

VONAGE HOLDINGS CORP
Form 10-K
February 16, 2012
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION • WASHINGTON, D.C. 20549

FORM 10-K

<input checked="" type="checkbox"/> Annual Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934 For the fiscal year ended December 31, 2011	or	<input type="checkbox"/> Transition Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934 For the transition period from to
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Commission file number 001-32887
VONAGE HOLDINGS CORP.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	11-3547680 (I.R.S. Employer Identification No.)
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23 Main Street, Holmdel, New Jersey (Address of principal executive offices)	07733 (Zip Code)
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Registrant's telephone number, including area code: (732) 528-2600

Securities registered pursuant to Section 12(b) of the Act:	
Title of each class	Name of each exchange on which registered
Common Stock, Par Value \$0.001 Per Share	The New York Stock Exchange
Securities registered pursuant to Section 12(g) of the Act:	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Check one:

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant at June 30, 2011 was \$641,189,789 based on the closing price of \$4.41 per share.

The number of shares outstanding of the registrant's common stock as of January 31, 2012 was 225,627,886.

Documents Incorporated By Reference

Selected portions of the Vonage Holdings Corp. definitive Proxy Statement, which will be filed with the Securities and Exchange Commission within 120 days after December 31, 2011, are incorporated by reference in Part III of this Form 10-K.

Table of Contents

VONAGE HOLDINGS CORP.
 FORM 10-K
 FOR THE FISCAL YEAR ENDED December 31, 2011

TABLE OF CONTENTS

	Page
PART I	
Item 1. <u>Business</u>	<u>2</u>
Item 1A. <u>Risk Factors</u>	<u>8</u>
Item 1B. <u>Unresolved Staff Comments</u>	<u>17</u>
Item 2. <u>Properties</u>	<u>17</u>
Item 3. <u>Legal Proceedings</u>	<u>17</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>19</u>
PART II	
Item 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>20</u>
Item 6. <u>Selected Financial Data</u>	<u>22</u>
Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>30</u>
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>40</u>
Item 8. <u>Financial Statements and Supplementary Data</u>	<u>41</u>
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>41</u>
Item 9A. <u>Controls and Procedures</u>	<u>41</u>
Item 9B. <u>Other Information</u>	<u>42</u>
PART III	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	<u>43</u>
Item 11. <u>Executive Compensation</u>	<u>43</u>
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>43</u>
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	<u>43</u>
Item 14. <u>Principal Accountant Fees and Services</u>	<u>43</u>
PART IV	
Item 15. <u>Exhibits, Financial Statement Schedules</u>	<u>47</u>
	<u>48</u>
	<u>F-1</u>

FORWARD-LOOKING STATEMENTS

Table of Contents

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains statements and other information which are deemed to be “forward-looking” within the meaning of the Private Securities Litigation Reform Act of 1995 (the “Litigation Reform Act”). These forward-looking statements and other information are based on our beliefs as well as assumptions made by us using information currently available.

The words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “will,” “should” and similar expressions, as they relate to us, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events, are subject to certain risks, uncertainties, and assumptions, and are not a guarantee of future performance.

Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in such forward-looking statements or information. In light of the significant uncertainties in these forward-looking statements, you should not place undue reliance on these forward-looking statements. The forward-looking statements and information contained in this Annual Report on Form 10-K relate to events and state our beliefs and the assumptions made by us only as to the date of this Annual Report on Form 10-K. We do not intend to update these forward-looking statements, except as required by law.

In accordance with the provisions of the Litigation Reform Act, we are making investors aware that such forward-looking statements, because they relate to future events, are by their very nature subject to many important factors that could cause actual results to differ materially from those contemplated by the forward-looking statements contained in this Annual Report on Form 10-K, any exhibits to this Form 10-K and other public statements we make. Such factors include, but are not limited to: the competition we face; our ability to adapt to rapid changes in the market for voice and messaging services; our ability to retain customers and attract new customers; our ability to establish and expand strategic alliances; our dependence on third party facilities, equipment, systems and services; our ability to implement our new billing and ordering management system; system disruptions or flaws in our technology and systems; intellectual property and other litigation that have been and may be brought against us; failure to protect our trademarks and internally developed software; our ability to obtain or maintain relevant intellectual property licenses; results of regulatory inquiries into our business practices; uncertainties relating to regulation of VoIP services; increased governmental regulation, currency restrictions, and other restraints and burdensome taxes and risks incident to foreign operations; our dependence upon key personnel; our history of net losses and ability to achieve consistent profitability in the future; fraudulent use of our name or services; our ability to maintain data security; security breaches and other compromises of information security; our dependence on our customers' existing broadband connections; differences between our service and traditional phone services, including our 911 service; any reinstatement of holdbacks by our vendors; our ability to obtain additional financing if required; restrictions in our debt agreements that may limit our operating flexibility; and other factors that are set forth in the “Risk Factors” section and other sections of this Annual Report on Form 10-K, as well as in our Quarterly Reports on Form 10-Q and Current Reports on Form 8-K.

FINANCIAL INFORMATION PRESENTATION

For the financial information discussed in this Annual Report on Form 10-K, other than per share and per line amounts, dollar amounts are presented in thousands, except where noted. All trademarks are the property of their owners.

Table of Contents

PART I

ITEM 1. Business

OVERVIEW

OVERVIEW

We are a leading provider of communications services connecting people through broadband devices worldwide. We rely heavily on our network, which is a flexible, scalable Session Initiation Protocol (SIP) based Voice over Internet Protocol, or VoIP, network. This platform enables a user via a single “identity,” either a number or user name, to access and utilize services and features regardless of how they are connected to the Internet, including over 3G, 4G, Cable, or DSL broadband networks. This technology enables us to offer our customers attractively priced voice and messaging services and other features around the world.

In 2009, we shifted our primary emphasis from the domestic home phone replacement market to the international long distance market. With Vonage World we offer unlimited calling domestically and to more than 60 countries, including India, Mexico, and China, for a flat monthly rate. We believe the value and convenience provided by Vonage World is particularly appealing to international long distance callers compared to offers from our competitors.

In addition to our landline telephony business, we are leveraging our technology to offer services and applications for mobile and other connected devices to address large existing markets. We introduced our first mobile offering in late 2009 and have continued to build upon our mobile services strategy with two product introductions in mid-2011. In early 2012, we introduced Vonage Mobile, our all-in-one mobile application that provides free calling and messaging between users who have the application, as well as low-cost international calling to more than 200 countries to any other phone. In addition, calls by users of the mobile application to Vonage home or business lines are also free. This mobile application works over WiFi, 3G and 4G and in more than 90 countries worldwide. Vonage Mobile consolidates the best features of our prior applications, while adding important functionality, better value, and improved ease of use. Vonage Mobile users can instantly add calling credit from within the application through iTunes or the Android Market for calls to users without the application. Vonage Mobile uses the phone's existing mobile number and contact list, eliminating the need for unique user names and duplicate identities for contacts and allowing users to build a free global calling and messaging network from their existing contacts using the application's multiple invitation system.

We have made significant financial progress over the past four years providing a solid foundation for the future. We have managed a significant strategic shift while transforming the cost structure in our core business to drive significant improvements in profitability. We enhanced the value of our product by investing in upgraded systems, streamlined processes, and improved customer experience, which we believe have helped stabilize our subscriber base while driving structural cost reductions throughout the company. In addition to reducing ongoing costs, these structural improvements enabled us to absorb incremental costs resulting from a growth in international minutes as we added new customers to our Vonage World plan. By lowering international termination costs, lowering domestic calling rates, and reducing the cost of our devices by nearly a third, we have significantly improved our profitability. In 2011, our core business generated substantial net income and cash flow on relatively flat service revenues, driven by an aggressive focus on driving efficiencies throughout our operations. Through two refinancings in the past 14 months, we have reduced our debt by over 50% and lowered interest rates from highs of 20% to less than 4%, saving \$43 million in annual interest expense from the debt structure in place in 2010.

We had approximately 2.4 million subscriber lines for broadband telephone replacement services as of December 31, 2011. We bill customers in the United States, Canada, and the United Kingdom. Customers in the United States represented 94% of our subscriber lines at December 31, 2011.

OUR VISION AND STRATEGY

Building on our solid financial foundation, we are focused on growth in three primary areas that target substantial existing revenue streams.

International long distance calling. We are solidifying our core business through continued penetration of international calling segments. The markets for international long distance are large and growing, and they allow us to leverage our VoIP network by providing customers a low-cost and convenient alternative to services offered by telecom and cable providers and international calling cards. According to industry data, the total outbound >international long distance calling market is estimated to be \$80 billion, and approximately 10 to 15 percent of all US households make international long distance calls, using a mix of home and mobile phones. While our primary emphasis remains the international long distance calling market in the United States, the domestic calling market continues to be attractive. Despite the shift to wireless and a decline in usage, according to industry data there are approximately 75 million households in the United States with landlines. This is a sizable market opportunity.

Our strategic focus on international segments has been successful. Approximately 50 percent of our customers are now on Vonage World, and approximately 35 percent are international long distance callers, which we classify as customers who make 20 or more minutes of international long distance calls per month. To increase the visibility of our Vonage World plan, we have shifted an increasing portion of our marketing budget from broad national advertising as we target attractive segments of the international long distance market. We have prioritized our marketing and sales programs, and in the past year and a half, opened three bilingual sales and service sites. As a result, our base of Hispanic callers has grown by more than 50 percent in the past year.

We have direct sales channels where customers can subscribe to our services on-line or through our toll-free number, as well as a retail distribution channel through regional and national retailers and localized street teams. In 2011, we doubled the number of retail distribution outlets with the recent addition of Best Buy, Kmart and Sears. Combined with our existing partners, Walmart, Fry's and Microcenter, we

Table of Contents

now have distribution agreements to sell our services in approximately 6,000 stores across the country. We now have approximately 60 event teams, up from six in January of 2011. These teams operate in 35 ethnic-concentrated markets across 18 states including California, Texas, Florida, and New York. These teams expand our presence in these communities by marketing and selling Vonage service at Hispanic and Asian-Indian events and community gathering places.

Mobile and other connected device services. We are developing next-generation services to meet the increasing demand for services by users of mobile and other connected devices. We believe that our efforts will capitalize on favorable trends including the proliferation of low or no-cost Wi-Fi and other broadband around the world and the accelerating rate of smart phone adoption. In early 2012, we introduced Vonage Mobile, our all-in-one mobile application that provides free calling and messaging between users who have the application, as well as low-cost international calling to more than 200 countries to any other phone. In 2012, we expect to extend our mobile services offering, including standalone mobile products for customers without smartphones as well as building additional features into our Vonage Mobile platform. We also plan to introduce a low cost international roaming feature which would allow customers to receive inbound calls on their mobile device, avoiding high carrier roaming fees while traveling.

Expansion opportunities outside of the United States. We currently have operations in the United States, United Kingdom, and Canada and believe that our low-cost Internet-based communications platform enables us to cost-effectively deliver voice and messaging services to other locations throughout the world.

The global consumer communications market is estimated to be \$200 billion and growing at approximately 7% per year. We expect to expand our geographic footprint through partnerships and are pursuing a range of business concepts which include jointly providing low rates and expanded footprints with international partners, to placing kiosks in foreign locations, to providing a full suite of communications services sold and marketed by other companies.

SERVICE OFFERINGS

Our home telephone replacement services are offered to residential, small office and home office customers through several service plans with different pricing structures. The service plans include an array of basic and enhanced features, and customers have the opportunity to purchase premium features for an additional fee. We also charge for local and international calling outside of plan limits. Information on our revenues, operating income, and identifiable assets appears in Note 1 to our consolidated financial statements included in Item 8 hereof.

Our primary residential offering is Vonage World with approximately 1.1 million subscriber lines as of December 31, 2011. For a flat monthly fee, this plan includes unlimited local calling and unlimited calling to landline phones in all cities and locations in more than 60 countries, including India, Mexico, and China, and unlimited calling to cellular phones in certain of those countries. In addition, the Vonage World offer includes unlimited Vonage Visual Voicemail, which is "readable voicemail" delivered via email or SMS text message, Vonage Extensions, which extends the plan to additional phone numbers and devices including smartphones and feature phones, and directory assistance. We also market other residential plans that include enhanced features or limited minutes, in addition to offering our legacy Residential Premium Unlimited plan to existing customers.

We view the small and home office market as a potential growth market. Today we offer two small and home office calling plans, one of which offers unlimited local and long distance calling anywhere in the United States, Canada, Puerto Rico, and five European countries and another that includes a specified number of minutes in the United States, Canada, and Puerto Rico. Both plans offer a free dedicated fax line.

As of December 31, 2011, approximately 94% of our United States subscriber lines were for residential service. Approximately 47% of those residential subscriber lines were under the Vonage World plan and 25% were under the Residential Premium Unlimited plan. We offer similar plans in Canada and the United Kingdom. Please see Note 11 to our consolidated financial statements for financial information about our geographic areas.

Each of our residential, small office and home office calling plans provides a number of basic features including call waiting, caller ID with name, call forwarding, and voicemail. We also offer, in some cases for additional fees, a number of enhanced services that we believe help differentiate our service from our competitors, such as:

> Area Code Selection. Customers can select from approximately 270 United States area codes for their telephone number for use with our service, regardless of physical location.

Virtual Phone Number. A customer can have additional inbound telephone numbers that ring on a primary subscriber line, each for an additional fee. Each of these inbound telephone numbers can have a different area code. In addition to United States virtual phone numbers, we offer virtual phone numbers for 19 other countries. For >example, a customer living in New York City with a New York City phone number can purchase a Toronto virtual phone number that rings on the customer's primary subscriber line. In this instance, a caller from Toronto could call the customer's virtual phone number and be billed as if the customer were in Toronto. Virtual phone numbers are not included in our subscriber line count.

Personalized Web-Enabled Voicemail. Our service allows customers to receive e-mail notification of a voicemail >with the voice message attached to the e-mail message as an audio file. Our customers can also check and retrieve voicemails online or from any phone.

Our mobile services include enhancements to our residential, small office and home office calling plans as well as mobile applications that can be initially downloaded for iPhone®, iPad®, iPod touch®, and Android® OS devices for free. In August 2011, we launched Extensions, an enhancement to our flat rate, unlimited international calling plan that extends the plan to additional phone numbers and devices including smartphones and feature phones. A customer may sign-up for up to two extensions with the first extension provided free of charge and the second extension incurring an additional fee. In early 2012, we introduced Vonage Mobile, our all-in-one mobile application that provides free calling and messaging between users who have the application, as well as low-cost international calling to more than 200 countries to any other phone. In addition, calls by users of the mobile application to Vonage home or business lines are also free. This mobile application works over WiFi, 3G and 4G and in more than 90 countries worldwide.

Table of Contents

Devices

In order to access our residential, small office, and home office services, a customer need only connect a standard telephone to a broadband Internet connection through a small Vonage-enabled device. After connecting the device, our customers can use their telephone to make and receive calls. Our adapter includes a networking router and generally permits a subscriber to connect up to two Vonage lines through a high-speed Internet connection. Vonage-enabled devices allow customers to use the Internet connection for their computer and telephones at the same time while ensuring a high quality calling experience. We also offer a cordless multi-phone system solution. Our plug-and-play Vonage-enabled devices permit portability as customers can take their Vonage device to different locations where broadband service is available. Since May 2009, we generally have not charged new customers for the adapters permitting use of our service.

TWORK OERATIONS

NETWORK OPERATIONS

Our network operations are conducted by a wholly-owned subsidiary that holds our networking equipment and employs the personnel who develop and operate our technology.

The Vonage network uses our customer's existing high-speed broadband Internet service to allow calls over the Internet either from a standard telephone through a Vonage-enabled device or through soft phone software or mobile client applications. Our service is not dependent on any specific type or provider of Internet service, and our customers are free to change their Internet service provider in response to a competitive alternative, or because they have moved to a different location. Our Vonage-enabled devices, soft phone software, and mobile client applications allow our customers to be authenticated and authorized to access to our network in a secure manner.

Our network is scalable and geographically distributed for robustness, high availability, and reliability across multiple call processing sites, using regional data interconnection points, where calls to non-Vonage customers are interconnected with the public switched telephone network. We periodically assess the locations of our regional data connection points in connection with efforts to improve the quality of and efficiency in delivering our service. In 2011, we consolidated certain interconnection points, increasing efficiencies and creating a platform for growth. Our interconnections with the public switched telephone network are made pursuant to agreements we have with several telecommunications providers. Under these agreements, we transfer calls originated by our customers to other carriers who connect the call to the called party. We pay a per-minute charge for this. The calls are routed from our network to other carriers' interconnected circuits at co-location facilities in which we lease space. This method of connecting to the public switched telephone network allows us to expand capacity quickly, as necessary to meet call volume, and to provide redundancy within our network. In 2011, we enhanced our call routing platform, increasing our control over call routing which lowered costs and improved call quality. Our business is not substantially dependent upon our agreements with any single carrier or our interconnection agreements because we can easily substitute other telecommunications providers in order to obtain the same or similar service.

Because Vonage's system is not constrained to use any specific broadband service provider to connect to our customers, we can centrally manage and share resources across our customer base to minimize capital investment when entering new markets.

The following are also important in supporting our network operations:

Network Operations Center. We currently maintain a network operations center at our headquarters with monitoring redundancies at several points within our network. The network operations center monitors and manages the status and health of our network elements, allowing us to manage our network in real time, respond to alert notifications, and re-route network traffic as needed. We pursue a multi-faceted approach to managing our network to ensure high call quality and reliable communications services to our customers.

Back Office Systems. In addition to our network management systems, we have developed a number of software systems that enable us to manage our network and service offerings more efficiently and effectively. Key aspects of these systems include:

Network Quality Metrics. We have implemented a suite of advanced metrics gathering and analysis tools that allow us to monitor the performance of our calling and data network, customer premises equipment, and other associated >calling elements in real-time. This suite is proprietary and was developed specifically to address the needs that Vonage has in monitoring, analyzing, understanding, troubleshooting, maintaining, and operating a world-class consumer VoIP platform.

Web Portal. We provide a fully functional customer Web portal that allows our customers to configure and manage almost all aspects of their service on the Internet without requiring intervention of a customer-care representative. >The portal permits customers to add and change features and phone numbers, update billing information, and access all of their call usage and billing details.

Emergency Calling Service and Enhanced 911 Service. We have deployed E-911 service to approximately 99.99% of our U.S. residential and small and home office customer base that is comparable to the emergency calling services provided to customers of traditional wireline telephone companies in the same area. Our E-911 service does not support the calls of our soft phone software users. The emergency calls of our soft phone software users are supported by a national call center. Not all Vonage products require 911 service capabilities, such as our mobile client products. To enable us to effectively deploy and provide our E-911 service, we maintain an agreement with a >provider that assists us in delivering emergency calls to an emergency service dispatcher at the public safety answering point, or PSAP, in the area of the customer's registered location and terminating E-911 calls. We also contract for the national call center that operates 24 hours a day, seven days a week to receive certain emergency calls and for the maintenance of PSAP databases for the purpose of deploying and operating E-911 services. The databases include contact, technical infrastructure, boundary, and routing information for delivery of calls to a PSAP or emergency service providers in the United States.

Local Number Portability. Unlike certain of our VoIP competitors, our system allows our telephone replacement customers to port telephone numbers, which allows new customers to retain their existing telephone numbers when >subscribing to our services. We rely on an agreement with a provider to facilitate the transfer of customer telephone numbers. In addition, we have engaged a provider that performs the third party verification of pertinent local number portability information from our subscribers prior to porting a customer from one local telephone company to us.

Table of Contents

Security. We have developed a service architecture and platform that uses industry-standard security techniques and allows us to remotely manage customer devices. Any Vonage-enabled device used by our customers can be securely managed by us, and these devices use authentication mechanisms to identify themselves to our service in order to place and receive calls. We regularly update our protocols and systems to protect against unauthorized access.

Internet Protocol (IP) Addresses. Every machine on the Internet has a unique identifying number called an Internet Protocol address or IP address. Though there has been recent publicity surrounding the exhaustion of IP addresses under the current Internet Protocol version, we have procured a supply of addresses that we believe will cover our needs for the foreseeable future.

MARKETING

Our marketing objective is to grow subscriber lines and revenue by cost-effectively acquiring and retaining customers. We employ an integrated multi-channel approach to marketing, whereby we evaluate and focus our efforts on efficient marketing vehicles to accomplish our goals. To do this, we make use of both broad-reaching and highly-targeted media channels in the general market and for specific international long distance markets, including television, direct mail, online, alternative media, telemarketing, partner marketing, and customer referral programs. We regularly evaluate the cost per acquisition by media vehicle and reallocate budgets to identify more effective media mixes. We make use of marketing research to gain consumer insights into brand, product, and service performance, and utilize those learnings to improve our messaging and media plans. Market research is also leveraged in the areas of testing, retention marketing, and product marketing to ensure we bring compelling products and services to market for our customers.

SALES AND DISTRIBUTION

Direct Sales

Our primary sales channels for our home telephone replacement services have been in-bound telemarketing and online direct sales. Customers can subscribe to our services at our websites, <http://www.vonage.com>, <http://www.vonage.ca> and <http://www.vonage.co.uk>, or through multiple toll free numbers including 1-877-4VONAGE. We are also increasing efforts to focus on promising international long distance markets. In 2011, we continued to enhance our complete Spanish language experience for our customers, including 24 hour per day inbound telesales, full customer service, a purpose-built Spanish language online environment and purchasing experience, television advertising, as well as direct mail.

Retail Sales

In addition to our direct sales channel, we also offer sales through our retail channel. In 2011, we doubled our retail presence from 3,000 to 6,000 locations at leading regional and national retailers, including Walmart, Sears, Kmart, Best Buy, Fry's Electronics, and Microcenter. We believe that the availability of our devices through premier retailers enhances and reinforces the Vonage brand, and that the retail channel increases our ability to acquire mainstream consumers by reaching them in a familiar and interactive shopping environment. National and regional retailers provide Vonage with a wide footprint to distribute our service. We have opened Vonage kiosks throughout the United States and continue to look at ways to optimize sales performance at each kiosk location while looking at growth opportunities in favorable geographic markets. We refined our kiosk operations in 2011 by supplementing our fixed cost kiosks with pay for performance cost structures in certain markets. In addition, we expanded our key market presence in markets with high ethnic concentration with the introduction of event teams in 2010. Our event teams provide culturally relevant ways to connect with customers at a grass roots level. We expanded our event team presence in 2011 and now operate in over 35 markets across 18 states including California, Texas, Florida, and New York.

Customer Service

We offer our customers support 24 hours a day, seven days a week through both our comprehensive online account management website and our toll free number. Many customers use our self-service website when they have a question or problem with their service and are able to resolve their concerns online without needing to speak to a

customer care representative. Our customers can manage almost all aspects of their accounts online. This capability empowers our customers through self-service and reduces our customer care expenses.

Customers who cannot or do not wish to resolve their questions through our website may contact a customer care representative through our toll free number. We staff our customer care organization through a combination of our own employees and outsourced customer care representatives. All new customer care representatives are trained through an established program developed by Vonage. We also have a separate team that provides advanced technical support for resolving customers' complex issues and an on-boarding team, which provides specialized assistance to new customers. We use extensive monitoring of call quality and customer satisfaction scores to determine additional training or coaching requirements for individual associates and to drive continuous improvement in our processes, policies, and technology.

Billing

All customer billing for our broadband telephone replacement services is automated through our website. We automatically collect all fees from our customers' credit card, debit card or electronic check payment ("ECP"). By collecting monthly subscription fees in advance and certain other charges immediately after they are incurred, we are able to reduce the amount of accounts receivable that we have outstanding, thus allowing us to have lower working capital requirements. Collecting in this manner also helps us mitigate bad debt exposure, which is recorded as a reduction to revenue. If a customer's credit card, debit card or ECP is declined, we generally suspend international calling. Historically, in most cases, we are able to correct the problem with the customer within the current monthly billing cycle. If the customer's credit card, debit card or ECP cannot be successfully processed during three billing cycles (i.e. the current and two subsequent monthly billing cycles), we terminate the account.

We are party to a contract with Amdocs, Inc. pursuant to which Amdocs, Inc. will (i) license to us billing and ordering software, (ii) provide professional services relating to the implementation, operation, support, and maintenance of the licensed systems, and (iii) transition support services in connection with migration to the licensed systems. We expect this software to provide us with enhanced ordering and billing capabilities to better suit the current and future needs of the business. The initial term of the agreement with Amdocs, Inc. extends for five years following the earlier to occur of (i) the date on which a specified number of subscribers are successfully migrated from our current billing and order systems to the licensed system or (ii) the first new subscriber is added to the licensed system. The platform is now operational and it is our intention to transition customers

Table of Contents

to the platform throughout 2012. Billing for some of our existing products such as mobile and other connected devices is handled through third party payment platforms such as iTunes and based on customer and business needs we may continue to use a range of payment vehicles including the Amdocs platform for our products and services in the future.

INTELLECTUAL PROPERTY

We believe that our technological position depends primarily on the experience, technical competence, and the creative ability of our engineering and technology staff. We routinely review our technological developments with our technology staff and business units to identify the aspects of our technology that provide us with a technological or commercial advantage and file patent applications as necessary to protect our technology in the United States and internationally. Our company policies require our employees to assign their intellectual property rights to us and to treat all technology as our confidential information.

In addition to developing technology and intellectual property, we evaluate the licensing and acquisition of technology and intellectual property of third parties to identify opportunities that may provide us with a strategic or commercial advantage in exchange for royalties or other payments. From time to time we receive letters from third parties initiating an opportunity to obtain patent licenses that might be relevant to our business. As a result of these efforts, we have acquired multiple U.S. and foreign patents, and obtained licenses to numerous other patents. We also have become involved in litigation alleging that our products or services infringe on third party patents or other intellectual property rights. See “Item 3. – Legal Proceedings—IP Matters.”

We are the owner of numerous United States and international trademarks and service marks and have applied for registration of our trademarks and service marks in the United States and abroad to establish and protect our brand names as part of our intellectual property strategy. Some of our registered marks are Vonage®, Vonage Mobile® and Vonage Visual Voicemail®.

We endeavor to protect our internally developed systems and maintain our trademarks and service marks. Typically, we enter into confidentiality or license agreements with our employees, consultants, customers, and vendors in an effort to control access to and distribution of our technology, software, documentation, and other information.

COMPETITION

We face continued strong competition from traditional telephone companies, cable companies, wireless companies, and alternative communication providers. Because most of our target customers are already purchasing communications services from one or more of these providers, our success is dependent upon our ability to attract these customers away from their existing providers. We believe that the principal competitive factors affecting our ability to attract and retain customers are price, call quality, customer service, and enhanced services and features.

Traditional telephone and cable companies

The traditional telephone and cable companies are our primary competitors for our broadband telephone services. Traditional telephone companies in particular have historically dominated their regional markets. These competitors include AT&T, Verizon Communications and CenturyLink, as well as rural incumbents such as Frontier Communications. Cable company competitors include companies such as Cablevision, Charter Communications, Comcast Corporation, Cox Communications, and Time Warner Cable. These traditional phone and cable company competitors are substantially larger and better capitalized than we are and have the advantage of a large existing customer base. Many of these competitors are continuing to make substantial investments in delivering broadband Internet access, VoIP phone service, and cable television to their customers and they often have larger product development and marketing budgets than us. Providing home phone, Internet access, and cable television to many of our existing and potential customers may enhance their image as trusted providers of services.

The traditional phone companies own networks that include a “last mile” connection to substantially all of our existing and potential domestic customers as well as the places our customers call domestically. As a result, the vast majority of the calls placed by a Vonage customer are carried over the “last mile” by a traditional phone company, and we

indirectly pay access charges to these competitors for each of these calls. In contrast, traditional wireline providers do not pay us when their customers call our customers.

Cable companies and, in many cases traditional phone companies, are also aggressively using their existing customer relationships to bundle services. For example, they bundle Internet access, cable television, and home phone service with an implied price for the phone service that may be significantly below ours. Certain traditional phone companies are also able to bundle wireless telephone service. Many of these competitors are able to advertise on their local access channels with no significant out-of-pocket cost and through mailings in bills with little marginal cost. They also receive advertising time as part of their relationships with television networks and are able to use this time to promote their telephone service offerings.

Traditional phone and cable companies' ownership of Internet connections to our customers could enable them to detect and interfere with the completion of our customers' calls. While we are not aware of any such occurrence, it is unclear whether current regulations would permit these companies to degrade the quality of, give low priority to or block entirely the information packets and other data we transmit over their lines. In addition, these companies may attempt to charge their customers more for using our services.

Many traditional phone and cable companies routinely send technicians to customers' premises to initiate service. Although this is expensive, it also can be more attractive to customers than installing their own router. In addition, these technicians may install an independent source of power, which can give customers assurance that their phone service will not be interrupted during power outages.

The traditional phone and cable companies have long-standing relationships with regulators, legislators, lobbyists, and the media. This can be an advantage for them because legislative, regulatory or judicial developments in our rapidly evolving industry could have a negative impact on us.

In many cases, we charge prices that are lower than prices charged by the traditional phone and cable companies. In addition, some of our competitors offer low introductory pricing followed by an increase in price after a certain period of time. We believe that these step-up promotions enable us to gain market share by attracting customers who leave our competitors following these price increases. We believe that we also currently compete successfully with the traditional phone and cable companies on the basis of the features we offer that they do not (such as area code

Table of Contents

selection, portable service, virtual phone numbers, and readable voice mail). We offer many of these features at no extra charge.

Wireless telephone companies

We also compete with wireless phone companies, such as AT&T, Sprint, T-Mobile, and Verizon Wireless, for both our broadband telephone services and our mobile services. Some consumers use wireless phones, instead of VoIP phones, as a replacement for a wireline phone. Also, wireless phone companies increasingly are providing wireless broadband Internet access to their customers. As wireless providers offer more minutes at lower prices and other services that improve calling quality, their services have become more attractive to households as a competing replacement for wireline service. For example, many wireless phone companies now offer dual mode phones, which permit voice communications over a Wi-Fi network when available and which do not count against mobile plan minutes. Certain wireless phone companies have also made available products incorporating femtocells that utilize broadband connections to act as a miniature cellular tower, listening for and enhancing signals from a subscriber's cell phone, improving call quality at a subscriber's residence or other location. Calls connected via a femtocell signal are carried over the customer's home broadband network allowing the wireless carriers to offer unlimited calling or discounted rates for calls from home. Wireless telephone companies have a strong retail presence and have significant financial resources. We are developing next-generation services to meet the emerging needs of mobile and other connected device users by delivering easy-to-use applications that provide significant cost savings in large existing markets. We believe that our efforts will capitalize on favorable trends including the proliferation of low or no-cost Wi-Fi and other broadband around the world, accelerating smart phone adoption rates, and the growth of social communities.

Alternative communication providers

We also compete against alternative communication providers such as magicJack, Skype, and Google Voice, some of which are larger than us and have the ability to devote greater resources to their communications services. Some of these service providers, including Internet product and software companies, have chosen to sacrifice telephony revenue in order to gain market share or attract users to their platform and have offered their services at low prices or for free. While not all of these competitors currently offer the ability to call or be called by anyone not using their service, line portability, E911 service, and customer service, in the future they may integrate such capabilities into their service offerings. As we continue the introduction of applications that integrate different forms of voice, messaging, and other services over multiple devices, we face competition from emerging competitors focused on similar integration, as well as from alternative communication providers.

There is a continuing trend toward consolidation of telecommunications companies, including the acquisition of alternative communication providers by Internet product and software companies with significant resources. In addition, certain of our competitors have partnered and may in the future partner with other competitors to offer products and services, leveraging their collective competitive positions. We also are subject to the risk of future disruptive technologies, which could give rise to significant new competition.

In connection with our increasing emphasis on the international long distance market, we face competition from low-cost international calling cards and VoIP providers in addition to traditional telephone companies, cable companies, and wireless companies.

EMPLOYEES

As of December 31, 2011, we had 1,008 employees. None of our employees are subject to a collective bargaining agreement.

AVAILABLE INFORMATION

We were incorporated in Delaware in May 2000 and changed our name to Vonage Holdings Corp. in February 2001. We maintain a website with the address www.vonage.com. The information contained on our website is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. Other than an investor's own Internet

access charges, we make available free of charge through our website our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we have electronically filed such material with, or furnished such material to, the Securities and Exchange Commission.

Table of Contents

ITEM 1A. Risk Factors

You should carefully consider the risks below, as well as all of the other information contained in this Annual Report on Form 10-K and our financial statements and the related notes included elsewhere in this Annual Report on Form 10-K, in evaluating our company and our business. Any of these risks could materially adversely affect our business, financial condition and results of operations and the trading price of our common stock.

For the financial information discussed in this Annual Report on Form 10-K, other than per share and per line amounts, dollar amounts are presented in thousands, except where noted.

If we are unable to compete successfully, we could lose market share and revenue.

The telecommunications industry is highly competitive. We face continued intense competition from traditional telephone companies, cable companies, wireless companies, and alternative communication providers. Our competitors include the traditional telephone service providers, including AT&T, Verizon Communications, and CenturyLink, which provide telephone service based on the public switched telephone network. Some of these traditional providers also have added VoIP services to their existing telephone and broadband offerings. We also face competition from cable companies, such as Cablevision, Charter Communications, Comcast Corporation, Cox Communications, and Time Warner Cable, which have added VoIP services to their existing cable television and broadband offerings. Further, as wireless providers, including AT&T, Sprint, T-Mobile, and Verizon Wireless, offer more minutes at lower prices, better coverage, and companion landline alternative services, including through products such as dual mode phones and femtocells, their services have become more attractive to households as a replacement for wireline service.

Most traditional wireline and wireless telephone service providers and cable companies are substantially larger and better capitalized than we are and have the advantage of greater name and brand name recognition and a large existing customer base. Because most of our target customers are already purchasing communications services from one or more of these providers, our success is dependent upon our ability to attract target customers away from their existing providers. Our competitors' financial resources may allow them to offer services at prices below cost or even for free in order to maintain and gain market share or otherwise improve their competitive positions. Our competitors also could use their greater financial resources to develop and market telephony and messaging services with more attractive features and more robust customer service. In addition, because of the other services our competitors provide, they often choose to offer VoIP services as part of a bundle that includes other products, such as video, high speed Internet access, and wireless telephone service, which we do not offer. This bundle may enable our competitors to offer VoIP service at prices with which we may not be able to compete or to offer functionality that integrates VoIP service with their other offerings, both of which may be more desirable to consumers. Any of these competitive factors could make it more difficult for us to attract and retain customers, reduce our market share and revenues, or cause us to lower our prices or offer additional features that may result in additional costs without commensurate price increases.

We also compete against alternative communication providers, such as magicJack, Skype, and Google Voice, some of which are larger than us, have greater name and brand recognition, and have the ability to devote greater resources to their communications services. Some of these service providers, including Internet product and software companies, have chosen to sacrifice telephony revenue in order to gain market share or attract customers to their platform or have lower cost structures and have offered their services at low prices or for free or using different payment structures such as one-time or low annual fees. As we continue the introduction of applications that integrate different forms of voice and messaging services over multiple devices, we face competition from emerging competitors focused on similar integration, as well as from established alternative communication providers. In order to compete with such service providers, we may have to reduce our prices, which would impair our profitability, or offer additional features that may cause us to incur additional costs without commensurate price increases.

In connection with our increasing emphasis on the international long distance market, we face competition from low-cost international calling cards and VoIP providers in addition to traditional telephone companies, cable companies, and wireless companies. To the extent that these providers target marketing to the same ethnic segments

that we target or strengthen their offerings to these segments, we may have to reduce our prices or increase promotions, which would impair our profitability, or offer additional features that may cause us to incur additional costs without commensurate price increase.

As a result of increasing competition, domestic and international telephony and messaging rates have generally decreased during the past few years, and we expect this trend to continue. We also receive inquiries or demands from state and municipal taxing authorities seeking payment of taxes or similar fees, which taxes and fees are charged to customers. Continued rate pressures or increasing cost to use our services could lessen or eliminate the pricing advantage that we maintain over certain competitors and cause customers or potential customers to select alternative providers or cause us to lower our prices, which would adversely impact our revenues and profitability.

There is a continuing trend toward consolidation of telecommunications companies, including the acquisition of alternative communication providers by Internet product and software companies, which may create competitors with greater resources. In addition, certain of our competitors have partnered and may in the future partner with other competitors to offer products and services, leveraging their collective competitive positions, which makes it more difficult to compete with them and could adversely affect our profitability.

If we fail to adapt to rapid changes in the market for voice and messaging services, then our products and services could become obsolete.

The market for our products and services is constantly and rapidly evolving as we and our competitors introduce new and enhanced products and services and react to changes in VoIP and messaging technology and customer demands. We may not be able to develop or acquire new products and plans or product and plan enhancements that compete effectively with present or emerging VoIP and messaging technologies or differentiate our products and plans based on functionality and performance. In addition, we may not be able to establish or maintain strategic alliances that will permit enhancement opportunities or innovative distribution methods for our products and plans.

To succeed, we believe that we need to expand into new market segments, develop new sources of revenue from new and existing customers, enhance our current products and plans, and develop new products and plans on a timely basis to keep pace with market needs and satisfy the increasingly sophisticated requirements of customers. VoIP and messaging technology is complex, and new products and plans and product and plan enhancements can require long development and testing periods. Any delays in developing and releasing new or enhanced products and plans, including as a result of any limitations with our internal systems or the integration of our new ordering and billing platforms,

Table of Contents

could cause us to lose revenue opportunities and customers. Any technical flaws in products we release could diminish the innovative impact of the products and have a negative effect on customer adoption and our reputation. We also are subject to the risk of future disruptive technologies. New products based on new technologies or new industry standards could render our existing products obsolete and unmarketable. If new technologies develop that are able to deliver competing voice and messaging services at lower prices, better or more conveniently, it could have a material adverse effect on us.

In early 2012, we introduced Vonage Mobile, our all-in-one mobile application that provides free calling and messaging between users who have the application, as well as traditional paid international calling to any other phone. Vonage Mobile is downloadable for free. In the future, we may enhance this service or introduce other similar services for mobile and other connected devices. These services may include optional added cost premium services such as international calling plans, alternatives for high priced international roaming services, and lower cost text messaging. If we are unable to attract users of these premium services offered by Vonage Mobile or future offerings, our net revenues may fail to grow as we expect.

If we are unsuccessful at retaining customers or attracting new customers, including customers who pay for our services for mobile and other Internet connected devices, we may experience a reduction in revenue or may be required to spend more money to grow our customer base.

Our rate of customer terminations for our broadband telephone replacement services, or average monthly customer churn, was 2.6% for the year ended December 31, 2011. During 2011, we added 613,991 customers while 656,641 of our customers terminated. Our churn rate could increase in the future if customers are not satisfied with the quality and reliability of our network, the value proposition of our products, and the ability of our customer service to meet the needs and expectations of our customers. In addition, competition from traditional telephone companies, cable companies, wireless companies, alternative communications providers, and low-cost international calling cards, disruptive technologies, general economic conditions, and our ability to activate and register new customers on the network, also influence our churn rate. While it is a small portion of our current business, we will have similar issues with customers for Vonage Mobile and other services for mobile and other Internet connected devices as that business develops.

As we continue to emphasize the international long distance market, we expect our churn to be impacted by the ethnic segments that we target. For example, we have found that certain ethnic segments have higher churn due to unwillingness to use our existing payment methods. We may not be able to educate these customers in these payment methods or offer alternative payment methods that serve the needs of these customers. In addition, certain ethnic segments that we target may be more likely to have poor or no credit history, indicating that they may have more difficulty affording the service, leading to higher churn for these customers.

Because of customer losses, we have to acquire new customers on an ongoing basis just to maintain our existing level of customers and revenues. As a result, marketing expense is an ongoing requirement of our business. If our churn rate increases, we will have to acquire even more new customers in order to maintain our existing revenues. We incur significant costs to acquire new customers, and expect to continue to do so in connection with the introduction of Vonage Mobile, and those costs are an important factor in maintaining profitability. Therefore, if we are unsuccessful in retaining customers, are required to spend significant amounts to acquire new customers beyond those budgeted, or our marketing and advertising efforts are not effective in targeting specific customer segments, our revenue could decrease or we could incur losses.

If we are unable to establish and expand strategic relationships our ability to grow revenues and offer new products under commercially attractive terms may be inhibited, which could adversely affect our business, results of operations, and financial condition.

An element of our growth strategy is to develop and maintain strategic relationships both in the U.S. and internationally. We have or are pursuing relationships in the U.S. retail industry as well as international concepts ranging from virtual peering relationships to full VoIP communication services to be marketed and distributed as a complement to an existing foreign provider's product suite. The development of these relationships may assist us in enhancing our brand, introducing our products and services to larger numbers of customers, developing and implementing new products and services, and generating additional revenue. We may not be able to enter into new

relationships in the U.S. or internationally on economic terms favorable to us. In addition, if we lose any of our important strategic relationships or if strategic relationships fail to benefit us as expected, our ability to grow revenues and offer new products may be inhibited which could adversely affect our business, results of operations, and financial condition.

Our ability to provide our telephony service and manage related customer accounts is dependent upon third-party facilities, equipment, and systems, the failure of which could cause delays of or interruptions to of our service, damage our reputation, cause us to lose customers, limit our growth, and affect our financial condition.

Our success depends on our ability to provide quality and reliable telephony service, which is in part dependent upon the proper functioning of facilities and equipment owned and operated by third parties and is, therefore, beyond our control. Unlike traditional wireline telephone service or wireless service, our service requires our customers to have an operative broadband Internet connection and an electrical power supply, which are provided by the customer's Internet service provider and electric utility company, respectively, and not by us. The quality of some broadband Internet connections may be too poor for customers to use our services properly. In addition, if there is any interruption to a customer's broadband Internet service or electrical power supply, that customer will be unable to make or receive calls, including emergency calls, using our service.

We outsource several of our network functions to third-party providers. For example, we outsource the maintenance of our regional data connection points, which are the facilities at which our network interconnects with the public switched telephone network. If our third-party service providers fail to maintain these facilities properly, or fail to respond quickly to problems, our customers may experience service interruptions. Interruptions in our service caused by third-party facilities have in the past caused and may in the future cause us to lose customers or cause us to offer substantial customer credits, which could adversely affect our revenue and profitability. If interruptions adversely affect the perceived reliability of our service, we may have difficulty attracting new customers, and our brand, reputation, and growth will be negatively impacted.

In order to access our residential, small office, and home office services, a customer needs to connect a standard telephone to a broadband Internet connection through a Vonage-enabled device that we provide. Although we closely monitor inventory levels, if we are unable to procure a sufficient number of devices from our single supplier in a timely manner, including as a result of a failure by a component supplier, we would be delayed in activating new customers and may lose these customers.

Table of Contents

We also rely on third party platforms for some of our back office functions that allow us to manage customer accounts. For example, we are a party to an agreement with Amdocs, Inc. to license systems to enhance our ordering and billing capabilities. The platform is now operational and it is our intention to transition customers to the platform throughout 2012. If we encounter material challenges during the implementation of the new systems or the transition of customers this could adversely affect customer satisfaction. Any failure to implement this ordering and billing system in the timeframe we expect, or at all, may materially affect our ability to introduce new products on the schedule that we prefer and could result in increased costs to enhance our existing ordering and billing systems or procure replacement systems or alternative means for ordering and billing our products. As a result, our growth, system of internal controls, or results of operations could be materially and adversely affected.

We rely on third parties to provide a portion of our customer service representatives, provide aspects of our E-911 service, and initiate local number portability for our customers. If these third parties do not provide our customers with reliable, high-quality service, our reputation will be harmed and we may lose customers.

We offer our customers support 24 hours a day, seven days a week through both our comprehensive online account management website and our toll free number. Our customer support is currently provided via United States based employees as well as third party partners located in the United States, Philippines, Costa Rica, Chile, Mexico, and India. We offer support in English, Spanish, and French Canadian. Our third-party providers generally represent us without identifying themselves as independent parties. The ability to support our customers may be disrupted by natural disasters, inclement weather conditions, civil unrest, and other adverse events in the locations where our customer support is provided.

We also contract for services required to provide E-911 services including assistance in routing emergency calls, terminating E-911 calls, operating a national call center that is available 24 hours a day, seven days a week to receive certain emergency calls, and maintaining PSAP databases for the purpose of deploying and operating E-911 services. Interruptions in service from our vendor could cause failures in our customers' access to E-911 services and expose us to liability and damage our reputation.

We also have agreements with companies that initiate our local number portability, which allow new customers to retain their existing telephone numbers when subscribing to our services.

If any of these third parties do not provide reliable, high-quality service, our reputation and our business will be harmed. In addition, industry consolidation among providers of services to us may impact our ability to obtain these services or increase our expense for these services.

Flaws in our technology and systems or our failure to adapt our systems to any new Internet Protocol could cause delays or interruptions of service, which could damage our reputation, cause us to lose customers, and limit our growth.

Although we have designed our service network to reduce the possibility of disruptions or other outages, our service may be disrupted by problems with our technology and systems, such as malfunctions in our Vonage-enabled device that we provide to customers, software or facilities and overloading of our network. As we attract new subscribers, we expect increased call volume that we need to manage to avoid network interruptions. In particular, as we have marketed to different international long distance markets, we have seen international call volumes to targeted countries increase. During the next few years we expect wide-spread industry adoption of a new Internet Protocol, which is a set of standard communications and routing mechanisms. Customers may experience periodic delays of service caused by the industry transition to this new Internet Protocol. Interruptions have caused and may in the future cause us to lose customers and offer substantial customer credits, which could adversely affect our revenue and profitability. Network interruptions have also impaired our ability at times to sign-up new customers and the ability of customers to manage their accounts. During 2011, we had multiple outages that affected groups of customers at various times, some of which affected large groups of customers for several hours. If service interruptions or other outages adversely affect the perceived reliability of our telephony service or customer service, we may have difficulty attracting and retaining customers and our brand reputation and growth may suffer.

We may be subject to damaging and disruptive intellectual property litigation that could materially and adversely affect our business, results of operations, and financial condition, as well as the continued viability of our company.

There has been substantial litigation in the VoIP and related industries regarding intellectual property rights and, given the rapid technological change in our industry and our continual development of new products and services, we and/or our commercial partners may be subject to infringement claims from time to time. For example, we may be unaware of filed patent applications and issued patents that could include claims covering our products and services. We were subject to patent infringement claims in the past, including suits that we settled in 2007 and 2008 for a total of \$243,825 with Verizon, Sprint, AT&T, Nortel Networks, and others. We are also currently named as a defendant in two suits that relate to alleged patent infringement and from time to time we receive letters from third parties initiating an opportunity for us to obtain licenses to patents that may be relevant to our business or alleging that our services infringe upon third party patents or other intellectual property. See “Item 3. – Legal Proceedings—IP Matters.” Parties making claims of infringement may be able to obtain injunctive or other equitable relief that could effectively block our ability to provide our services and could cause us to pay substantial royalties, licensing fees, damages or settlement fees. The defense of any lawsuit could divert management’s efforts and attention from ordinary business operations and result in time-consuming and expensive litigation, regardless of the merits of such claims. These outcomes may:

- >result in the loss of a substantial number of existing customers or prohibit the acquisition of new customers;
- >cause us to accelerate expenditures to preserve existing revenues;
- >cause existing or new vendors to require prepayments or letters of credit;
- >cause our credit card processors to demand reserves or letters of credit or make holdbacks;
- >result in substantial employee layoffs;
- >materially and adversely affect our brand in the marketplace and cause a substantial loss of goodwill;

Table of Contents

> cause our stock price to decline significantly or otherwise cause us to fail to meet the continued listing requirements of the New York Stock Exchange, which could distract management and result in the delisting of our common stock from the exchange;

> materially and adversely affect our liquidity, including our ability to pay debts and other obligations as they become due;

> cause us to change our business methods or services;

> require us to cease certain business operations or offering certain products and services; and

> lead to our bankruptcy or liquidation.

If we fail to protect our internally developed systems and software and our trademarks, we may become involved in costly litigation or our business or brand may be harmed.

Our ability to compete effectively is dependent in large part upon the maintenance and protection of systems and software that we have developed internally based on open standards. While we own eight internally developed U.S. issued patents, have a number of pending patent applications, and have acquired third party patents, we cannot patent much of the technology that is important to our business. Our pending patent applications may not be granted. Any issued patent that we own may be challenged, narrowed, invalidated, or circumvented. To date, we have relied on copyright and trade secret laws, as well as confidentiality procedures and licensing arrangements, to establish and protect our rights to this technology. We typically enter into confidentiality or license agreements with our employees, consultants, customers, and vendors in an effort to control access to and distribution of technology, software, documentation, and other information. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use this technology without authorization. Policing unauthorized use of this technology is difficult. The steps we take may not prevent misappropriation of the technology we rely on. In addition, effective protection may be unavailable or limited in some jurisdictions outside the United States, Canada, and the United Kingdom. Litigation may be necessary in the future to enforce or protect our rights or to determine the validity and scope of the rights of others. That litigation could cause us to incur substantial costs and divert resources away from our daily business, which in turn could materially adversely affect our business.

The unlicensed use of our brand by third parties could harm our reputation, cause confusion among our customers, and impair our ability to market our services. To that end, we have registered numerous trademarks and service marks and have applied for registration of our trademarks and service marks in the United States and abroad to establish and protect our brand names as part of our intellectual property strategy. If our applications receive objections or are successfully opposed by third parties, it will be difficult for us to prevent third parties from using our brand without our permission. Moreover, successful opposition to our applications might encourage third parties to make additional oppositions or commence trademark infringement proceedings against us, which could be costly and time consuming to defend against. If we decide to take limited or no action to protect our trademarks, our trademark rights may be diluted and subject to challenge or invalidation, which could materially and adversely affect our brand in the marketplace.

Certain rights to third party patents and technology may expire and not be extended, or may not be available.

Certain previously disclosed patent rights granted to the Company under our agreements with AT&T and Sprint will expire between January 2013 and May 2014. It may be necessary to negotiate extensions of such rights, and if so and we are unable to do so on terms acceptable to us upon expiration, our making, using, and selling of existing and future products and services may be subject to challenges as infringing AT&T or Sprint patents. In addition, we may seek to obtain rights to third party technology in the future, but may not be able to agree upon commercially reasonable terms or at all with respect to obtaining such rights. If we are unable to extend existing licenses or are unable to obtain rights to other technology that may be commercially advantageous or necessary for our product and service offerings, we may experience a decrease in the quality of our products or services or we may lose the ability to provide our products

and services on a non-infringing basis until alternative technology or suitable alternative products and services can be developed, identified, obtained (through acquisition, license or other grants of rights), and integrated. We may incur significant costs and harm to our reputation from lawsuits and regulatory inquiries related to our business practices, which may also divert the attention of our management from other aspects of our business. In 2010, we reached a settlement in several purported class actions in California, New Jersey, and Washington that alleged a wide variety of deficiencies with respect to our business practices, marketing disclosures, e-mail marketing, and quality issues for both phone and fax service. The settlement included a release and dismissal with prejudice of all consumer claims against us and provided a settlement benefit of \$4,750 into a common fund for the benefit of class members. The common fund included all awarded fees, costs, and expenses (including attorneys' fees and costs), some of the costs to provide notice of settlement, administrative expenses, and incentive awards, if any, with the remainder of the common fund to be distributed to members of the class who timely filed claims, with the balance of the fund, if any, to be distributed cy pres to charity if approved by the court pursuant to a plan of allocation among class members. We have been subject to periodic regulatory inquiries regarding our business practices, including an investigation settled in 2009 with a group of 32 States attorney generals into certain of our business practices. There was no finding of any violation or wrongdoing by us, and the 32 states participating in the settlement have released us and our affiliates from the matters investigated. We paid \$3,000 in connection with the settlement and compliance with other provisions of the settlement is ongoing. On July 18, 2011 we entered into an amended settlement agreement initiated at our request to reflect revised business practices associated with our new "consumable" product offerings. Any similar claims or regulatory inquiries, whether successful or not, could require us to devote significant amounts of monetary or human resources to defend ourselves and could harm our reputation. We may need to spend significant amounts on our legal defense, senior management may be required to divert their attention from other portions of our business, new product launches may be deferred or canceled as a result of any proceedings, and we may be required to make changes to our present and planned products or services. If, as a result of any proceedings, a judgment is rendered or a decree is entered against us, it may materially and adversely affect our business, financial condition, and results of operations and harm our reputation.

Table of Contents

Our services are subject to regulation, and future legislative, regulatory or judicial actions could adversely affect our business and expose us to liability.

Our business has developed in a relatively lightly regulated environment. However, the United States and other countries have applied some traditional telephone company regulations to VoIP and continue to evaluate how VoIP should be regulated. The effects of future regulatory developments are uncertain.

Interconnected VoIP providers, such as Vonage, are subject to certain Federal Communications Commission ("FCC") rules. For example, on August 5, 2005, the FCC released an Order extending the obligations of the Communications Assistance for Law Enforcement Act ("CALEA") to interconnected VoIP providers. Under CALEA, telecommunications carriers must assist law enforcement in executing electronic surveillance, which include the capability of providing call content and call-identifying information to a local enforcement agency, or LEA, pursuant to a court order or other lawful authorization. To date, we have taken significant steps towards CALEA compliance. We could be subject to an enforcement action by the FCC if our CALEA solution is deemed not fully operational. Effective February 2, 2011, another FCC order reduced to one business day the amount of time that a telecommunications provider such as Vonage has to port a telephone number to another provider. If we, or third parties we rely upon for porting, have difficulty complying with the new one-day porting requirement, we could be subject to FCC enforcement action.

Future legislative, judicial or other regulatory actions could have a negative effect on our business. If we become subject to the rules and regulations applicable to telecommunications providers in individual states, we may incur significant litigation and compliance costs, and we may have to restructure our service offerings, exit certain markets, or raise the price of our services, any of which could cause our services to be less attractive to customers. In addition, future regulatory developments could increase our cost of doing business and limit our growth.

As we expand our international operations into new geographies, we will be increasingly subject to risks that are inherent in operating abroad, including increased governmental regulation, currency restrictions and other restraints, and burdensome taxes.

Our services are in use in countries outside of the United States, Canada, and the United Kingdom where we have regular operations, including countries where providing VoIP services is or may be illegal. It is possible that governments outside of the United States, Canada, and the United Kingdom may try to subject our services to governmental regulations, including telecommunications, data retention, privacy, consumer protection, financial, and other laws and regulations. In addition, if these governments believe that we are providing unauthorized service in their countries, they may pursue fines, penalties, or other governmental action, including criminal action, that may damage our brand and reputation.

As we expand our international operations into new geographies, we expect to become subject to numerous additional governmental regulations, including telecommunications, data retention, privacy, consumer protection, financial, and other applicable laws and regulations. Some of these regulations may be complicated or unsettled. Any failure to comply with governmental regulation could result in fines, penalties, or other governmental action, including criminal action, and may damage our brand and reputation. In addition, changes in legislation or regulations and actions by regulators, including changes in administration and enforcement policies, may from time to time require modifications to our offerings or the payment of fines and penalties, or both. In the United States, Canada, and United Kingdom, we are not a regulated telecommunications business. We may need to change our service offerings to avoid regulation as a telecommunications business in a jurisdiction or if we are treated as a regulated telecommunications business, we may be required to incur additional expenses. If we use a local partner to provide services in a country and the local partner does not comply with applicable governmental regulations, we may face additional regulation, liabilities, penalties or other governmental action, and our brand and reputation may be harmed.

As a United States-based company, any foreign subsidiary that we use for international operations may be subject to a variety of governmental regulations in the countries where we market our products, including tariffs and taxes. For example, distributions of earnings and other payments, including interest, received from our foreign subsidiaries may be subject to withholding taxes imposed by the jurisdiction in which such entities are formed or operating, which will reduce the amount of after-tax cash we can receive. In general, as a United States corporation, we may claim a foreign tax credit against our federal income tax expense for such foreign withholding taxes and for foreign income taxes paid

directly by foreign corporate entities in which we own 10% or more of the voting stock. The ability to claim such foreign tax credits and to utilize net foreign losses is, however, subject to numerous limitations, and we may incur incremental tax costs as a result of these limitations or because we are not currently in a tax-paying position in the United States. We may also be required to include in our income for United States federal income tax purposes our proportionate share of certain earnings of those foreign subsidiaries that are classified as “controlled foreign corporations” without regard to whether distributions have been actually received from such subsidiaries. As we expand international operations we will become more dependent on the economies of the markets in which we have operations. These markets are expected to be in countries with economies in various stages of development or structural reform, and our operations in such markets also could be affected by:

- > political, social and economic instability;
- > war, civil disturbance or acts of terrorism;
- > taking of property by nationalization or expropriation without fair compensation;
- > imposition of limitations on conversions of foreign currencies into United States dollars or remittance of dividends and other payments by foreign subsidiaries;
- > hyperinflation; and
- > impositions or increase of investment and other restrictions or requirements by foreign governments.

In particular, our research and development personnel and facility are located in Israel. Political, economic and military conditions in Israel directly affect our operations. For example, increased violence or armed conflict in Israel or the Palestinian territories may disrupt travel and communications in the region, harming our operations there. Furthermore, some of our employees in Israel are obligated to perform up to 36 days of military reserve duty annually and may be called to active duty in a time of crisis. The absence of these employees for significant periods may

Table of Contents

cause us to operate inefficiently during these periods.

Our international operations involve transactions in a variety of currencies. Our financial results may be significantly affected by fluctuations of currency exchange rates. To the extent that foreign subsidiaries distribute dividends in local currencies in the future, the amount of cash to be received by us will be affected by fluctuations in exchange rates, and such shifts in the currency exchange rates may have a material adverse effect on us. We do not maintain derivatives for managing foreign currency exchange rate risks.

A number of our agreements are governed by the laws of, and subject to dispute resolution in the courts of, or through arbitration proceedings in, the country or region in which the operations are located. We cannot accurately predict whether such forum will provide us with an effective and efficient means of resolving disputes that may arise in the future. Even if we are able to obtain a satisfactory decision through arbitration or a court proceeding, we could have difficulty enforcing any award or judgment on a timely basis. Our ability to obtain or enforce relief in the United States is uncertain.

We may be exposed to liabilities under the Foreign Corrupt Practices Act, the UK Bribery Act, and similar laws, and any determination that we violated any of these laws could have a material adverse effect on our business.

We are subject to the Foreign Corrupt Practice Act ("FCPA"), the UK Bribery Act and other laws that prohibit improper payments or offers of payments to foreign governments and their officials and political parties by persons and entities for the purpose of obtaining or retaining business. We have operations, agreements with third parties, and make sales internationally. Our international activities create the risk of unauthorized payments or offers of payments by one of our employees, consultants, sales agents or distributors, even though these parties are not always subject to our control. It is our policy to implement safeguards to discourage these practices by our employees, consultants, sales agents or distributors. However, our existing safeguards and any future improvements may prove to be less than effective, and our employees, consultants, sales agents or distributors may engage in conduct for which we might be held responsible. Violations of the FCPA, the UK Bribery Act or other laws may result in severe criminal or civil sanctions, and we may be subject to other liabilities, which could negatively affect our business, operating results, and financial condition.

We are dependent on a small number of individuals, and if we lose key personnel upon whom we are dependent, our business will be adversely affected.

Many of the key responsibilities of our business have been assigned to a relatively small number of individuals. Our future success depends to a considerable degree on the vision, skills, experience, and effort of our senior management, especially Marc P. Lefar, our Chief Executive Officer. The loss of the services of these officers could have a material adverse effect on our business. In addition, our continued growth depends on our ability to attract and retain experienced key employees.

We have incurred cumulative losses since our inception and may not achieve consistent profitability in the future.

While we achieved net income of \$409,044, which included the release of \$325,601 of the valuation allowance recorded against our net deferred tax assets that we recorded as a one-time non-cash income tax benefit, for the year ended December 31, 2011, from our inception through December 31, 2011, our accumulated deficit is \$762,857.

Although we believe we will achieve consistent profitability in the future, we ultimately may not be successful. We believe that our ability to achieve consistent profitability will depend, among other factors, on our ability to continue to achieve and maintain substantive operational improvements and structural cost reductions while maintaining and growing our net revenues. In addition, certain of the costs of our business are not within our control and may increase. For example, we and other telecommunications providers are subject to regulatory termination charges imposed by regulatory authorities in countries to which customers make calls, such as India where regulatory authorities have been petitioned by local providers to consider termination rate increases. As we attract additional international long distance callers, we will be more affected by these increases to the extent that we are unable to offset such costs by passing through price increases to customers.

We may be unable to fully realize the benefits of our net operating loss ("NOL") carry forwards if an ownership change occurs.

If we were to experience a "change in ownership" under Section 382 of the Internal Revenue Code ("Section 382"), the NOL carry forward limitations under Section 382 would impose an annual limit on the amount of the future taxable

income that may be offset by our NOL generated prior to the change in ownership. If a change in ownership were to occur, we may be unable to use a significant portion of our NOL to offset future taxable income. In general, a change in ownership occurs when, as of any testing date, there has been a cumulative change in the stock ownership of the corporation held by 5% stockholders of more than 50 percentage points over an applicable three-year period. For these purposes, a 5% stockholder is generally any person or group of persons that at any time during an applicable three-year period has owned 5% or more of our outstanding common stock. In addition, persons who own less than 5% of the outstanding common stock are grouped together as one or more “public group” 5% stockholders. Under Section 382, stock ownership would be determined under complex attribution rules and generally includes shares held directly, indirectly (through intervening entities), and constructively (by certain related parties and certain unrelated parties acting as a group).

Third parties may fraudulently use our name to obtain access to customer accounts and other personal information, use our services to commit fraud or steal our services, which could damage our reputation, limit our growth, and cause us to incur additional expenses.

Our customers have been subject to “phishing,” which occurs when a third party calls or sends an email or pop-up message to a customer that claims to be from a business or organization that provides services to the customer. The purpose of the inquiry is typically to encourage the customer to visit a bogus website designed to look like a website operated by the legitimate business or organization or provide information to the operator. At the bogus website, the operator attempts to trick the customer into divulging customer account or other personal information such as credit card information or to introduce viruses through “trojan horse” programs to the customers’ computers. This has resulted in identity theft from our customers and the unauthorized use of Vonage services. Third parties have also used our communications services to commit fraud. Although we have engaged a third party to assist in the shutdown of purported phishing sites, if we are unable to detect and prevent “phishing,” use of our services for fraud, and similar activities, our brand reputation and growth may suffer and we may incur additional costs, including costs to increase

Table of Contents

security, or be required to credit significant amounts to customers.

Third parties also have used our communications services without paying, including by submitting fraudulent credit card information. This has resulted in our incurring the cost of providing the services, including incurring call termination fees, without any corresponding revenues. We have implemented anti-fraud procedures in order to limit the expenses resulting from theft of service, which were not material in 2011. If our procedures are not effective, theft of service could significantly increase our expenses and negatively impact our profitability.

Our business may be harmed if we are unable to maintain data security and meet Payment Card Industry data security standards.

We are dependent upon automated information technology processes. Any failure to maintain the security of our data and our employees' and customers' confidential information, including via the penetration of our network security and the misappropriation of confidential information, could result in financial obligations to third parties, fines, penalties, regulatory proceedings, and private litigation with potentially large costs. Any such failure also could put us at a competitive disadvantage and result in deterioration in our employees' and customers' confidence in us, which may have a material adverse impact on our business, financial condition, and results of operations.

We make available on our website our privacy policy, which describes how we collect, use, and disclose our customers' personal information. As we expand our international operations into new geographies, we may become subject to local data security, privacy, data retention, and disclosure laws and regulations. It may be difficult for us to comply with these laws and regulations if they were deemed to be applicable to us.

We are subject to Payment Card Industry ("PCI") data security standards, which require periodic audits by independent third parties to assess compliance. PCI data security standards are a comprehensive set of requirements for enhancing payment account data security that was developed by the PCI Security Standards Council including American Express, Discover Financial Services, JCB International, MasterCard Worldwide, and VISA Inc., to help facilitate the broad adoption of consistent data security measures. Failure to comply with the security requirements as identified in subsequent audits or rectify a security issue may result in fines. While we believe it is unusual, restrictions on accepting payment cards, including a complete restriction, may be imposed on companies that are not compliant. Security breaches and other disruptions could compromise our information and expose us to liability, which would cause our business and reputation to suffer.

In the ordinary course of our business, we collect and store sensitive data, including intellectual property, our proprietary business information and that of our customers, suppliers, and business partners, and personally identifiable information of our customers and employees, in our data centers and on our networks. The secure processing, maintenance, and transmission of this information is critical to our operations and business strategy.

Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to error, malfeasance or other disruptions by an employee or third-party provider. Any such breach could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such access, disclosure or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information, regulatory penalties, disruption to our operations, damage to our reputation, and a loss of confidence in our products and services, which could adversely affect our business.

The success of our business relies on customers' continued and unimpeded access to broadband service. Providers of broadband services may be able to block our services or charge their customers more for also using our services, which could adversely affect our revenue and growth.

Our customers must have broadband access to the Internet in order to use our service. Some providers of broadband access, including outside of the United States, may take measures that affect their customers' ability to use our service, such as degrading the quality of the data packets we transmit over their lines, giving those packets low priority, giving other packets higher priority than ours, blocking our packets entirely or attempting to charge their customers more for also using our services.

In the United States, there continues to be some uncertainty regarding whether suppliers of broadband Internet access have a legal obligation to allow their customers to access and use our service without interference. In December 2010, the FCC adopted new net neutrality rules that would protect services like ours from such interference. Several parties have sought judicial review of the FCC's net neutrality rules. These appeals are currently pending. Interference with

our service or higher charges for using our service could cause us to lose existing customers, impair our ability to attract new customers, and harm our revenue and growth. These problems could also arise in international markets. Most foreign countries have not adopted formal net neutrality rules like those adopted by the FCC.

If customers do not accept the differences between our service and traditional telephone service, they may choose to remain with their current telephone service provider or may choose to return to service provided by traditional telephone companies.

For certain users, aspects of our service are not the same as traditional telephone service. Our continued growth is dependent on the adoption of our services by mainstream customers, so these differences are important. For example:

> Both our E-911 and emergency calling services are different, in significant respects, from the 911 service associated with traditional wireline and wireless telephone providers and, in certain cases, with other VoIP providers.

> Our customers may experience lower call quality than they are used to from traditional wireline telephone companies, including static, echoes, and delays in transmissions.

> Our customers may experience higher dropped-call rates than they are used to from traditional wireline telephone companies.

> Customers who obtain new phone numbers from us do not appear in the phone book and their phone numbers are not available through directory assistance services offered by traditional telephone companies.

> Our customers cannot accept collect calls.

Table of Contents

>Our customers cannot call premium-rate telephone numbers such as 1-900 numbers and 976 numbers.

In the event of a power loss or Internet access interruption experienced by a customer, our service is interrupted.

> Unlike some of our competitors, we have not installed batteries at customer premises to provide emergency power for our customers' equipment if they lose power, although we do have backup power systems for our network equipment and service platform.

If customers do not accept the differences between our service and traditional telephone service, they may choose to remain with their current telephone service provider or may choose to return to service provided by traditional telephone companies.

Our emergency and E-911 calling services may expose us to significant liability.

The FCC rules for the provision of 911 service by interconnected VoIP providers, such as the VoIP service we provide, require that for all geographic areas covered by the traditional wireline E-911 network, interconnected VoIP providers must provide E-911 service as defined by the FCC's rules. Under the FCC's rules, E-911 service means that interconnected VoIP providers must transmit the caller's telephone number and registered location information to the appropriate PSAP for the caller's registered location. Vonage provides E-911 service, under the FCC's rules, to approximately 99.99% of its subscriber lines.

The remaining subscriber lines do not have E-911 service for a variety of reasons including refusal by PSAPs to accept VoIP 911 calls, the inability of PSAPs to receive the registered location data from us, and the failure by third party companies with whom we contract to provide aspects of our E-911 service to obtain the necessary access or complete implementation of the necessary interfaces to the traditional wireline E-911 infrastructure. In addition, certain of our services designed to be highly mobile including soft phone service, which is software that enables a customer to make telephone calls from a computer, route callers to a national emergency call center that in turns routes the call to the appropriate PSAP.

We could be subject to enforcement action by the FCC for our subscriber lines that do not have E-911 service. This enforcement action could result in significant monetary penalties and restrictions on our ability to offer non-compliant services.

Delays our customers may encounter when making emergency services calls and any inability of a PSAP to automatically recognize the caller's location or telephone number can have devastating consequences. Customers have attempted, and may in the future attempt, to hold us responsible for any loss, damage, personal injury or death suffered as a result. In July 2008, the New and Emerging Technologies 911 Improvement Act of 2008 became law and provided that interconnected VoIP providers have the same protections from liability for the operation of 911 service as traditional wireline and wireless providers. Limitations on liability for the provision of 911 service are normally governed by state law and these limitations typically are not absolute. Thus, for example, we could be subject to liability for a problem with our 911 service where our failures are greater than mere negligence. It is also unclear under the FCC's rules whether the limitations on liability would apply to those subscriber lines where Vonage does not provide E-911 service.

Our credit card processors have the ability to impose significant holdbacks in certain circumstances. The reinstatement of such holdbacks likely would have a material adverse effect on our liquidity.

Historically, our credit card processors have established reserves to cover any exposure that they may have as we collect revenue in advance of providing services to our customers, which is a customary practice for companies that bill their customers in advance of providing services. During 2010, our credit card processors released all reserves which consisted of cash reserves of \$23,101 and a cash-collateralized letter of credit for \$10,500. Under our credit card processing agreements with our Visa, MasterCard, American Express, and Discover credit card processors, the credit card processor has the right, in certain circumstances, including adverse events affecting our business, to impose a holdback of our advanced payments purchased using a Visa, MasterCard, American Express, or Discover credit card, as applicable, or demand additional reserves or other security. If circumstances were to occur that would allow any of these processors to reinstate a holdback, the negative impact on our liquidity likely would be significant. In addition, our Visa and MasterCard credit card processing agreement may be terminated by the credit card processor at its discretion if we are deemed to be financially insecure. As a significant portion of payments to us are made through

Visa and MasterCard credit cards, if the credit card processor does not assist in transitioning our business to another credit card processor, the negative impact on our liquidity likely would be significant. There were no cash reserves and cash-collateralized letters of credit with any credit card processors as of December 31, 2011.

If we require additional capital, we may not be able to obtain additional financing on favorable terms or at all.

We may need to pursue additional financing to respond to new competitive pressures, pay extraordinary expenses such as litigation settlements or judgments or fund growth, including through acquisitions. Because of our past significant losses and our limited tangible assets, we do not fit traditional credit lending criteria, which, in particular, could make it difficult for us to obtain loans or to access the capital markets. In addition, the credit documentation for our recent financing contains affirmative and negative covenants that affect, and in many respects may significantly limit or prohibit, among other things, our and certain of our subsidiaries' ability to incur, refinance or modify indebtedness and create liens.

The debt agreements governing our July 2011 financing contain restrictions that may limit our flexibility in operating our business.

On July 29, 2011, we consummated a financing consisting of an \$85,000 senior secured term loan and a \$35,000 revolving credit facility (the "2011 Credit Facility") replacing our December 14, 2010 financing. The 2011 Credit Facility contains customary representations and warranties and affirmative covenants that limit our ability and/or the ability of certain of our subsidiaries to engage in specified types of transactions. These covenants and other restrictions may under certain circumstances limit, but not necessarily preclude, our and certain of our subsidiaries' ability to, among other things:

- >consolidate or merge;
- >create liens;
- >incur additional indebtedness;
- >dispose of assets;
- >consummate acquisitions;
- >make investments; or
- >pay dividends and other distributions.

Table of Contents

Under the 2011 Credit Facility, we are required to comply with the following financial covenants: specified maximum consolidated leverage ratio, specified minimum consolidated fixed coverage charge ratio, minimum cash position and maximum capital expenditures. Our ability to comply with such financial and other covenants may be affected by events beyond our control, so we may not be able to comply with these covenants. A breach of any such covenant could result in a default under the 2011 Credit Facility. In that case, the lenders could elect to declare due and payable immediately all amounts due under the 2011 Credit Facility, including principal and accrued interest.

The market price of our common stock has been and may continue to be volatile, and purchasers of our common stock could incur substantial losses.

Securities markets experience significant price and volume fluctuations. This market volatility, as well as general economic conditions, could cause the market price of our common stock to fluctuate substantially. The trading price of our common stock has been, and is likely to continue to be, volatile. Many factors that are beyond our control may significantly affect the market price of our shares. These factors include:

- >changes in our earnings or variations in operating results;
- >any shortfall in revenue or increase in losses from levels expected by securities analysts;
- >judgments in litigation;
- >operating performance of companies comparable to us;
- >general economic trends and other external factors; and
- >market conditions and competitive pressures that prevent us from executing on our future growth initiatives.

If any of these factors causes the price of our common stock to fall, investors may not be able to sell their common stock at or above their respective purchase prices, or we may face delisting from the New York Stock Exchange. Jeffrey A. Citron, our founder, non-executive Chairman, and a significant stockholder, exerts significant influence over us.

As of December 31, 2011, Mr. Citron beneficially owned approximately 22.6% of our outstanding common stock, including outstanding securities exercisable for common stock within 60 days of such date. As a result, Mr. Citron is able to exert significant influence over all matters presented to our stockholders for approval, including election and removal of our directors and change of control transactions. In addition, as our non-executive Chairman, Mr. Citron has and will continue to have influence over our strategy and other matters as a board member. Mr. Citron's interests may not always coincide with the interests of other holders of our common stock.

Our certificate of incorporation and bylaws, the agreements governing our indebtedness, and the terms of certain settlement agreements to which we are a party contain provisions that could delay or discourage a takeover attempt, which could prevent the completion of a transaction in which our stockholders could receive a substantial premium over the then-current market price for their shares.

Certain provisions of our restated certificate of incorporation and our second amended and restated bylaws may make it more difficult for, or have the effect of discouraging, a third party from acquiring control of us or changing our board of directors and management. These provisions:

- > permit our board of directors to issue additional shares of common stock and preferred stock and to establish the number of shares, series designation, voting powers (if any), preferences, other special rights, qualifications, limitations or restrictions of any series of preferred stock;
- > limit the ability of stockholders to amend our restated certificate of incorporation and second amended and restated bylaws, including supermajority requirements;

- > allow only our board of directors, Chairman of the board of directors or Chief Executive Officer to call special meetings of our stockholders;
- > eliminate the ability of stockholders to act by written consent;
- > require advance notice for stockholder proposals and director nominations;
- > limit the removal of directors and the filling of director vacancies; and
- > establish a classified board of directors with staggered three-year terms.

In addition, a change of control would constitute an event of default under our 2011 Credit Facility. Upon the occurrence of an event of default, the lenders could elect to declare due and payable immediately all amounts due under our 2011 Credit Facility, including principal and accrued interest, and may take action to foreclose upon the collateral securing the indebtedness.

Under our 2011 Credit Facility, a “change of control” would result from the occurrence of, among other things, the acquisition by any person or group (other than Mr. Citron and his majority-controlled affiliates) of 35% or more of the voting and/or economic interest of our outstanding common stock on a fully-diluted basis.

We encourage you to read the agreement in full, including the definition of “change of control” therein. The 2011 Credit Facility has been previously filed with the Securities and Exchange Commission as Exhibit 10.1 to a Form 8-K filed by us on July 29, 2011.

Further, we were named as a defendant in several suits that related to patent infringement and entered into agreements to settle certain

Table of Contents

of the suits in 2007. Certain terms of those agreements, including licenses and covenants not to sue, will be restricted upon a change of control, which may discourage certain potential purchasers from acquiring us. Such provisions could have the effect of depriving stockholders of an opportunity to sell their shares at a premium over prevailing market prices. Any delay or prevention of, or significant payments required to be made upon, a change of control transaction or changes in our board of directors or management could deter potential acquirors or prevent the completion of a transaction in which our stockholders could receive a substantial premium over the then-current market price for their shares.

ITEM 1B. Unresolved Staff Comments

Not applicable.

ITEM 2. Properties

The following is a summary of our offices and locations:

Location	Business Use	Square Footage	Lease Expiration Date
Holmdel, New Jersey	Corporate Headquarters, Network Operations, Customer Service, Sales and Marketing, and Administration	350,000	2017
London, United Kingdom	Sales and Marketing, Administration	3,472	