LOSS OF ANY KIND, WHETHER OR NOT THE COMPANY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGE OR LOSS, NOR SHALL ANY RECOVERY AGAINST THE COMPANY, WHETHER IN CONTRACT, TORT (INCLUDING NEGLIGENCE, STRICT LIABILITY OR OTHERWISE) BE GREATER IN AMOUNT THAN THE CHARGES PAID BY THE CUSTOMER TO THE COMPANY UNDER THIS TARIFF. THE CUSTOMER ASSUMES ALL RISKS AND LIABILITY FOR LOSS, DAMAGE OR INJURY TO PERSONS OR PROPERTY OF THE CUSTOMER OR OTHERS ARISING OUT OF USE OR POSSESSION OF THE SERVICES PROVIDED UNDER THIS TARIFF.

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1145 Herndon Parkway
Herndon, VA 20170

Section 3 – GENERAL RULES AND REGULATIONS (cont'd)

3.1 UNDERTAKING OF THE COMPANY (cont'd)

3.1.3 Liability of the Company (cont'd)

3.1.3.3 The Company shall not be liable for any failure of performance hereunder due to causes beyond its control, including but not limited to any acts of God, fire, lightning, explosion, flood, extreme weather conditions or other catastrophes; any law, order, regulation, directive, action or request of the United States Government, or any other government, including state and local governments having jurisdiction over the Company, or of any department, agency, commission, bureau, corporation or other instrumentality of any one or more of said governments, or of any civil or military authority; any national emergencies, insurrections, riots or wars; or any labor difficulties.

3.1.3.4 The Company shall not be liable for any act or omission of Other Facilities Suppliers or for any damages, including Usage Charges, the Customer may incur as a result of the unauthorized use or misuse of the Service. Unauthorized use or misuse includes, but is not limited to, the unauthorized use or misuse of Service by the Customer, the Customer's employees, third parties, or the public. The Company does not warrant or guarantee that it can prevent unauthorized use or misuse, and the Customer is responsible for controlling access to, and use of, the Service.

3.1.3.5 The Company shall also not be liable for: (a) the interception or breach in privacy or security of any Service or communications provided under this Tariff; (b) libel, slander, or infringement of copyright arising from or in connection with the transmission of communications by means of the Service provided by the Company; or (c) infringement of patents or trade secrets arising from the combination, connection, or use of the Service with Customer-provided equipment, facilities or services.

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Herndon, VA 20170

Section 3 – GENERAL RULES AND REGULATIONS (cont'd)

3.1 UNDERTAKING OF THE COMPANY (cont'd)

3.1.3 Liability of the Company (cont'd)

3.1.3.6 Each provision of this Tariff limiting or excluding liability operates separately and survives independently of the others.

3.1.4 Uncompleted Calls

There shall be no charges for uncompleted calls.

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Effective: _____, 2002

Issued By: Manager Rates and Tariffs
1145 Herndon Parkway
Herndon, VA 20170

Section 3 – GENERAL RULES AND REGULATIONS (cont'd)

3.2 OBLIGATIONS OF THE CUSTOMER

3.2.1 Use Of Service

Any service provided under this Tariff may be resold to or shared (jointly used) with other persons at the customer's option. The customer remains solely responsible for all use of service ordered by it or billed to its telephone number(s) pursuant to this Tariff, for determining who is authorized to use its service, and for promptly notifying the Company of any unauthorized use. The customer may advise its customers that a portion of its service is provided by the Company, but the customer shall not represent that the Company jointly participates with the customer in the provision of the service.

3.2.2 Reserved.

3.2.3 Minimum Period of Service

The minimum period of service is one month except as otherwise provided in this Tariff.

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Effective: _____, 2002

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1145 Herndon Parkway
Herndon, VA 20170

Section 3 – GENERAL RULES AND REGULATIONS (cont'd)

3.2 OBLIGATIONS OF THE CUSTOMER (cont'd)

3.2.4 Payment for Services

- 3.2.4.1 The Customer is responsible for payment of all Charges for Service furnished by the Company to the Customer. Charges for each Service shall commence on its Operational Service Date. All Charges for services shall be paid in accordance with the timeframe set forth in Section 4 of this Tariff. The Customer shall provide the Company 30 days' advance notice in writing of any change in its address or payment method for prepaid services that are based upon recurring Monthly Charges. The Customer's responsibility for timely payment of all Charges is not changed due to the Customer's failure to receive an invoice.
- 3.2.4.2 The Customer shall not be excused from paying the Company for Service provided to the Customer or any portion thereof on the basis that unauthorized use or misuse occurred over the Service. The Customer shall indemnify and hold harmless the Company against all costs, expenses, claims or actions arising from unauthorized use or misuse of any nature of the Service. If the Company initiates legal proceedings to collect any amount due hereunder and the Company substantially prevails in such proceedings, then the defendant Customer shall pay the reasonable counsel fees and costs of the Company in prosecuting such proceedings and appeals.
- 3.2.4.3 State and local sales, use, excise and other taxes and surcharges, where applicable, shall be added to the Charges contained herein, unless the Customer provides a properly executed certificate of exemption from such taxes and surcharges.

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Herndon, VA 20170

Section 3 – GENERAL RULES AND REGULATIONS (cont'd)

3.2 OBLIGATIONS OF THE CUSTOMER (cont'd)

3.2.4 Payment for Services (cont'd)

- 3.2.4.4 The Customer may be required to provide suitable security, including but not limited to a deposit or other such advance payment, to be held by the Company as a guaranty of the payment of Charges in accordance with the Commission's rules.
- 3.2.4.5 The Company, upon the termination of Service, will refund the Customer's deposit, or the balance in excess of unpaid Charges, if any, for Service in accordance with the Commission's rules.
- 3.2.4.6 When the Customer disputes a charge for the Company's Service, the Customer shall: I(i) advise the Company in writing that the charge or any portions thereof is disputed by the Customer; and (ii) provide a written explanation of the basis for the dispute within 30 days of the invoice date in question. The Company will review the Customer's these materials and notify the Customer within 15 days of the outcome of its review.
- 3.2.4.7 The Customer shall be responsible for the payment of a Returned Check Charge of \$10.00 when the bank returns a check that has been presented to the Company by a customer in payment for charges.
- 3.2.4.8 Customer is in default unless payment for a prepaid service with a Monthly Charge is cleared by the Customer's credit card or financial institution on the Due Date.
- 3.2.4.9 Reserved.

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Effective: _____, 2002

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1145 Herndon Parkway
Herndon, VA 20170

Section 3 – GENERAL RULES AND REGULATIONS (cont'd)

3.3 SUSPENSION OR TERMINATION OF SERVICE

3.3.1 Suspension by the Company

Subject to the Commission's rules, the Company may, without incurring any liability, suspend Service to the Customer if such action is necessary to protect Company employees, agents, sub-contractors, facilities, equipment or Service; provided, however, that the Company shall give Customers who are capable of being identified prompt advance notice of any such suspension where possible.

Upon non-payment of any sum owing to the Company for Monthly Charges under this Tariff, the Company may, by 24 hours advance notice to the Customer suspend the furnishing of Service under this Tariff without incurring any liability. Suspension for cause does not relieve the Customer of any obligation to pay Charges that have accrued. Should the Company restore Service after suspension for cause, the Customer shall be responsible for the payment of any outstanding Charges, along with any reconnection charges the Company may incur from third parties from the the suspension and restoration of Service.

3.3.2 Termination by the Company

The Company may terminate Service to the Customer for cause, without incurring any liability: (a) after suspension of Service for nonpayment in accordance with Section 3.3.1, if such non-payment is not corrected within two (2) days following the suspension of Service; (b) when the Company has reason to believe that the Customer is not in compliance with any provision of this Tariff; (c) when the Company has reason to believe that the Customer provided false or misleading information to the Company in connection with a Service Order; (d) when the Company has reason to believe that the Customer has used or has attempted to use the Service for an illegal or unlawful purpose; or (e) following the initiation by or against the Customer of a proceeding in bankruptcy, reorganization, insolvency, receivership or assignment for the benefit of creditors. Termination for cause does not relieve the Customer of any obligation to pay Charges that have accrued for Service provided under this Tariff.

Issued: August 2, 2002

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Issued By: Manager Rates and Tariffs
1145 Herndon Parkway
Herndon, VA 20170

Section 3 – GENERAL RULES AND REGULATIONS (cont'd)

3.3 SUSPENSION OR TERMINATION OF SERVICE (cont'd)

3.3.3 Termination by the Customer

The Customer may terminate service according to the conditions of that service as stated under Section 4, Service Offerings.

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Herndon, VA 20170

Section 3 – GENERAL RULES AND REGULATIONS (cont'd)

3.4 PERFORMANCE CREDITS FOR SERVICE INTERRUPTIONS

No Performance Credits are available for service interruptions.

Issued: August 2, 2002

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Issued By: Manager Rates and Tariffs
1145 Herndon Parkway
Herndon, VA 20170

Section 4 -- INTRASTATE TOLL SERVICES

CONTENTS

	<u>Page</u>
4.1 GENERAL	21
4.1.1 Description.....	21
4.1.2 Timing of Calls.....	21
4.1.3 Promotional Trial Services.....	21
4.2 PREPAID SERVICES	22
4.2.1 Flat Rate Service.....	22
4.2.1.1 Unlimited Long Distance Calling Plan	22
4.2.2 Metered Service.....	25
4.2.2.1 Prepaid Calling Cards.....	25
4.2.2.2 E-TRANS-PORT™	27
4.2.2.3 Talk 500.....	34

Issued: August 2, 2002

Effective: _____, 2002

Issued By: Manager Rates and Tariffs
1145 Herndon Parkway
Herndon, VA 20170

Section 4 – INTRASTATE TOLL SERVICES (cont'd)

4.1 GENERAL

4.1.1 Description

Intrastate toll service is furnished for communication between telephones within the State in accordance with the regulations and schedules of charges specified in this Tariff. The toll service charges specified in this section are in payment for all service furnished between the calling and called telephone, except as otherwise provided in this Tariff.

4.1.2 Timing Of Calls

Unless otherwise indicated, all calls are timed in one- minute increments and all calls that are fractions of a minute are rounded up to the next whole minute. Call timing ends when the calling station "hangs up," thereby releasing the network connection. If the called station "hangs up" but the calling station does not, chargeable time ends when the network connection is released by automatic timing equipment in the telephone network.

4.1.3 Promotional Trial Services

The Company may establish temporary promotional programs wherein it may waive or reduce nonrecurring or recurring charges, to introduce a present or potential customer to a service not previously subscribed to by the customer. During a Promotional Trial, the service is provided to all eligible customers who ask to participate. Appropriate notification of the promotion will be made to all eligible customers by using direct mail, broadcast or print media, direct contact or other comparable means of notification. The Company retains the right to limit the size and scope of a Promotional Trial.

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Section 4 – INTRASTATE TOLL SERVICES (cont'd)

4.2 PREPAID SERVICES

4.2.1 Flat Rate Service

4.2.1.1 Unlimited Long Distance Calling Plan

4.2.1.1.1 General Description

The Unlimited Long Distance Calling Plan is a residential prepaid service that allows a Customer to place unlimited intrastate and interstate calls during a 30-day period for a fixed Monthly Charge. The Customer may place calls from a fixed residential phone, payphone or cellular phone (additional charges from the Customer's cellular service provider may apply) using an 800 number supplied by the Company.

4.2.1.1.2 Service Ordering

A Customer may order the Unlimited Long Distance Calling Plan through telemarketing channels or directly by calling Customer Service at 1-866-873-7500. Once a valid Service Order has been placed, the Company will provide the Customer with an 800-access number and a PIN.

4.2.1.1.3 Service Restrictions

The Unlimited Long Distance Calling Plan is available for use only by individual residential subscribers. Business, corporations and other such entities are ineligible for this service. The Customer must utilize a touch-tone phone in order to access the service. Simultaneous calls using a single PIN are prohibited.

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Section 4 – INTRASTATE TOLL SERVICES (cont'd)

4.2 PREPAID SERVICES (cont'd)

4.2.1 Flat Rate Service (cont'd)

4.2.1.1 Unlimited Long Distance Calling Plan (cont'd)

4.2.1.1.4 Service Period

After placing a valid Service Order, the Customer is entitled to utilize the Unlimited Long Distance Calling Plan for a 10-day period, during which no charges shall apply. Following the 10-day trial period, the Company shall charge the Customer the Monthly Charges set forth in Section 5 of this Tariff for each 30-day period (Service Period). The Service Period may begin at any point in a given month. The service period continues until terminated in accordance with the terms set forth in this Tariff.

4.2.1.1.5 Payment

Payment is made through automatic debit from the bank account specified by the Customer or through automatic charges to an approved credit card. By placing a Service Order, Customer expressly agrees to permit the Company to debit the specified bank account or to charge the designated credit card at the beginning of each Service Period.

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Section 4 – INTRASTATE TOLL SERVICES (cont'd)

4.2 PREPAID SERVICES (cont'd)

4.2.1 Flat Rate Service (cont'd)

4.2.1.1 Unlimited Long Distance Calling Plan (cont'd)

4.2.1.1.6 Termination by the Customer

The Service Period continues until terminated by the Customer or the Company. The Customer may terminate service by providing advanced notice to the Company no later than 5 days prior to the beginning of a new 30-day Service Period. Such cancellation shall be effective for the next Service Period. No partial refunds or credits are available.

4.2.1.1.7 Termination by the Company

In addition to its rights under Section 3.3.2 of this Tariff, the Company shall have the right to terminate service immediately in the event that Customer has insufficient funds available when the Company attempts to collect the Monthly Charge through the debit of the Customer bank account or credit card.

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