VONAGE HOLDINGS CORP
Form 10-K
March 03, 2009
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# FORM 10-K

x Annual Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934

*For the fiscal year ended December 31, 2008*

or

¨ Transition Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934

*For the transition period from _____to_____*

Commission file number 001-32887

# VONAGE HOLDINGS CORP.

*(Exact name of registrant as specified in its charter)*

| | |
|---|---|
| Delaware<br>*(State or other jurisdiction of*<br>*incorporation or organization)* | 11-3547680<br>*(IRS Employer Identification No.)* |
| 23 Main Street, Holmdel, New Jersey<br>*(Address of principal executive offices)* | 07733<br>*(Zip Code)* |

(732) 528-2600

*Registrant s telephone number, including area code*

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: None

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

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 x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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. x

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 x 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 x

The aggregate market value of the common equity held by non-affiliates of the registrant at June 30, 2008 was $106,540,281.

The number of shares outstanding of the registrant s common stock as of January 31, 2009 was 156,712,852.

*Documents Incorporated By Reference*

Selected portions of the Vonage Holdings Corp. definitive Proxy Statement, which is expected to be filed with the Securities and Exchange Commission within 120 days after December 31, 2008, are incorporated by reference in Part III of this Form 10-K.

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VONAGE HOLDINGS CORP.

FORM 10-K

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2008

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VONAGE ANNUAL REPORT 2008

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From time to time, we may provide information, whether orally or in writing, including certain statements in this Annual Report on Form 10-K, 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 forward-looking statements. Such statements reflect our current views with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected or intended or using other similar expressions. 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: restrictions in our debt agreements that may limit our operating flexibility; any failure to meet New York Stock Exchange listing requirements; the competition we face; worsening economic conditions; our history of net operating losses; our ability to obtain additional financing if needed; results of pending litigation and intellectual property and other litigation that may be brought against us; results of regulatory inquiries into our business practices; differences between our service and traditional phone services, including our 911 service; our dependence on third party facilities, equipment and services; system disruptions or flaws in our technology; our dependence on our customers existing broadband connections; uncertainties relating to regulation of VoIP services; 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.

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.

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PART I

# **ITEM 1.** Business

We are a leading, pure-play provider of broadband telephone services to residential and small office and home office customers with over 2.6 million subscriber lines as of December 31, 2008. While customers in the United States represented 95% of our subscriber lines in 2008, we continue to serve customers internationally with services in Canada and the United Kingdom.

Our service is portable and we enable our customers to make and receive phone calls with a telephone almost anywhere a broadband Internet connection is available. We transmit these calls using Voice over Internet Protocol, or VoIP, technology, which converts voice signals into digital data packets for transmission over the Internet. At a cost effective rate, each of our calling plans provides a number of basic features typically offered by traditional telephone service providers, plus a wide range of enhanced features that we believe differentiate our service and offer an attractive value proposition to our customers. We also offer a number of premium services for additional costs.

Vonage has developed both a direct sales channel, as represented by web sites and toll free numbers, and a retail distribution channel through national retailers including Best Buy and Wal-Mart. The direct and retail distribution channels are supported through highly integrated advertising campaigns across multiple media such as online, television, direct mail, alternative media, telemarketing, partner marketing and customer referral programs.

Our primary source of revenue is subscription fees that we charge customers for our service plans, primarily on a monthly basis. We also generate revenue from the sale of devices that connect a customer s phone to the Internet, for international calls customers make that are not included in their service plan, for additional features that customers add to their service plans and through activation fees we charge customers to activate their service.

We continue to leverage the following factors that have been instrumental in building our customer base:

> *Strong Brand Identity*. We believe our strong brand recognition has enhanced our ability to sell our services through direct and retail distribution channels, allowing us to capitalize on growing market demand for broadband and VoIP.

> *Attractive Value Proposition*. We offer our customers an attractive value proposition: a portable land-line phone replacement with unique and compelling features that differentiates our service from the competition at prices for domestic and international calling considerably lower than those of traditional telephone services.

> *Innovative, Low-Cost Technology Platform*. We believe our innovative software and network technology platform not only provides us with a competitive advantage over many other VoIP service providers but also allows us to maintain a low cost structure relative to traditional telephone and cable companies that need to build or lease costly last-mile networks.

While we will continue to build upon these strengths, we have identified six strategic imperatives that we believe will drive efficiencies and improve our business performance through 2009 and beyond:

> *Onboarding and Early Life Satisfaction*. Delivery of a frictionless experience from the time of sale through the customer s active use of service.

> *Distribution and Marketing Effectiveness*. Increasing our gross line additions without increasing our year-over-year investment in marketing.

> *Network, Product and Platform Reliability and Quality*. Ensuring our services deliver a consistent, high quality experience.

> *New and Enhanced Products and Services*. Developing differentiated products that meet the needs of specific customer segments and promote frequent usage and brand loyalty.

> *Cost Optimization*. Achieving a reduction in per line operating costs that more than offsets inflationary pricing and potential compression in average revenue per line.

> *Organizational Capacity and Skills Enhancement*. Increasing the organization s productivity through talent management, employee development and improved management tools.

We offer our broadband telephone services to customers through a variety of service plans with different pricing structures. All of our service plans include an array of both basic and enhanced features, and customers have the opportunity to purchase a number of premium features at an additional fee. In order to access our service, 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.

### *Plans*

In the United States, we offer three residential calling plans plus an option for expanded international service, and two small office and home office plans:

> *Residential Premium Unlimited*. Subject to certain restrictions, this plan includes unlimited local and long distance calling anywhere in the U.S., Canada and Puerto Rico. It also includes free calls to five select European countries.

> *Residential Basic 500*. This plan includes 500 minutes per month of local and long distance calling anywhere in the U.S., Canada, and Puerto Rico. Customers are charged 3.9¢ per minute after the first 500 monthly minutes used.

> *Vonage Pro*. This plan combines the Residential Premium Unlimited Plan with certain premium services described below like Vonage Companion and Vonage Visual Voicemail.

> *Small Business Unlimited*. Subject to certain restrictions, this plan includes unlimited local and long distance calling anywhere in the U.S., Canada and Puerto Rico for business customers. It also includes free calls to five select European countries and a free dedicated fax line.

> *Small Business Basic*. This plan includes 1,500 minutes per month of local and long distance calling anywhere in the U.S., Canada, and Puerto Rico for business customers. Customers are charged 3.9¢ per minute after the first 1,500 monthly minutes used. This plan also includes a free dedicated fax line.

> *World Plans*. For a monthly fee, Residential Premium Unlimited Plan customers can choose to add an international calling plan where they can make unlimited calls to a region of their choice.

We also offer other plans, including Residential Fax Service, Business Fax Service and Vonage SoftPhone, which are described below. As of December 31, 2008, approximately 92% of our U.S. subscriber lines were for residential service, and approximately 76% of those residential subscriber lines 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.

### *Basic and Enhanced Features*

Each of our calling plans provides a number of basic features including call waiting, caller ID with name, call forwarding and voicemail. All of our calling plans also include a wide range of enhanced features at no additional charge to our customers, such as:

> *Area Code Selection.* Customers can select from approximately 259 U.S. area codes for their telephone number for use with our service, regardless of physical location.

> *Service and Number Portability.* Our service is portable. Our customers can use their Vonage phone numbers to make and receive calls almost anywhere in the world that a broadband Internet connection is available by taking their Vonage-enabled device with them.

> *Online Account Management.* Customers can view and manage their accounts online. Our service provides capabilities such as real-time feature management, call forwarding options and a lifetime call activity log.

> *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.

### *Premium Services*

We also offer a number of premium services for additional fees. These services include:

> *Vonage Visual Voicemail.* This feature allows a customer to have their voicemail messages transcribed to text and sent to their e-mail address or mobile phone.

> *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. For example, a customer living in New York City with a New York City phone number can purchase a Los Angeles virtual phone number that rings on the customer s primary subscriber line. In this instance, a caller from Los Angeles could call the customer s virtual phone number and be billed as if the customer were in Los Angeles. In addition to U.S. virtual phone numbers, we offer international virtual phone numbers as well. Virtual phone numbers are not included in our subscriber line count.

> *Toll Free Plus.* A customer can have toll free numbers that ring on an existing subscriber line. Toll free numbers are not included in our subscriber line count.

> *Vonage SoftPhone.* A softphone is a software application that can be downloaded and installed on computers, laptops and WiFi-enabled personal digital assistant devices. It enables a user to use a computer as a full-functioning telephone, with its own phone number, through a screen-based interface that works just like a telephone keypad.

> *Residential Fax Service.* For a monthly fee, we offer 250 minutes of outgoing fax service within the United States, Puerto Rico and Canada on a dedicated fax line plus unlimited incoming faxes, with customers charged a per minute fee of 3.9 cents thereafter.

> *Business Fax Service.* We offer 500 minutes of outgoing fax service within the United States, Puerto Rico and Canada on a dedicated fax line plus unlimited incoming faxes, with customers charged a per minute fee of 3.9 cents thereafter. One business fax line is included in each of our business calling plans.

***Devices***

We believe that our ability to offer a variety of devices with enhanced features and capabilities differentiates our service offering from that of many of our competitors. Our plug-and-play Vonage-enabled devices permit portability because customers can take their Vonage device to different locations where broadband service is available, including switching between different Internet service providers, while continuing to make and receive calls on their Vonage phone number. We offer our customers a range of equipment alternatives for their Vonage-enabled devices based upon our continued relationships with technology companies.

> *Vonage V-Portal.* The Vonage V-Portal can connect up to two Vonage lines through a high-speed Internet connection and includes a networking router. It has a user-friendly LCD display with caller ID and call timer, call logs, language selection, and built-in upstream bandwidth tester. Utilizing Vonage s advanced quality of service software, the Vonage V-Portal allows customers to use the Internet connection for their computer and telephones at the same time while ensuring a high quality calling experience.

> *Analog Telephone Adapter.* Our analog telephone adapters, which convert analog audio signals into digital data packets for transmission over the Internet, are plugged in between the customer s telephone and existing broadband Internet connection.

> *Integrated Adapter and Wireless Router.* Our integrated adapters and wireless routers simplify installation by

combining a standard analog telephone adapter, a broadband router and a wireless (WiFi) access point in one device.

> *Vonage Bundled Cordless Phone and V-Portal.* Our cordless multi-phone system offers customers further simplification of equipment by combining a Digital Enhanced Cordless telecommunications, or DECT, cordless phone system, our V-Portal and a router into one easy to install package. These cordless multi-phone systems are designed to appeal to the needs of mainstream consumers who are looking for a whole house solution.

> *V-Phone.* The Vonage V-Phone is a USB compatible device designed for use with our service. Vonage software comes pre-loaded on the V-Phone and updates itself on the device s 256 megabyte flash drive without requiring the customer to install any software on the host laptop or PC. The V-Phone comes with a standard 2.5 millimeter stereo earpiece microphone and customers can make and receive calls by plugging the device into virtually any Windows-based laptop or PC with a high speed broadband Internet connection.

> *Vonage Companion.* Vonage Companion is a downloadable softphone that can be loaded on a laptop or PC. Vonage Companion has the same phone number as a customer s main Vonage phone line and incoming calls can ring to both the main phone line and Vonage Companion.

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.

### *How Vonage Calls Work*

The Vonage system uses our customer s existing high-speed broadband Internet service to connect a Vonage-enabled device to our call processing complex over the Internet. Our service is not dependent on any specific type or provider of Internet service, and our customers are free to change the provider of their Internet service as they wish, either because of a competitive alternative, or because they have moved to a different location.

The Vonage-enabled adapter adapts our customer s existing telephones to Vonage s VoIP-based system. When a customer places a call on our system, their Vonage-enabled adapter signals to our call processing system to deliver the call either to the traditional telephone network, or to another Vonage customer. Our call processing system is scalable and geographically distributed in four distinct Call Processing Centers for robustness and reliability.

The Vonage-enabled adapter converts the traditional analog voice signal from our customer s telephone into a series of IP packets that are sent over his high-speed broadband connection, across the Internet, to a VoIP media gateway at one of our Regional Data Connection Points, where the packets are converted back into traditional public switched telephone network telephone signals. Vonage s architecture has VoIP media gateways and connections to our public switched telephone network termination partners at multiple, distributed geographical locations for capacity, scalability and reliability.

The voice functionality of the Vonage-enabled adapters are remotely configured and managed by Vonage. We can remotely perform software upgrades to enable new features or address operational issues without requiring an in-home service technician or our customer s involvement.

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.

Our web-based customer portal allows our customers to manage most aspects of their Vonage service without requiring the intervention of a customer-care representative. Customers can add and change features, phone numbers, update billing information and review their historical calling and billing records using this self-service portal. Since we remotely manage the Vonage-enabled adapters, customers see a common and consistent interface, regardless of what generation equipment they may have.

***Core Network Elements***

> *Call Processing Centers.* Our call processing centers communicate with the equipment at the Vonage customer s location to authenticate and authorize access to our network. The call processing centers are also responsible for all call signaling in our network, such as initiating phone calls, delivering inbound calls to a customer s phone, and other calling features such as call forwarding. The call processing centers are built from our internally-developed software and industry-standard servers and make use of techniques in distributed computing.

> *Regional Data Connection Points*. Calls into or out of our network, where one of the parties is not a Vonage customer, are interconnected with the public switched telephone network at 17 regional data connection points in the United States, Canada, Chile, Mexico and the United Kingdom. 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 transferred from our equipment to other carriers at connection points that are typically housed in small co-location facilities in which we lease space from other telecommunications providers. We generally pay monthly for this co-location, based on the amount of space we use. 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. Our business is not substantially dependent upon our agreements with other carriers or our interconnection agreements, because we can easily substitute other telecommunications providers in order to obtain the same or similar service at similar cost.

> *Network Operations Center.* We currently maintain a network operations center at our headquarters and 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 offering more efficiently and effectively. Key aspects of these systems include:

> *Customer Device Management System.* We have developed a suite of software solutions that enable us to remotely provision, monitor and configure customer devices and services. When we develop new service offerings or software solutions, we can securely update a customer s equipment and software features without the need for costly field visits.

> *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. In addition, we have developed our own scaleable Web-based billing system that allows our customers to access all of their call usage and billing details.

> *Reporting Tools.* To enhance our network operations efforts, we have a series of internally-developed monitoring and reporting tools that enable us to more effectively manage our network and quickly and efficiently recognize and respond to potential issues.

> *Emergency Calling Service and Enhanced 911 Service.* We have deployed E-911 service to approximately 99.1% of our U.S. customer base that is comparable to the emergency calling services provided to customers of traditional wireline telephone companies in the same area. For customers in areas where our E-911 service is available, emergency calls are routed, subject to the limitations discussed below, directly to an emergency services dispatcher at the public safety answering point, or PSAP, in the area of the customer s registered location. The dispatcher will have automatic access to the customer s telephone number and registered location information. However, if a customer places an emergency call using the customer s Vonage-enabled device in a location different from the one registered with us, the emergency call will be routed to a PSAP in the customer s registered location, not the customer s actual location at the time of the call. Every time a customer moves his or her Vonage-enabled device to a new location, the customer s registered location information must be updated and verified. Until this occurs, the customer will have to verbally advise the emergency dispatcher of his or her actual location at the time of the call and wait for the call to be transferred, if possible, to the appropriate local emergency response center before emergency assistance can be dispatched.

In some cases, even under our 911 service, emergency calls may be routed to a PSAP in the area of the customer s registered location, but such PSAP may not be capable of receiving our transmission of the caller s registered location information and, in some cases, the caller s phone number. Where the emergency call center is unable to process the information, the caller is provided a service that is similar to the basic 911 services offered to some wireline telephone customers and some wireless customers. In these instances, the emergency caller may be required to verbally advise the operator of their location at the time of the call and, in some cases, provide a call back number so that the call can be handled or forwarded to an appropriate emergency dispatcher.

The emergency calls of customers located in areas where we currently do not provide either E-911 or the basic 911 described above are either routed directly to the PSAP in the area of the customer s location or supported by a national call center that is run by a third party provider and operates 24 hours a day, seven days a week. In these cases, a caller must provide the operator with his or her physical location and call back number. If a customer reaches the call center, the operator will coordinate connecting the caller to the appropriate PSAP or emergency services provider. Our E-911 service does not support the calls of our V-Phone, WiFi phone, Vonage Companion and Vonage SoftPhone users. The emergency calls of our V-Phone, WiFi phone, Vonage Companion and Vonage SoftPhone users are supported by the national call center.

> *Agreements with E-911 Service Providers.* To enable us to effectively deploy and provide our E-911 service, we maintain

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an agreement with a provider that assists us in delivering emergency calls to an emergency service dispatcher at the 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 maintain agreements with several companies that maintain 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.

> *Other Agreements.* We have entered into agreements with several service providers to assist us with operations. In particular, we contract with third parties to support local number portability for our customers, which allow new customers to retain their existing telephone numbers when subscribing to our services.

  > We rely on agreements with providers to facilitate the transfer of customer telephone numbers and provide us with certain operations support systems services that enable us to implement our local number portability solution.

  > Third Party Verification, Inc. performs the third party verification of pertinent local number portability information from our subscribers. This verification is an integral process step prior to porting a customer from one local telephone company to us. Our agreement with Third Party Verification, Inc. will continue through May 2009, and will automatically renew for one-year periods thereafter, unless either we or Third Party Verification, Inc. notifies the other party within sixty days of the expiration of the relevant period.

> *Security.* We have developed a service architecture and platform that use industry-standard security techniques and allow 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.

Our marketing objective is to achieve subscriber line goals by cost-effectively acquiring and retaining customers. We believe that Vonage is well-positioned in the digital phone market.

We employ an integrated multi-channel approach to marketing. We make use of broad-reach and highly-targeted media channels including television, online, direct mail, alternative media, telemarketing, partner marketing and customer referral programs. As a national provider, we believe we are able to buy online and traditional media in a highly efficient manner. Our customers have a variety of vehicles to purchase our services and products, through the internet, by phone, in a retail store or at a kiosk. In addition, we accept a multiple forms of payment such as credit cards, debit cards, and electronic check payments, or ECP.

We monitor the results of our marketing efforts closely in a number of ways, including the cost of acquiring new subscriber lines, to evaluate which approaches produce the best results and deploy our marketing resources accordingly. All of our testing follows disciplined direct marketing tactics, which help us isolate the variables that are driving performance. Because we track performance beyond the gross sale, we are able to prioritize those programs that bring in high value, long-term customers.

We make use of marketing research to gain consumer insights into brand, product and service performance. We also monitor brand strength among VoIP, broadband and dial-up customers. Market research is also leveraged in the areas of testing, retention marketing and product marketing. We believe gaining insights into customer needs, wants and preferences is a key marketing asset.

We augment these marketing efforts with Refer-a-Friend, our online customer referral program. Under this program, existing customers can use the Vonage website to send e-mails to their friends that describe our service offerings and track their responses. We also introduced a referral feature that allows referrers to use their Vonage telephone number as a type of coupon code to allow greater word of mouth exposure. In return for referring a new customer, both the new and the existing customer receive a service credit.

### *Direct Sales*

The primary sales channels for our service historically have been through 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 1-800-4VONAGE. We complement these sales channels with marketing vehicles including television, direct mail, alternative media, outbound telemarketing, partner marketing, and customer referral programs.

### *Retail Sales*

In addition to our direct sales channel, we also offer sales through our retail channel. Our service currently is available at the outlets of leading national retailers, including Best Buy and Wal-Mart. We believe that the availability of our devices through premier retailers enhances and reinforces the Vonage brand with consumers and that the retail channel increases our ability to acquire mainstream consumers by reaching them in a familiar and interactive shopping environment. Further, as consumer adoption patterns shift, Vonage has augmented its national retailer footprint by adding regional retailers such as Brandsmart and Fry s Electronics. National and regional retailers provide Vonage with a wide footprint to distribute our service. In looking at ways to increase control in the sales channel, we opened Vonage kiosks throughout the United States in 2006 and 2007 and continue to look at ways at optimize sales performance at each kiosk location while looking at growth opportunities in favorable geographic markets. We had 31 kiosks in operation at the end of 2008.

### *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. We believe that many customers use our online account management website first when they have a question or problem with their service and that many of them 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 both 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 can contact a live customer care representative through our toll free number. We staff our customer care hotline 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 called Advanced Technical Support for resolving customers complex issues that could not be handled by our other representatives. We use extensive monitoring of call quality and customer satisfaction scores to determine additional training or coaching requirements for individual employees.

### *Billing*

All customer billing is automated through our website. We automatically collect all fees from our customers credit card, debit card or 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 believe that our technological position depends primarily on the experience, technical competence and the creative ability of our engineering and technology staff. We review our technological developments with our technology staff and business units to identify the features of our core technology that provide us with a technological or commercial advantage and file patent applications as necessary to protect these features 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. We have been issued three patents and have filed several other patent applications to protect our technology, which are currently pending.

In addition to developing technology, we evaluate the licensing and acquisition of intellectual property of others in order to identify technology that provides us with a technological or commercial advantage. In 2006, we acquired three patents from Digital Packet Licensing Inc. that enable VoIP technology. The patents are related to the compression of packetized digital signals commonly used in VoIP technology. Two of the patents have expired, and the other patent expires in 2013.

We were named as a defendant in several suits that relate to patent infringement and entered into settlement agreements to settle certain of the suits, which in certain cases include payments, patent licenses and covenants not to sue.

We are the owner of 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. Some of our registered marks include Vonage®, Redefining Communications®, Vonage Digital Voice® and Vonage The Broadband Phone Company®. These registered marks have a duration of five years from the date they are registered.

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.

We face strong competition from incumbent telephone companies, cable companies, alternative voice communication providers and wireless companies. 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, reliability, customer service and enhanced services and features.

***Incumbent telephone companies***

The incumbent telephone companies are our primary competitors and have historically dominated their regional markets. These competitors include AT&T, Qwest Communications and Verizon Communications as well as rural incumbents, such as Frontier Communications. These competitors are substantially larger and better capitalized than we are and have the advantage of a large existing customer base. In addition, many users of traditional phone service who might otherwise switch to our service may believe that they cannot cancel their traditional phone service without also losing their broadband DSL service. While a majority of broadband users today subscribe to cable modem service, recent trends suggest that DSL providers are gaining broadband market share. Others are not willing to install a Vonage-enabled device, accept the limitations of our emergency calling service or forgo service during power outages. Before subscribing to our service, a substantial majority of our new customers must first decide to terminate their service from their incumbent telephone company or pay for our service in addition to their existing service.

In many cases, we charge prices that are significantly lower than prices charged by the incumbent phone companies. We believe that we currently compete successfully with the incumbent phone companies on the basis of the features we offer that they do not (such as area code selection and virtual phone numbers) and features we offer at no extra charge. However, the ability of telephone companies to offer DSL last mile connections has significantly enhanced their ability to compete with us on the basis of price and features.

The incumbent phone companies own networks that include a last mile connection to substantially all of our existing and potential customers as well as the places our customers call. As a

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result, the vast majority of the calls placed by a Vonage customer are carried over the last mile by an incumbent 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. Their last mile connections enable these competitors to bundle phone service with Internet access and television at prices we may find difficult to compete with.

The incumbent phone companies, as well as the 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.

***Cable companies***

These competitors include companies such as Cablevision, Comcast Corporation, Cox Communications and Time Warner Cable (a division of Time Warner Inc.). Cable companies have significant financial resources and have made and are continuing to make substantial investments in delivering broadband Internet access and phone service to their customers. Providing Internet access and cable television to many of our existing and potential customers allows them to engage in highly targeted, low-cost direct marketing and may enhance their image as trusted providers of services.

Cable companies are also aggressively using their existing customer relationships to bundle services. For example, they bundle Internet access, cable television and phone service with an implied price for the phone service that may be significantly below ours. They 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 they are able to use this time to promote their telephone service offerings.

Many cable companies 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.

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 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. This could also apply to phone companies that connect our customers to the Internet.

We believe our ability to successfully compete with cable companies is enhanced by the features we offer that cable companies do not offer (such as portable service and wide choice of area codes) and because our national presence makes us more attractive to national retail outlets and allows us to more efficiently purchase national advertising.

***Wireless telephone companies***

We also compete with wireless phone companies, such as AT&T, Sprint, T-Mobile and Verizon Wireless. 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 and may in the future offer VoIP to their customers. As wireless providers offer more minutes at lower prices and companion landline alternative services, their services have become more attractive to households as a competing replacement for wireline service. Wireless telephone companies have a strong retail presence and have significant financial resources.

***Alternative voice communication providers***

We also compete against established alternative voice communication providers, such as Skype (a service of eBay Inc.), magicJack and independent VoIP service providers. Some of these service providers have chosen to sacrifice revenue in order to gain market share and have offered their services at lower prices or for free. Google Inc., Microsoft Corporation and Yahoo! Inc. also offer free instant messaging services that are voice enabled.

While not all of these competitors currently offer the ability to call or be called by anyone not using their service, in the future they may integrate such capabilities into their service offerings.

In addition, a continuing trend toward consolidation of telecommunications companies and the formation of strategic alliances within the telecommunications industry, as well as the development of new technologies, could give rise to significant new competition.

As of December 31, 2008, we had 1,491 employees. None of our employees is subject to a collective bargaining agreement.

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 and 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.

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Our Chief Executive Officer and Chief Financial Officer have provided the certifications required by Rule 13a-14(a) under the Securities Exchange Act of 1934, copies of which are filed as exhibits to this Annual Report on Form 10-K. In addition, an annual chief executive officer certification was submitted by our then Interim Chief Executive Officer to the New York Stock Exchange on June 3, 2008 in accordance with the New York Stock Exchange listing requirements.

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# **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.*

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

On November 3, 2008, we consummated a financing consisting of (i) a $130,300 senior secured first lien credit facility (the First Lien Senior Facility ), (ii) a $72,000 senior secured second lien credit facility (the Second Lien Senior Facility ) and (iii) the sale of $18,000 of our 20% senior secured third lien notes due 2015 (the Convertible Notes and collectively, the Financing ). The First Lien Senior Facility, the Second Lien Senior Facility and the Note Purchase Agreement governing the Convertible Notes contain various covenants and other restrictions 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:

- incur, prepay, refinance or modify indebtedness;
- create liens;
- pay dividends on or repurchase our capital stock or make other restricted payments;
- make investments;
- enter into acquisitions, sales and mergers;
- enter into sale and leaseback transactions;
- amend our organizational documents, or amend, modify or waive litigation settlements, key employment agreements or other material contracts;
- incur marketing expenses in excess of specified thresholds;
- change the nature of our business or enter into additional lines of business; and
- enter into transactions with our stockholders and affiliates.

Under the Financing agreements, we are required to maintain a specified minimum fixed charge coverage ratio, maximum leverage ratio and senior secured debt leverage ratio. In addition, these agreements require us to maintain minimum levels of consolidated adjusted EBIDTA, liquidity and pre-marketing operating income and limit our capital expenditures. Upon the repayment of our obligations under the First Lien Senior Facility and the Second Lien Senior Facility, the covenants will fall-away, but the Note Purchase Agreement for the Convertible Notes will continue to limit our ability to incur indebtedness and make restricted payments. Our ability to comply with such financial and other covenants can 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 these agreements. In that case, the lenders and the noteholders could elect to declare due and payable immediately all amounts due under the Financing agreements, including principal, accrued interest, a make-whole premium and, in the case of the Convertible Notes, liquidated damages, and may take action to foreclose upon the collateral securing the indebtedness.

***If we do not meet the New York Stock Exchange continued listing requirements, our common stock may be delisted.***

The New York Stock Exchange ( NYSE ) listing standards require us, among other things, to maintain an average closing price of at least $1.00 per share of common stock and a minimum average global market capitalization of at least $100,000 during any consecutive 30-trading-day period. On October 24, 2008, we were notified by the NYSE that we were not in compliance with the NYSE listing standard relating to minimum average share price. We have notified the NYSE of our intent to cure the deficiency. We must bring our share price and average share price back above $1.00 within six months from the receipt of the NYSE notice, subject to possible extension including for any suspension of the listing standard by the NYSE, to regain compliance with the NYSE s price condition, or our common stock will be subject to suspension and delisting procedures. During the cure period and subject to compliance with NYSE s other continued listing standards, our common stock will continue to be listed on the NYSE.

On February 9, 2009, we were notified by the NYSE that we had fallen below the NYSE s continued listing standard relating to minimum average global market capitalization. We subsequently notified the NYSE that we will submit a plan within 45 days from the receipt of the NYSE notice that demonstrates our ability to regain compliance within 18 months. Upon receipt of this plan, the NYSE has 45 calendar days to review and determine whether we have made a reasonable demonstration of our ability to come into conformity with the relevant standards within the 18 month period. The NYSE will either accept the plan, at which time we will be subject to ongoing monitoring for compliance with this plan, or the NYSE will not accept the plan and we will be subject to suspension and delisting proceedings.

A delisting of our common stock could negatively impact us by: (i) reducing the liquidity and market price of our common stock; (ii) reducing the number of investors willing to hold or acquire our common stock, which could negatively impact our ability to raise equity financing; (iii) limiting our ability to use a registration statement to offer and sell freely tradable securities, thereby preventing us from accessing the public capital markets; (iv) impairing our ability to provide equity incentives to our employees and (v) causing an increase in the conversion rate under the Convertible Notes, resulting in the issuance of additional shares upon conversion. A delisting of our common stock is not an event of default under the documents governing our senior credit facilities and Convertible Notes.

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

The telecommunications industry is highly competitive. We face intense competition from traditional telephone companies, wireless companies, cable companies and alternative voice communication providers. Our principal competitors are the traditional telephone service providers, including AT&T, Qwest Communications and Verizon Communications, and rural incumbents such as Frontier Communications, 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, Comcast Corporation, Cox Communications, and Time Warner Cable (a division of Time Warner Inc.), which have added VoIP services to their existing cable television, voice and broadband offerings. Further, as wireless providers, including AT&T, Sprint, T-Mobile and Verizon Wireless, offer more minutes at lower prices and companion landline alternative services, 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 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 offer VoIP services with more attractive service packages that include on-site installation and more robust customer service. In addition, because of the other services our competitors provide, they may 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, cause us to lower our prices in order to compete and reduce our market share and revenues.

We also compete against established alternative voice communication providers, such as Skype (a service of eBay Inc.), magicJack and independent VoIP service providers. Some of these service providers may choose to sacrifice revenue in order to gain market share and have offered their services at lower prices or for free. Google Inc., Microsoft Corporation and Yahoo! Inc. also offer free instant messaging services that are voice enabled. In order to compete with such service providers, we may have to reduce our prices, which would delay or prevent our profitability.

We also are subject to the risk of future disruptive technologies. If new technologies develop that are able to deliver competing voice services at lower prices, better or more conveniently, it could have a material adverse effect on us.

***Current economic conditions may adversely affect our industry, business and results of operations.***

The United States economy is currently undergoing a period of slowdown and very high volatility and the future economic environment may continue to be less favorable than that of recent years. A substantial portion of our revenues comes from residential and small office and home office customers whose spending patterns may be affected by prevailing economic conditions. While we believe that the weakening economy had a modest effect on our net subscriber additions and ability of our customers to pay us during recent months, if these economic conditions continue to deteriorate, the growth of our business and results of operations may be more impacted. Economic conditions may cause more households to rely solely on a mobile phone for home telecommunications and eliminate landline connections. In addition, reduced consumer spending may drive us and our competitors to offer certain services at promotional prices, which could have a negative impact on our operating results.

***A higher rate of customer terminations would negatively affect our business by reducing our revenue or requiring us to spend more money to grow our customer base.***

Our rate of customer terminations, or average monthly customer churn, was 3.1% for the year ended December 31, 2008. During that period, 816,661 of our customers terminated. In the fourth quarter of 2008, our average monthly customer churn was 2.9%. Our churn rate could increase in the future if customers are not satisfied with the quality and reliability of our network, products and core operational platforms and our customer service. Other factors, including increased competition from other providers, disruptive technologies, general economic conditions and our ability to properly activate and register new customers on the network, also influence our churn rate.

Because of churn, 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 those costs are an important factor in determining our net losses and achieving future profitability. Therefore, if we are unsuccessful in retaining customers or are required to spend significant amounts to acquire new customers beyond those budgeted, our revenue could decrease and our net losses could increase.

***We have incurred quarterly losses since our inception, and we may continue to incur losses in the future.***

We have incurred losses since our inception, and we may continue to incur losses in the future. For the period from our inception through December 31, 2008, our accumulated deficit was $1,052,861. For the year ended December 31, 2008, our net loss was $64,576. Our net losses initially were driven primarily by start-up costs and the cost of developing our technology and later by patent litigation settlements and marketing expenses. Most recently, our net losses have been driven principally by marketing expenses and investments in research and development and customer care. We will also incur increased interest expense as a result of the Financing that we completed in November 2008. In the past, we projected that we would generate net income during future periods, but then generated a net loss. Although we believe we will achieve profitability in the future, we ultimately may not be successful and we may never achieve profitability.

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***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 respond to opportunities to develop or acquire complementary businesses or technologies. Because of our significant losses to date 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, prepay, refinance or modify indebtedness and create liens.

***We are and in the future 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.***

We have received notice that certain patents of a third party may be relevant to our business and we are named as a defendant in a suit that relates to patent infringement. See Item 3. Legal Proceedings IP Matters. In addition, we have been subject to other infringement claims in the past, including suits that we settled for a total of $243,825 with Verizon, Sprint, AT&T, Nortel Networks and others, and, given the rapid technological change in our industry and our continual development of new products and services, we may be subject to infringement claims in the future. We may be unaware of filed patent applications and issued patents that could include claims covering our products and services.

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 or damages. The defense of any lawsuit could divert management s efforts and attention from the 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;

> lead to an event of default under the terms of our Financing documents, which could permit the lenders and noteholders to declare due and payable immediately all amounts due under the Financing agreements, including principal, accrued interest, a make-whole premium and, in the case of the Convertible Notes, liquidated damages and take action to foreclose upon the collateral securing the indebtedness;

> cause us to accelerate expenditures to preserve exiting revenues;

> cause existing or new vendors to require prepayments or letters of credit;

> cause our credit card processors to demand additional reserves or letters of credit or make holdbacks;

> result in substantial employee layoffs;

> materially and adversely affect our brand in the market place and cause a substantial loss of goodwill;
> cause our stock price to decline significantly or otherwise cause us to fail to meet the continued listing requirements of the NYSE, 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; and

> lead to our bankruptcy or liquidation.

***We are currently subject to securities class action litigations, the unfavorable outcome of which might have a material adverse effect on our financial condition, results of operations and cash flows.***

A number of putative class action lawsuits have been filed against us, certain of our officers and directors, and the lead underwriters of our initial public offering, alleging, among other things, securities laws violations. On January 9, 2007, the Judicial Panel on Multidistrict Litigation transferred all complaints to the District of New Jersey. On November 19, 2007, the plaintiffs filed a consolidated Amended Complaint, which generally alleges: (i) we made misstatements regarding subscriber line growth and average monthly churn rate; (ii) we failed to disclose problems with facsimile transmissions and a pending fax litigation case; (iii) we failed to disclose all patent infringement claims and issues; and (iv) that the Directed Share Program suffered from various infirmities. On January 18, 2008, we filed our motions to dismiss the Amended Complaint. Briefing on the matter was completed by April 2, 2008 and the Court heard oral argument on October 10, 2008. The Court has not yet ruled on the motion. We cannot determine the outcome or resolution of these claims or the timing for their resolution. In addition to the expense and burden incurred in defending this litigation and any damages that we may suffer, our management s efforts and attention may be diverted from the ordinary business operations in order to address these claims. If the final resolution of this litigation is unfavorable to us, our financial condition, results of operations and cash flows may be materially adversely affected if our existing insurance coverage is unavailable or inadequate to resolve the matter.

***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.***

We have been named in several purported class actions in California, New Jersey, and Washington alleging 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. We have also been subject to periodic regulatory inquiries regarding our business practices, including an ongoing investigation by a group of 28 states attorney generals into certain of our business practices for which we have received 22 document requests. Class action litigation and regulatory inquiries of these types are often expensive and time consuming and their outcome may be uncertain.

Any such 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.

***Certain aspects of our service are not the same as traditional telephone service, which may limit the acceptance of our services by mainstream consumers and our potential for growth.***

For certain users, certain 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.

> 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 Federal Communications Commission ( 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 public safety answering point ( PSAP ) for the caller s registered location. Vonage provides E-911 service, under the FCC s rules, to approximately 99.1% 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 Vonage SoftPhone service, which is software that enables a customer to make telephone calls from a computer, the Vonage V-Phone, which is a softphone on a USB memory device that enables the user to make telephone calls from any computer to which the V-Phone is connected, and Vonage Companion, which is a softphone that can be loaded on a personal computer, do not provide E-911 service. These services 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 ability to provide our service is dependent upon third-party facilities and equipment, the failure of which could cause delays or interruptions of our service, damage our reputation, cause us to lose customers and limit our growth.***

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 also 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.

***We rely on third parties to provide a portion of our customer service representatives, initiate local number portability for our customers and provide aspects of our E-911 service. 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. We rely on multiple third parties outside of the U.S. to provide a portion of the customer service representatives that respond to customer inquiries. These third-party providers generally represent us without identifying themselves as independent parties. A significant portion of customer service representatives that respond to our customers inquiries are based in the Philippines. The ability of third party providers to provide these representatives may be disrupted by natural disasters, civil unrest and other adverse events that may impact the Philippines.

We also maintain an agreement with an E-911 provider to assist us in routing emergency calls directly to an emergency service dispatcher at the PSAP in the area of the customer s registered location and terminating E-911 calls. We also contract with a provider for the national call center that operates 24 hours a day, seven days a week to receive certain emergency calls and with several companies that maintain PSAP databases for the purpose of deploying and operating E-911 services. Interruptions in service from these vendors 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 could cause delays or interruptions of service, 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 software or other facilities and overloading of our network. Our customers and potential customers subscribing to our services have experienced interruptions in the past and may experience interruptions in the future as a result of these types of problems. Interruptions have in the past and may in the future cause us to lose customers or potential customers and offer substantial customer credits, which could adversely affect our revenue and profitability. During 2008, we had multiple outages that affected groups of customers at various times, some of which affected large groups of customers for several hours. In addition, because our systems and our customers ability to use our services are Internet-dependent, our services may be subject to hacker attacks from the Internet, which could have a significant impact on our systems and services. If service interruptions adversely affect the perceived reliability of our service, we may have difficulty attracting and retaining customers and our brand reputation and growth may suffer.

***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 recently completed the process of upgrading our network, systems and procedures to meet Payment Card Industry ( PCI ) data security standards, which requires periodic audits, including an initial audit that began in late 2008, 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 the initial audit or 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.

***Our credit card processors have the ability to take significant holdbacks or increase existing reserves in certain circumstances. The initiation of such holdbacks or increased reserves likely would have a material adverse effect on our liquidity.***

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. As such, we have provided our credit card processors with cash reserves of $22,023 and a cash collateralized letter of credit for $10,413 as of December 31, 2008. Under our credit card processing agreements with our Visa/MasterCard, American Express, Barclays and Discover credit card processors, the credit card processor has the right, in certain circumstances,

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including adverse events affecting our business, to impose a holdback of our advanced payments purchased using a Visa/MasterCard, American Express, Barclays 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 initiate a holdback or considerably increase reserves, the negative impact on our liquidity likely would be significant. In addition, our Visa/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.

***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 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.

It is not clear whether suppliers of broadband Internet access have a legal obligation to allow their customers to access and use our service without interference. As a result of recent decisions by the U.S. Supreme Court and the FCC, providers of broadband services are subject to relatively light regulation by the FCC. Consequently, federal and state regulators might not prohibit broadband providers from limiting their customers access to VoIP or otherwise discriminating against VoIP providers. In August 2008, however, the FCC found that it had the authority to order a major cable operator to cease using network management practices that interfered with its broadband service users ability to use certain types of applications. The cable operator has sought judicial review of the FCC s decision. Interference with our service or higher charges for also 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.

***Because much of our potential success and value lies in our use of internally developed systems and software, if we fail to protect them, it could negatively affect us.***

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 have three internally developed issued patents, several pending patent applications and acquired three patents from Digital Packet Licensing, Inc., we cannot patent much of the technology that is important to our business. To date, we have relied on copyright, trademark 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.

***Regulation of VoIP services is developing and therefore uncertain, and future legislative, regulatory or judicial actions could adversely affect our business and expose us to liability.***

Our business has developed in an environment largely free from government regulation. However, the United States and other countries have begun to assert regulatory authority over VoIP and are continuing to evaluate how VoIP will be regulated in the future. Both the application of existing rules to us and our competitors and the effects of future regulatory developments are uncertain.

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.

Our international operations are also subject to regulatory risks, including the risk that regulations in some jurisdictions will prohibit us from providing our services cost-effectively or at all, which could limit our growth. Currently, there are several countries where regulations prohibit us from offering service. In addition, because customers can use our services almost anywhere that a broadband Internet connection is available, including countries where providing VoIP services is illegal, the governments of those countries may attempt to assert jurisdiction over us, which could expose us to significant liability and regulation.

***We identified a material weakness in our internal control over financial reporting which was remediated as of December 31, 2007 and may identify additional material weaknesses in the future that may cause us to fail to meet our reporting obligations or result in material misstatements of our financial statements.***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with accounting principles generally accepted in the United States. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company s annual or interim financial statements will not be prevented or detected on a timely basis.

Our management, after discussions with our audit committee and our independent registered public accounting firm, BDO Seidman LLP, determined that it was necessary to restate our consolidated financial statements for the quarters ended June 30, 2007 and September 30, 2007 in order to correct the amount of stock-based compensation expense recorded by us for those periods. In light of the restatement, we believe that a material weakness existed in the design of our internal control procedures relating to recording stock-based compensation expense, which was remediated as of December 31, 2007.

If we fail to maintain the adequacy of our internal controls, we may not be able to conclude in the future that we have effective internal control over financial reporting in accordance with the Sarbanes-Oxley Act. Moreover, effective internal controls are necessary for us to produce reliable financial reports and are important to help prevent fraud. As a result, our failure to maintain effective internal controls could result in the loss of investor confidence in the reliability of our financial statements, which in turn could harm the market value of our common stock. Any failure to maintain effective internal controls also could impair our ability to manage our business and harm our financial results.

***Our common stockholders may suffer dilution in the future upon exercise of our Convertible Notes.***

In connection with the Financing, we issued $18,000 aggregate principal amount of Convertible Notes to Silver Point Finance, LLC, certain of its affiliates, other third parties and affiliates of us. If the conversion rights in the Convertible Notes are exercised, the exercising noteholders may obtain a significant equity interest in us and other stockholders may experience significant and immediate dilution. Conversion of the entire $18,000 aggregate principal amount of Convertible Notes at the initial conversion rate would have resulted in an increase of our outstanding common stock from 156,647,943 shares (as of December 31, 2008) to 218,716,909 shares, an approximate 39.6% increase or 28% dilution to our common stockholders.

***Jeffrey A. Citron, our founder, Chairman and a significant stockholder, exerts significant influence over us.***

As of December 31, 2008, Mr. Citron beneficially owned approximately 36.5% of our outstanding common stock, including outstanding securities convertible into or exercisable for common stock prior to December 31, 2008. 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 Chairman, Mr. Citron has and will continue to have significant influence over our strategy and other matters. Mr. Citron s interests may not always coincide with the interests of other holders of our common stock.

***We may be unable to fully realize the benefits of our net operating loss ( NOL ) carryforwards 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 carryforward 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 (though intervening entities) and constructively (by certain related parties and certain unrelated parties acting as a group).

***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:

> judgments in our litigation;

> changes in our earnings or variations in operating results;

> any shortfall in revenue or increase in losses from levels expected by securities analysts;

> changes in regulatory policies or tax law;

> operating performance of companies comparable to us; and

> general economic trends and other external factors.

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.

***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 Financing agreements. Upon the occurrence of an event of default, the lenders and the noteholders could elect to declare due and payable immediately all amounts due under the Financing agreements, including principal, accrued interest, a make-whole premium and, in the case of the Convertible Notes, liquidated damages, and may take action to foreclose upon the collateral securing the indebtedness.

Under our Financing agreements, a change of control would result from the occurrence of, among other things:

> the disposition by Jeffrey A. Citron, our Chairman, or certain of his affiliates of shares of common stock in excess of certain specified amounts;

> the acquisition by any person or group (other than Mr. Citron and his majority-controlled affiliates or certain investment funds related to New Enterprise Associates) of at least 30% of the voting and/or economic interest of our outstanding common stock on a fully-diluted basis or of the power to elect a majority of our board of directors, if such acquirer also has a greater voting and/or economic interest in our company than Mr. Citron and his majority-owned affiliates;

> a change in our Chief Executive Officer, unless an interim successor and permanent successor reasonably acceptable to the administrative agent and note agent is appointed within specified time periods; or

> the acquisition by Silver Point Finance, LLC and its affiliates and related funds of at least 50% of the voting and/or economic interest of our outstanding common stock on a fully-diluted basis or those entities obtaining the power to elect a majority of our board of directors.

We encourage you to read the agreements in full, including the definition of change of control therein. These Financing agreements have been previously filed with the Securities and Exchange Commission as exhibits to Amendment No. 8 to our Schedule TO, which was filed on October 22, 2008.

Further, we were named as a defendant in several suits that related to patent infringement and entered into agreements to settle certain 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 acquirers 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 |
| Mississauga, Ontario | Customer Service, Sales and Marketing, Administration | 28,500 | 2010 |
| London, United Kingdom | Sales and Marketing, Administration | 3,472 | 2010 |

We believe that the facilities that we occupy are adequate for our current needs and do not anticipate leasing any additional space.

# ITEM 3. Legal Proceedings

### *Litigation*

*State Attorney General Proceedings.* In 2008, Vonage learned that a group of 28 states attorney generals had begun an investigation into certain of our business practices. We have received document requests from 22 of the participating states. The requests seek information that Vonage previously produced to the Wisconsin Attorney General as part of an investigation commenced in November 2007, which consisted of, among other things, sales and retention marketing scripting, advertising disclosures, and information related to our money back guarantee. The most recent requests also seek, among other things, information related to marketing and billing practices, as well as early termination fees. To date, none of the attorney generals have filed a complaint against us or taken other formal action. We are unable to predict whether a formal action will be filed against us. We intend to fully cooperate in the investigation.

*IPO Litigation.* During June and July 2006, Vonage, several of our officers and directors, and the firms who served as the underwriters in our initial public offering ( IPO ) were named as defendants in several purported class action lawsuits arising out of our IPO. On January 9, 2007, the Judicial Panel on Multidistrict Litigation transferred all complaints to the District of New Jersey. On September 7, 2007, the Court appointed Zyssman Group as the lead plaintiff, and the law firm of Zwerling, Schachter and Zwerling, LLP as lead counsel. On November 19, 2007, the plaintiffs filed the Amended Complaint, which generally alleges: (i) defendants made misstatements regarding subscriber line growth and average monthly churn rate; (ii) defendants failed to disclose problems with facsimile transmissions and a pending fax litigation case; (iii) defendants failed to disclose all patent infringement claims and issues; and (iv) that the Directed Share Program suffered from various infirmities. On January 18, 2008, defendants filed their motions to dismiss the Amended Complaint, and briefing on the matter was completed by April 2, 2008, and the Court heard oral argument on

October 10, 2008. The Court has not yet ruled on the motion. The firms who served as underwriters to the IPO, pursuant to an indemnification agreement entered into between us and those firms prior to the IPO have demanded that Vonage reimburse them for the costs and fees incurred by them in defense of the IPO litigation. In addition, three of the firms have demanded that Vonage reimburse them for the costs and fees incurred by them in response to various regulatory inquiries by the Financial Industry Regulatory Authority (formerly the NASD) and the New York Stock Exchange, among other things. Vonage has declined to reimburse these three firms any fees or expenses.

*Consumer Class Action Litigations.* We have been named in several purported class actions venued in California, New Jersey, and Washington alleging a wide variety of deficiencies with respect to our business practices, marketing disclosures, email marketing and quality issues for both phone and fax service.

For example, there are various class actions, on behalf of both nationwide and state classes, pending in New Jersey, Washington and California generally alleging that we delayed and/or refused to allow consumers to cancel their Vonage service; failed to disclose procedural impediments to cancellation; failed to adequately disclose that their 30-day money back guarantee does not give consumers 30 days to try out our services; suppressed and concealed the true nature of our services and disseminated false advertising about the quality, nature and terms of our services; imposed an unlawful early termination fee; and invoked unconscionable provisions of our Terms of Service to the detriment of customers. On May 11, 2007, plaintiffs in one action petitioned the Judicial Panel on Multidistrict Litigation (the Panel ),

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seeking transfer and consolidation of the pending actions to a single court for coordinated pretrial proceedings. In an Order dated August 15, 2007, the Panel transferred the pending actions to the United States Court for the District of New Jersey, captioned *In re Vonage Marketing and Sales Practices Litigation*, MDL No. 1862, Master Docket No. 07-CV-3906 (USDC, D.N.J.). On October 1, 2007, counsel for one group of plaintiffs moved before the Court for Consolidation and Appointment of Co-Lead Counsel of the actions, and requested time to file an Amended Consolidated Complaint. On November 6, 2008 the Court entered an Order Granting Consolidation and Appointment of Co-Lead Counsel, and ordered that a consolidated Complaint be filed within 45 days, which Complaint was filed on December 19, 2008. On February 6, 2009, we filed a Motion to Compel Arbitration.

*Nebraska Public Service Commission.* On November 15, 2007, the Director of the Nebraska Telecommunications Infrastructure and Public Safety Department of the Nebraska Public Service Commission filed a complaint (the PSC Complaint ) before the Nebraska Public Service Commission (the NPSC ) alleging that Vonage is required to contribute to the Nebraska Universal Service Fund ( NUSF ) and has failed to do so. The PSC Complaint seeks an order compelling Vonage to contribute to the NUSF, as well as administrative penalties. Vonage is vigorously defending itself against the PSC Complaint. On December 6, 2007, Vonage filed its answer. On or about December 20, 2007, Vonage also brought a complaint for declaratory and injunctive relief against the NPSC in the United States District Court for the District of Nebraska. On March 3, 2008, the United States District Court for the District of Nebraska issued a Memorandum and Order granting Vonage s Motion for a Preliminary Injunction and Declaratory Relief. Specifically, the Court enjoined the NPSC from asserting state jurisdiction over Vonage to force Vonage to contribute to the NUSF and found the NPSC s assertion of state jurisdiction over Vonage to force Vonage to pay into the NUSF is unlawful as preempted by the Federal Communications Commission ( FCC ). On April 1, Nebraska filed a Notice of Appeal to the 8th Circuit Court of Appeals. On April 2, Vonage filed a motion for summary judgment in the district court, arguing the court should grant our permanent injunction. The district court, in a May 9, 2008 order, denied Vonage s request for summary judgment without prejudice. On December 12, 2008 the 8th Circuit Court of Appeals heard oral argument on the appeal and we are awaiting the Court s ruling.

*New Mexico Public Service Commission.* On June 27, 2008, the New Mexico Public Regulation Commission ( NMPRC ) filed a complaint for Declaratory Judgment ( NMPRC Complaint ) in the United States District Court for the District of New Mexico, alleging that Vonage is required to contribute to the New Mexico Universal Service Fund ( NMUSF ) and failed to do so. The NMPRC Complaint seeks an order compelling Vonage to contribute to the NMUSF. Vonage is vigorously defending itself against the NMPRC Complaint. On or about July 21, 2008, Vonage filed a Motion to Dismiss the NMPRC Complaint, and the NMPRC filed a response to the Motion to Dismiss. On November 12, 2008 the Magistrate Judge issued Proposed Findings and Recommended Disposition, recommending that the Company s Motion to Dismiss be granted. On November 21, 2008, NMPRC filed its objections to the Magistrate s Judge s recommended disposition, and on December 11, 2008 the Company filed its response to the NMPRC objections to the Magistrate Judge s recommendation to dismiss the complaint. On January 28, 2009, the District Court Judge heard oral argument and stayed the litigation pending the 8th Circuit decision in the Nebraska Public Service Commission litigation, referenced above.

*City of New York vs. Verizon and Vonage.* On April 21, 2008, the City of New York and the Sheriff of the City of New York filed a complaint ( NYC Complaint ) in New York State Court against Verizon and Vonage, arising out of collection efforts on the $58,000 judgment entered against Vonage in the *Verizon vs. Vonage* patent litigation. The City alleges that either Verizon or Vonage is liable for $2,900, which represents a poundage fee of 5% of the value of the property sought to be levied upon. On May 13, 2008, Vonage filed a motion to dismiss one count of the NYC Complaint. On May 16, 2008, Verizon filed a motion to dismiss the NYC Complaint in its entirety. The Court denied both motions and the parties are currently engaged in discovery.

*PC Management*. By letter dated February 2, 2009, PC Management, Inc. ( PCM ) provided written notice to us of its intent to arbitrate a dispute concerning PCM s right to an early termination fee under a Master Services Agreement for mobile services. Although the arbitration proceeding has not commenced, we believe that PCM will claim entitlement to approximately $1,875 in contractual termination fees.

### *IP Matters*

*Alcatel-Lucent.* On November 4, 2008, Vonage received a letter from Alcatel-Lucent initiating an opportunity for Vonage to obtain a non-exclusive patent license to certain of its patents that may be relevant to Vonage s business. Vonage is currently analyzing the applicability of such patents to its business. If Vonage determines that these patents are applicable to its business and valid, it may incur expense in licensing them. If Vonage determines that these patents are not applicable to its business or invalid, it may incur expense and damages if there is litigation.

*Centre One.* On December 5, 2008, Centre One filed a lawsuit against Vonage and its subsidiary Vonage America Inc. in the United States District Court for the Eastern District of Texas alleging that some of Vonage s products and services are covered by a patent held by Centre One (United States Patent No. 7,068,668) entitled Method and Apparatus for Interfacing a Public Switched Telephone Network and an Internet Protocol Network for Multi-Media Communication . The suit also named Verizon Communications Inc. and deltathree Inc. as defendants. Vonage believes Centre One is a firm owned by a sole inventor. Vonage is currently reviewing the validity of the Centre One patent and whether any of Vonage s products and services are covered by it.

From time to time, in addition to those identified above, Vonage is subject to legal proceedings, claims, investigations and proceedings in the ordinary course of business, including claims of alleged infringement of third-party patents and other intellectual property rights, commercial, employment and other matters. In accordance with generally accepted accounting principles, Vonage makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss or range of loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. We believe that we have valid defenses with respect to the legal matters pending against Vonage. Given the uncertainty surrounding litigation and our inability to assess the likelihood of a favorable or unfavorable outcome in the above noted matters, it is possible that the resolution of one or more of these matters could have a material adverse effect on our consolidated financial position, cash flows or results of operations.

### *Regulation*

Telephony services are subject to a broad spectrum of state and federal regulations. Because of the uncertainty over whether VoIP should be treated as a telecommunications or information service, we have been involved in a substantial amount of state and federal regulatory activity. Implementation and interpretation of the existing laws and regulations is ongoing and is subject to litigation by various federal and state agencies and courts. Due to the uncertainty over the regulatory classification of VoIP service, there can be no assurance that we will not be subject to new regulations or existing regulations under new interpretations, and that such change would not introduce material additional costs to our business.

#### *Federal CALEA*

On August 5, 2005, the FCC released an Order extending the obligations of 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.

The FCC required all interconnected VoIP providers to become fully CALEA compliant by May 14, 2007. To date, we have taken significant steps towards CALEA compliance, which include testing a CALEA solution with the FBI and delivering lawful CALEA requests. We have also implemented alternative solutions that allow CALEA access to call content and call-identifying information. The FCC and law enforcement officials have been advised as to our CALEA progress and our efforts at implementing alternative solutions. We could be subject to an enforcement action by the FCC if our CALEA solution is deemed not fully operational.

#### *State Telecommunications Regulation*

In general, the focus of interconnected VoIP telecommunications regulation is at the federal level. On November 12, 2004, the FCC declared that our service is subject to federal regulation and preempted the Minnesota Public Utilities Commission, or MPUC, from imposing certain of its regulations on us. The FCC s decision was based on its conclusion that our service is interstate in nature and cannot be separated into interstate and intrastate components. On March 21, 2007, the United States Court of Appeals for the $8^{th}$ Circuit affirmed the FCC s declaratory ruling preempting state regulation of Vonage s service. The $8^{th}$ Circuit found that it is impossible for Vonage to separate its interstate traffic from its intrastate traffic because of the nomadic nature of the service. As a result, the $8^{th}$ Circuit held that it was reasonable for the FCC to preempt state regulation of Vonage s service. The $8^{th}$ Circuit was clear, however, that the preemptive effect of the FCC s declaratory ruling may be reexamined if technological advances allow for the separation of interstate and intrastate components of the nomadic VoIP service. Therefore, the preemption of state authority over Vonage s service hinges on the inability to separate the interstate and intrastate components of the service.

While this ruling does not exempt us from all state oversight of our service, it effectively prevents state telecommunications regulators from imposing certain burdensome and inconsistent market entry requirements and certain other state utility rules and regulations on our service. State regulators continue to probe the limits of federal preemption in their attempts to apply state telecommunications regulation to interconnected VoIP service. The Nebraska Public Service Commission and New Mexico Public Regulatory Commission cases, discussed above under the Litigation section to this note, are examples of state public utility commission attempts to extend traditional state telecommunications regulation to our service. In these cases, the state public utility commissions are seeking to apply state universal service funding requirements to Vonage. Kansas has also determined that they have jurisdiction to seek state universal service funding from interconnected VoIP providers. Similarly, the Public Utility Commission of Ohio has adopted rules that would apply state fees for Telephone Relay Service to interconnected VoIP service. We expect that state public utility commissions and state legislators will continue their attempts to apply state telecommunications regulations to interconnected VoIP service.

#### *State and Municipal Taxes*

For a period of time, we did not collect or remit state or municipal taxes (such as sales, excise, and ad valorem taxes), fees or surcharges ( Taxes ) on the charges to our customers for our services, except that we have historically complied with the New Jersey sales tax. We have received inquiries or demands from a number of state and municipal taxing and 911 agencies seeking payment of Taxes that are applied to or collected from customers of providers of traditional public switched telephone network services. Although we have consistently maintained that these Taxes do not apply to our service for a variety of reasons depending on the statute or rule that establishes such obligations, a number of states have changed their statutes as part of streamlined sales tax initiatives and we are now collecting and remitting sales taxes in those states. In addition, a few states address how VoIP providers should contribute to support public safety agencies, and in those states we began to remit fees to the appropriate state agencies. We have also contacted authorities in each of the other states to discuss how we can financially contribute to the 911 system. We do not know how all these discussions will be resolved, but there is a possibility that we will be required to pay or collect and remit some or all of these

Taxes in the future. Additionally, some of these Taxes could apply to us retroactively. As such, we have a reserve of $2,915 at December 31, 2008 as our best estimate of the potential tax exposure for any retroactive assessment. We believe the maximum estimated exposure for retroactive assessments is $12,056 as of December 31, 2008.

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# **ITEM 4.** Submission of Matters to a Vote of Security Holders

On November 3, 2008, a special meeting of stockholders was held to ask stockholders of Vonage Holdings Corp. to approve the issuance of all shares of Vonage common stock that may be issued upon conversion of $18,000 of convertible secured third lien notes that Vonage and Vonage America Inc., one of Vonage s subsidiaries, issued following the special meeting as co-issuers in a private placement, including shares of Vonage common stock that may be issued to our directors, officers and substantial security holders upon conversion of such notes. The number of votes which the shares of the Company s stock represented at the special meeting in person or by proxy was 113,800,341, constituting more than a majority of the votes which the outstanding shares of the Company s common stock were entitled to vote at the special meeting. There were 113,540,680 votes cast in favor, 235,553 votes against and 24,108 votes abstained.

Our executive officers and directors are listed below.

**Marc P. Lefar, Director and Chief Executive Officer.** Marc P. Lefar, age 45, has been our Chief Executive Officer and a director since July 2008. Prior to joining Vonage, Mr. Lefar was Founder and Principal of Marketing Insights, a technology and media consultancy that he founded in May 2007. Prior to founding that firm, Mr. Lefar served as Chief Marketing Officer of Cingular Wireless from February 2003 to April 2007. Mr. Lefar also served as Executive Vice President, Marketing and Value-Added Services of Cable and Wireless Global from 2000 to 2002. He also held senior leadership roles at Verizon Wireless and GTE Wireless. Mr. Lefar spent the first nine years of his career at Procter & Gamble.

**John S. Rego, Executive Vice President, Chief Financial Officer and Treasurer.** John S. Rego, age 47, joined Vonage as Chief Financial Officer in July 2002 and manages accounting, finance, planning, taxation and facilities. From 2001 to 2002, Mr. Rego served as Vice President of Finance for business operations at RCN Corporation. From 1998 to 2000, Mr. Rego served in a variety of corporate and operational finance positions at Winstar Communications, including Vice President of Finance for the SME, Internet, Web Hosting and Professional Services divisions. Additionally, Mr. Rego spent over 14 years in practice as a certified public accountant with international CPA firms.

**Louis A. Mamakos, Executive Vice President and Chief Technology Officer.** Louis A. Mamakos, age 49, has been our Chief Technology Officer since July 2004 and oversees all technology functions at Vonage, which include supervision of all research projects and integration of all technology-based activities into Vonage s corporate strategy. Prior to joining Vonage, Mr. Mamakos served as a Fellow for Hyperchip, Inc., a start-up that built scaleable, high-performance core routers, from July 2002 to May 2004. Prior to Hyperchip, Mr. Mamakos held various engineering and architecture positions at UUNET Technologies, now known as MCI, from 1993 to May 2002. Prior to UUNET Technologies, Mr. Mamakos spent nearly 12 years as Assistant Manager for Network Infrastructure at the University of Maryland, College Park.

**Jamie Haenggi, Chief Marketing Officer.** Jamie Haenggi, age 39, has served as Chief Marketing Officer since May 2007 and is responsible for overseeing Marketing, Retail Sales and Corporate Communications. From November 2006 through April 2007, Ms. Haenggi served as Vice President of Customer Life. Prior to joining Vonage, from 1997, Ms. Haenggi served as Vice President of Worldwide Marketing for ADT Security Services and various other sales and marketing operational roles. Ms. Haenggi s experience in the home security and protection industry also includes tenure as the head of marketing and acquisition integration at Holmes Protection and as the Director of National Guardian s International Division.

**Jeffrey A. Citron, Director, Chairman.** Jeffrey A. Citron, age 38, has been the Chairman of our board of directors since January 2001. Mr. Citron was also our Chief Executive Officer from January 2001 through February 2006. He served as our Chief Strategist from February 2006 to July 2008 and assumed the additional role of Interim Chief Executive Officer from April 2007, upon the resignation of Vonage s prior Chief Executive Officer, until July 2008. In 1995, Mr. Citron founded The Island ECN, a computerized trading system designed to automate the order execution process. Mr. Citron became the Chairman and CEO of Datek Online Holdings Corp. in February 1998 and departed The Island ECN and Datek Online Holdings Corp. in October 1999.

**Peter Barris, Director.** Peter Barris, age 57, joined our board of directors in September 2004. Mr. Barris has served as Managing General Partner of New Enterprise Associates, LLC, or NEA, since 1999. He has been with NEA since 1992, and he serves as either an executive officer or General Partner of various NEA entities. Mr. Barris serves on the boards of directors of Innerworkings, Inc., Neutral Tandem, Inc. and the Mid-Atlantic Venture Association, as well as several private companies in the NEA portfolio. Mr. Barris is a member of the Board of Trustees of Northwestern

University and the Board of Overseers of Tuck School at Dartmouth College.

**Morton David, Director.** Morton David, age 72, joined our board of directors in August 2001. Mr. David served as the Chairman and Chief Executive Officer of Franklin Computer Corporation (later Franklin Electronic Publishers, Inc.) from 1983 to 1998. Mr. David previously served on the board of directors of Datek Online Holdings Corp. from 1998 until its acquisition by Ameritrade Holdings in 2002 and on the board of directors of Sharper Image Corporation from 1998 until 2008.

**Michael Krupka, Director.** Michael Krupka, age 43, joined our board of directors in July 2007. Mr. Krupka has served as Managing Director of Bain Capital Ventures since its founding in 2000. Prior to Bain Capital Ventures, Mr. Krupka was a Managing Director and Principal with the Private Equity Group of Bain Capital Partners, LLC from 1994 to 2000, during which time he focused on technology and technology-driven companies, including software, hardware, database and telecommunication services. Earlier at Bain Capital Partners, LLC, from 1991 to 1994, Mr. Krupka was a Principal of Information Partners, a fund focused on early-stage information technology investing. Prior to Bain Capital Partners, LLC, Mr. Krupka was a consultant with

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Bain & Company. Mr. Krupka serves on the board of directors of a number of privately held companies.

**J. Sanford Miller, Director.** J. Sanford (Sandy) Miller, age 59, joined our board of directors in January 2004. Mr. Miller is a General Partner in Institutional Venture Partners, or IVP, which he joined in April 2006. Prior to joining IVP, Mr. Miller was a Senior Partner at 3i, which he joined in 2001. Prior to joining 3i, Mr. Miller co-founded Thomas Weisel Partners in 1998, where he was a Member of the Executive Committee, Chief Administrative and Strategic Officer and Co-Director of Investment Banking. From 1990 to 1998, Mr. Miller was a Senior Partner at Montgomery Securities, where he led the technology and healthcare groups. Mr. Miller serves on the Board of Visitors of the Stanford University School of Law. Mr. Miller is our Lead Independent Director.

**Jeffrey J. Misner, Director.** Jeffrey Misner, age 55, joined our board of directors in March 2008. Mr. Misner served as Executive Vice President and Chief Financial Officer of Continental Airlines, Inc. from August 2004 until his retirement in August 2008. Mr. Misner joined Continental Airlines, Inc. in 1995 and previously served in various capacities, most recently as Senior Vice President and Chief Financial Officer.

**Governor Thomas J. Ridge, Director.** Governor Thomas J. Ridge, age 63, joined our board of directors in August 2005. Governor Ridge has served as President and Chief Executive Officer of Ridge Global, LLC, a global strategic consulting company since July 2006. From April 2005 to July 2006, he was President and Chief Executive Officer of Thomas Ridge LLC. From January 2003 to January 2005, Governor Ridge served as the Secretary of the United States Department of Homeland Security. From 2001 through 2002, Governor Ridge served as the Special Assistant to the President for Homeland Security, an Executive Office created by President Bush in October 2001. Governor Ridge served as Governor of the Commonwealth of Pennsylvania for two terms from 1995 through 2001 and was a member of the U.S. House of Representatives from 1983 through 1995. Governor Ridge currently serves on the boards of directors of The Hershey Company and Exelon Corporation.

**John J. Roberts, Director.** John J. Roberts, age 64, joined our board of directors in August 2004. Mr. Roberts served as Global Managing Partner for PricewaterhouseCoopers LLP from 1998 until his retirement in June 2002. From 1994 to 1998, Mr. Roberts served as Chief Operating Officer of Coopers & Lybrand, which merged with Price Waterhouse in 1998. He currently serves on the boards of directors and audit committees of Armstrong World Industries, Inc. and Safeguard Scientifics, Inc. and the board of trustees and audit committee of the Pennsylvania Real Estate Investment Trust. He is a Member of the American Institute of Certified Public Accountants.

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PART II

# ITEM 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

### *Price Range of Common Stock*

Our common stock has been listed on the New York Stock Exchange under the ticker symbol VG since May 24, 2006. Prior to that time, there was no public market for our common stock. The following table sets forth the high and low sales prices for our common stock as reported on the NYSE for the quarterly periods indicated.

| | Price Range of Common Stock | |
|---|---|---|
| | High | Low |
| **2008** | | |
| Fourth quarter | $ 1.32 | $ 0.57 |
| Third quarter | $ 1.96 | $ 0.90 |
| Second quarter | $ 2.05 | $ 1.66 |
| First quarter | $ 2.43 | $ 1.69 |
| **2007** | | |
| Fourth quarter | $ 2.70 | $ 0.96 |
| Third quarter | $ 3.19 | $ 0.89 |
| Second quarter | $ 4.43 | $ 2.83 |
| First quarter | $ 7.01 | $ 2.98 |

### *Holders*

At January 31, 2009, we had approximately 198 stockholders of record. This number does not include beneficial owners whose shares are held in street name.

### *Dividends*

We have never paid cash dividends on our common stock, and we do not anticipate paying any cash dividends on our common stock for at least the next 12 months. We intend to retain all of our earnings, if any, for general corporate purposes, and, if appropriate, to finance the expansion of our business.

### *Use of Proceeds from Initial Public Offering*

On May 23, 2006, the Securities and Exchange Commission declared effective our Registration Statement on Form S-1 (File No. 333-131659) relating to our IPO. After deducting underwriting discounts and commissions and other offering expenses, our net proceeds from the offering equaled approximately $491,144, which includes $1,896 of costs incurred in 2005. We have invested the net proceeds of the offering in short-term, interest bearing securities pending their use to fund our expansion, including funding marketing expenses and operating losses. Except for payments in connection with IP litigation settlements and debt repayment, there has been no material change in our planned use of proceeds from our IPO as described in our final prospectus filed with the Securities and Exchange Commission pursuant to Rule 424(b). We did not use any of the net proceeds from the IPO until after the year ended December 31, 2006. Through the year ended December 31, 2008, we used $418,881 of the net proceeds from the IPO to fund operating activities of $270,926 including $212,225 for IP litigation settlements, $40,327 to pay noteholders of our previously issued convertible notes, $26,799 for debt related costs related to the Financing and $80,829 for capital expenditures, software development and patent purchases.

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### *Stock Performance Graph*

The graph below compares the cumulative total return of our common stock between May 24, 2006 (the date of our IPO) and December 31, 2008, with the cumulative total return of (1) the S&P 500 Index, (2) the NASDAQ Telecom Index and (3) the NYSE Composite Index. This graph assumes the investment of $100 on May 24, 2006 in our common stock, the S&P 500 Index, the NASDAQ Telecom Index and the NYSE Composite Index, and assumes the reinvestment of dividends, if any. The graph assumes the initial value of our common stock on May 24, 2006 was the closing sales price of $14.85 per share.

The graph below and related information shall not be deemed soliciting material or filed with the Securities and Exchange Commission or otherwise subject to the liabilities of Section 18 of the Securities Exchange Act of 1934, nor shall such information be deemed incorporated by reference into any filing under the Securities Act of 1933 or the Exchange Act, except to the extent we specifically request that such information be treated as soliciting material or specifically incorporate such information by reference into a document filed under the Securities Act or the Exchange Act.

*Among Vonage Holdings Corp., the S&P 500 Index, the NASDAQ Telecom Index and the NYSE Composite Index*