BOULT • CUMMINGS®
CONNERS • BERRY PLC

RECEIVED
2007 AUG 31 AM 9:19
T.R.A. DOCKET ROOM

Henry Walker
(615) 252-2363
Fax: (615) 252-6363
Email: hwalker@boultcummings.com

August 30, 2007

Eddie Roberson, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

Re: ***Request for an Investigation of the Business Partnership Between Memphis Light, Gas & Water and Memphis Networx, LLC***
Docket No. 07-00183

Dear Chairman Roberson:

Attached are the initial responses to data requests from the Staff in the above-captioned docket. These responses will be supplemented with more up-to-date information as it becomes available. For example, the 2006 financial report of Memphis Networx is not yet finished but should be available within a short time.

Some of the information described in the responses, such as the reports and audits filed by Networx with the TRA pursuant to Docket 09-00909, are on file at the agency. To avoid duplication, the responses make reference to those documents but we have not included additional copies of reports the agency already has.

Some of the questions, such as those concerning the names of customers, the salaries of employees, and amounts owed to vendors, appear to seek information which is highly confidential. In the absence of a proprietary agreement prohibiting the disclosure of the information, the respondents respectfully decline to provide it. We also note that some of the requested information does not appear to fall within the broad parameters of the TRA's regulatory jurisdiction, and the respondents therefore reserve the right to raise these jurisdictional objections at a later time. We will be happy to discuss with you and your staff these issues and would note that many of the same questions raised in the data requests are also the subject of an ongoing audit recently approved by the Memphis City Council.

Please do not hesitate to contact me with any questions about these responses.

Very truly yours,

BOULT, CUMMINGS, CONNERS & BERRY, PLC

By: [signature]
Henry Walker

HW/djc

1639798 v1
108680-001 8/30/2007

BEFORE THE
TENNESSEE REGULATORY AUTHORITY

August 30, 2007

In re: Request for an Investigation of the Business Partnership Between Memphis Light, Gas & Water and Memphis Networx, LLC	)))	Docket No. 07-00183

RESPONSES TO DATA REQUEST

Memphis Networx ("Networx") and Memphis, Light, Gas & Water ("MLGW") respectfully submit the following responses to the Tennessee Regulatory Authority's ("TRA") data request submitted August 8, 2007.

1. Provide the estimated interest income foregone on the funds invested by MLGW in Memphis Networx.

RESPONSE: The interest foregone on funds invested by MLGW in Memphis Networx is estimated to equal the imputed interest charged by the Electric Division to the Telecommunications Division in regard to the loan. Per the Revolving Line of Credit Note of August 19, 2002, the interest rate of each calendar month shall be the monthly average of the prime lending rate posted by a majority of the nation's largest banks that appear daily in the <u>Wall Street Journal</u> less three percentage points but in no event shall the interest rate for any calendar month be less than the highest interest rate earned by MLGW on its invested electric plant funds. MLGW has calculated and accrued this interest since the origination of the revolving line of credit note. As of December 30th, 2006, this amount was $3,572,371.

2. Provide the amount and source of the investment by MLGW in Memphis Networx.

RESPONSE: Total investment as of July 30, 2007 was $28,536,644. Funding was provided from MLGW Electric Division working capital. The Electric Division made an interdivisional loan to the Telecommunications Division, and the Telecommunications Division made the investment by providing capital contributions to Memphis Networx in exchange for membership interest in the company.

3. Provide the history (loan amount, payment schedule, outstanding balance) for any loans between MLGW and Memphis Networx.

RESPONSE: On December 30, 2004, a Note and Warrant Purchase Agreement was entered into between Memphis Networx, LLC, Memphis Broadband, LLC, and MLGW. This agreement specified that Memphis Broadband and MLGW would provide bridge loan financing to the Company in an amount up to $375,000 each, for a total of $750,000. Promissory notes were issued bearing interest at 8% per annum, due and payable on or before July 1, 2005. The promissory notes were secured by a first lien security interest in all assets of the Company and provided for the issuance of warrants, representing, in the aggregate, the right to purchase up to 750,000 units of the Company or a fully diluted 7.5% share in the Company in the event the bridge loan was not paid on or before July 1, 2005. MLGW funded its portion of the bridge loan on January 7, 2005.

On April 7, 2005, MLGW agreed to provide an additional ninety-day bridge loan of up to $750,000 to Memphis Networx, such loan to bear interest at 8% per annum and providing for the issuance of additional warrants. Funding of $500,000 was made on April 25, 2005, and additional funding of $150,000 was made on May 18, 2005. All of the bridge loans were repaid in full on June 27, 2005.

All permanent capital provided to Networx by MLGW was in the form of equity.

3.1 Provide a debt amortization schedule for any loans identified in No. 3 above.

RESPONSE: See response to question 3 above.

3.2 Identify how funds from the loans were utilized by Memphis Networx and if any of the funds have not been used.

RESONSE: The bridge loan was used to cover operating expenses during the period that permanent capital was secured in 2005. The bridge loan was paid off in 2005 so no unused funds remain.

3.3 Describe any provisions in the Memphis City Charter that apply to the transfer of funds between divisions of MLGW and the action taken for compliance with those city charter provisions.

RESPONSE: Section 1 of Ordinance No. 3054, amending those sections of the Charter of the City of Memphis relative to Memphis Light, gas and Water Division provides in pertinent part:

> "Notwithstanding any other provision of the Charter, the monies and funds of any division may be loaned to another division in such amounts and upon such terms as the Board of Light, Gas & Water Commissioners may authorize and approve."

In addition to provisions of the Charter of the City of Memphis, T.C.A. § 7-52-403 authorizes municipal electric systems to make inter-division loans, subject to the approval of the State Director of

Local Finance. As referenced in response to question 10.1, below, MLGW secured approvals of its interdivision loans. The corresponding MLGW Board actions occurred as follows:

On August 19, 1999 the MLGW Board of Commissioners approved a resolution authorizing the establishment of the Telecommunications Division as a subdivision of the Electric Division. In a separate resolution on that same date, the MLGW Board approved a loan in an amount not to exceed $20 million from the electric system to the Telecommunications Division, a subdivision of the Electric Division.

On June 6, 2002 the MLGW Board of Commissioners approved a resolution authorizing an increase in the amount of the loan from the Electric Division to its subdivision, the Telecommunications Division from $20 million up to $26 Million.

On July 11, 2002 the MLGW Board of Commissioners approved a resolution authorizing an increase in the loan from the Electric Division to its subdivision, the Telecommunications Division from $26 million up to $32 million.

4. Identify any expenses paid by MLGW on behalf of Memphis Networx over and beyond the $29 million that was contributed/invested.

RESPONSE: No expenses were paid by MLGW on behalf of Memphis Networx.

4.1 Identify any salaries paid by MLGW to Memphis Networx employees.

RESPONSE: No salaries to Memphis Networx employees were paid by MLGW.

4.2 Identify any MLGW employees that have performed work for Memphis Networx.

RESPONSE: No MLGW employees have performed work for Memphis Networx. However, MLGW employees have performed oversight and monitoring roles of Memphis Networx on behalf of MLGW (e.g., MLGW Board members of Memphis Networx). Also, MLGW employees occasionally performed pole preparation and other outside plant work for Memphis Networx billed in accordance with the standard rates charged to any other carrier pursuant to the fiber optics agreement between MLGW and Networx dated September 6, 2000.

5. Identify by name and address any initial private investors and the current investors in Memphis Networx.

RESPONSE: *Initial and current private investors in Memphis Networx*

Memphis Broadband, LLC
1779 Kirby Parkway #1
Box 223
Memphis, TN 38138

5.1 State the amounts the private investors have contributed to Memphis Networx.

RESPONSE: Memphis Broadband invested $6.4 million from 2000 to 2002. It then provided an unconditional guaranty in the amount of $6.9 million in 2005 to allow Networx to access that amount of additional capital.

5.2 Identify the silent partners, if any, in Memphis Broadband, Memphis Networx and A&L.

RESPONSE: A&L has not been involved in Memphis Networx since 1999. We have no knowledge of their investment entity. There are only two investors in Memphis Networx which are MLGW and Memphis Broadband. The members of Memphis Broadband are as follows:

- Memphis Angels, LLC, a Delaware limited liability company
- Memphis Broadband II, LLC, a Delaware limited liability company
- Belz Broadband Associates, a Tennessee general partnership
- M-Net 2000, a Tennessee general partnership
- Memphis Telecom, LLC

The structure of Memphis Broadband was previously disclosed in the December 21, 2000 filing of the Amendment to the Application of Memphis Networx, LLC and the pre-filed testimony of several of the involved parties.

5.3 Describe any relationship between past or current investors in Memphis Networx and the companies submitting bids to purchase Memphis Networx. Describe the nature of any relationship identified.

RESPONSE: There was no known relationship between any past or current investors and the companies submitting bids to purchase Memphis Networx. In addition, to our knowledge, there are no investors in CII, the winning bidder, that are residents of Shelby County or that were involved in any way with Memphis Networx.

5.4 Identify any dividend payments or other compensation paid to investors in Memphis Networx.

RESONSE: There have been no dividend payments or any other compensation paid to investors in Memphis Networx.

6. Provide a listing of Memphis Networx customers (separate by wholesale and retail).

RESPONSE: Networx objects to this question on the grounds that the question requests confidential, competitively sensitive information about the identity of Networx's customers. Furthermore, federal law prohibits the disclosure of customers' names without the express permission of each customer.

6.1 Provide a breakdown of the percentage of total customers that reside or operate businesses within the City of Memphis.

RESPONSE: 80% reside or operate businesses in Memphis.

6.2 Provide a copy of rate schedules and fees assessed to Memphis Networx customers.

RESPONSE: All of Networx's customer are served through special contract arrangements. The provisions of the contracts and the names of the customers are confidential.

7. Provide a map of Memphis Networx fiber optic network.

RESPONSE: See attached map showing existing and planned network routes.

8. Provide a listing of Memphis Networx creditors.

RESPONSE: Networx objects to this question on the grounds that the question requests confidential financial information, the public disclosure of which could harm the company. In an effort to be responsive, however, Networx will provide the Authority with each of the annual financial audits of Networx. (The 2006 audit will be available shortly.) Networx also refers the Authority to the annual audits and financial reports previously filed by Networx with the Authority pursuant to the requirements set forth in Docket 99-00909.

8.1 Provide the balance owed by Memphis Networx to each creditor and the date the debt was incurred.

RESPONSE: See response to Question 8.

9. Identify the recurring monthly expenses for Memphis Networx, including the payee and the amount of each expense, for the latest twelve months.

RESPONSE: See response to Question 8.

10. Provide documentation describing or reflecting the manner in which any new division of MLGW was transformed into a membership/investment in a private concern.

RESPONSE: See answer to question 3.3 above.

10.1 Provide any documentation from the State Comptroller's office for approving any investment in a private concern.

RESPONSE: The following documents attached reflect the approvals of the State Director of Local Finance of MLGW's inter-division loan that, in turn, was used to fund MLGW's capital contributions in Memphis Networx:

(1) Letter dated November 24, 1999 to John McCullough, Vice-President and Chief Financial Officer of MLGW from David H. Bowling, Acting Director, State of Tennessee, Comptroller of the Treasury, Division of Local Finance.

(2) Letter dated January 22, 2002 to John McCullough, Vice-President and Chief Financial Officer of MLGW from David H. Bowling, Acting Director, State of Tennessee, Comptroller of the Treasury, Division of Finance.

(3) Letter dated August 28, 2002 to John McCullough, Vice-President and Chief Financial Officer of MLGW from David H. Bowling, Acting Director, State of Tennessee, Comptroller of the Treasury, Division of Finance.

The operating agreement of Memphis Networx addresses MLGW's rights and responsibilities as a member in Memphis Networx. The TRA was presented with the Amended and Restated Operating Agreement dated November 29, 2000 and approved that operating agreement pursuant to T.C.A. § 7-52-103 by order dated August 9, 2001 in TRA Docket 99-00909.

11. Identify all employees of Memphis Networx since the establishment of the company and provide salary information for each employee, including bonuses paid, compensation packages, etc.

RESPONSE: See response to Question 8. Networx also objects on the grounds that the requested information unnecessarily intrudes upon the privacy of its employees.

12. Provide a schedule detailing the construction costs for building the fiber optic network.

RESPONSE: $14,292,100 (Outside plant: $8,644,471; Broadband equipment: $5,647,639).

13. Provide copies of MLGW and Memphis Networx financial statement e.g. balance sheets, income statements, etc for the past five years.

RESPONSE: The financial reports of MLGW can be obtained from the utility's website, www.mlgw.com, under "publications" and "annual report." The financial statements of Networx are still being reviewed to determine whether they contain confidential information. The non-confidential information will be provided shortly.

14. Provide all documentation that serves as a basis and/or support for the decision to sell Memphis Networx.

RESPONSE: The request for "all documentation" is very broad and an exhaustive search would be difficult. See the attached copy of letter dated June 27, 2007 from Nick Clark, Commissioner, MLGW Board of Commissioners to Mr. Tom Marshall, Chairman, Memphis City Council and copied to Mayor Herenton, the Memphis City Council, the MLGW Board of Commissioners, and the Networx Board of Directors. This document presents an overview of the primary considerations supporting the decision of MLGW to sell its membership interest in MLGW.

15. State whether MLGW had in place any mechanism for monitoring the status and financial condition of Memphis Networx. If so, identify the person(s) who had the responsibility, including job title and location in MLGW, for the reviewing and mechanism.

RESPONSE: MLGW had three of six Board seats at Memphis Networx. These seats were filled by John McCullough, an officer of MLGW, Nick Clark, a Board member of MLGW, and Derek Renfroe. All three were very active in the oversight of Memphis Networx.

16. Identify any consultants retained by MLGW or the private investors to provide advice regarding the sale of Memphis Networx. Provide the terms of the consultant contracts or provide a copy of the contract. If no consultant was retained, please explain why.

RESPONSE: The company retained an investment bank, the McLean Group, to consult on the sale process and conduct an auction for the company. MLGW and the private investors interacted extensively with this group throughout the process.

17. Identify how the sales proceeds will be distributed.

RESPONSE: Sales proceeds were first used to repay the senior secured debt of the company. Then, the deal expenses were paid which included lawyers and The McLean Group. Then a retention bonus was paid to the senior management team members in the aggregate amount of $76,864. Then, net sales proceeds were distributed to the following parties:

Mark Ivie	0.95%	Equity granted in employment agreement
MLGW	49.03%	
Memphis Broadband	50.02%	

18. Are there any existing provision that allow current owners to purchase the company at the same price before the sale to the outside party is consummated? If so, please provide a copy of these provisions.

RESPONSE: No. The sale has been consummated to CII. The Memphis Networx, LLC Agreement which details any such provisions was filed with the TRA in 2000.

19. Identify by name and address each financial institution with which Memphis Networx has transacted business.

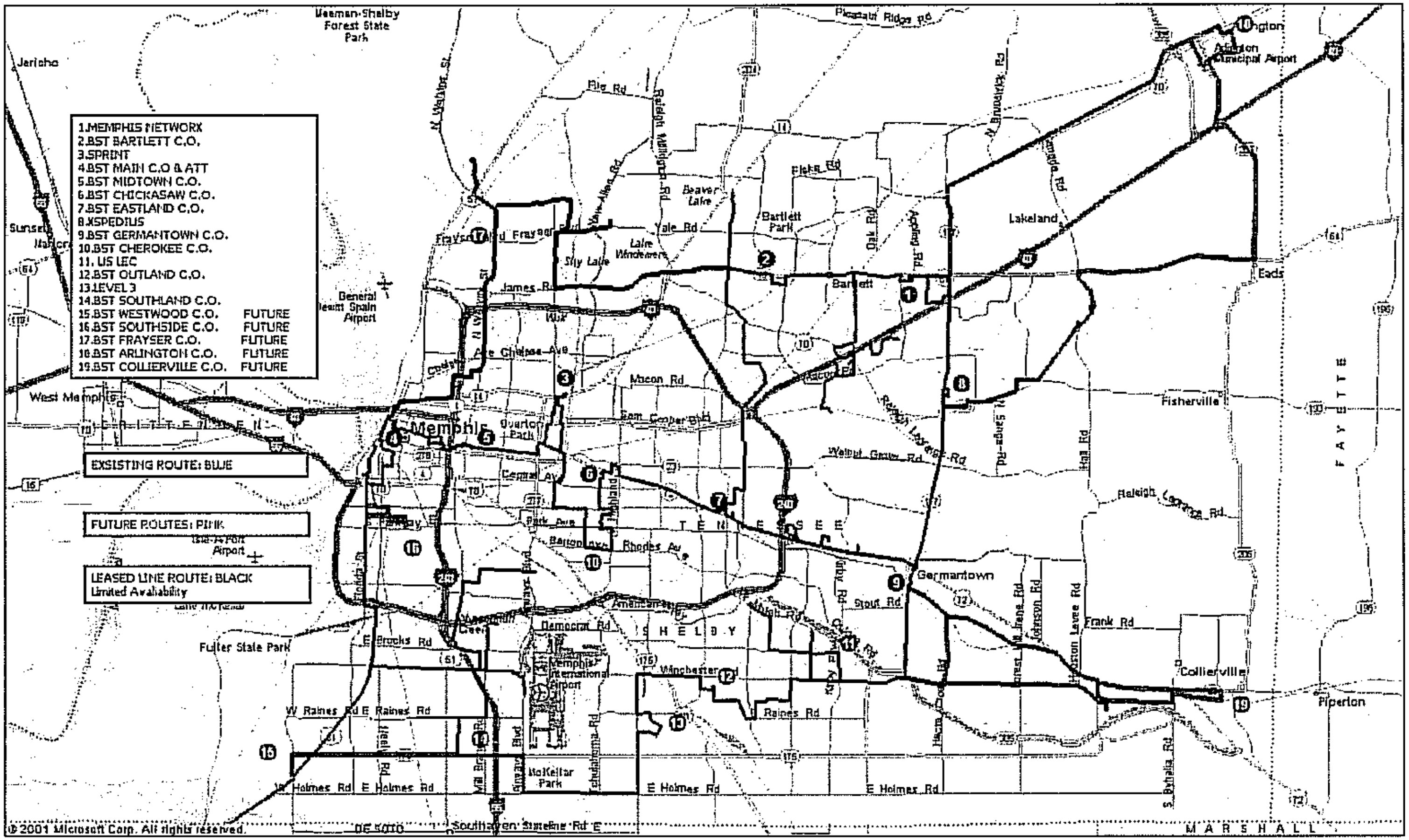
RESPONSE: Renasant Bank
5240 Poplar Avenue
Memphis, Tennessee 38119

20. Identify any losses on the investment in Memphis Networx that may have resulted in a tax write-off for any investors and state whether such losses are still available for tax write-offs.

RESPONSE: The company generated approximately $14 million in losses from 2002 to 2006 which were passed on to investors due to the structure of the company as a limited liability company. The impact of the losses allocated to each investor depends on the specific tax situation of the investor. Passive tax losses may have resulted in an offset to taxable gains up to the amount of basis an investor had in the company for some or all investors.

21. Provide the legal authority for the vote by MLGW board to sell Memphis Networx.

RESPONSE: See attached legal opinion provided by Allan J. Wade, Esq.


1.MEMPHIS NETWORX
2.BST BARTLETT C.O.
3.SPRINT
4.BST MAIN C.O & ATT
5.BST MIDTOWN C.O.
6.BST CHICKASAW C.O.
7.BST EASTLAND C.O.
8.XSPEDIUS
9.BST GERMANTOWN C.O.
10.BST CHEROKEE C.O.
11. US LEC
12.BST OUTLAND C.O.
13.LEVEL 3
14.BST SOUTHLAND C.O.
15.BST WESTWOOD C.O. FUTURE
16.BST SOUTHSIDE C.O. FUTURE
17.BST FRAYSER C.O. FUTURE
18.BST ARLINGTON C.O. FUTURE
19.BST COLLIERVILLE C.O. FUTURE
EXSISTING ROUTE: BLUE
FUTURE ROUTES: PINK
LEASED LINE ROUTE: BLACK
Limited Availability
Meeman-Shelby Forest State Park
Memphis
Germantown
Collierville
Lakeland
Bartlett
Fisherville
Piperton
Eads
Jericho
West Memphis
Fuller State Park
McKellar Park
Memphis International Airport
General DeWitt Spain Airport
S H E L B Y
F A Y E T T E
M A R S H A L L
T E N N E S S E E
© 2001 Microsoft Corp. All rights reserved.

Question 7

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DIVISION OF LOCAL FINANCE
SUITE 500 JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-0274
PHONE (615) 741-4276
FAX (615) 532-9237

November 24, 1999

Mr. John McCullough
Vice-President, Finance and
Chief Financial Officer
Memphis Light, Gas and Water Division
PO Box 430
Memphis, Tennessee 38101-0430

Dear Mr. McCullough:

You have submitted letters dated September 30, 1999, and November 19, 1999, together with supporting documentation, concerning a plan which has been approved by the Board of Commissioners of the Memphis Light, Gas and Water Division to develop, construct and operate a telecommunications system pursuant to the authority of Tennessee Code Annotated, Title 7, Chapter 52, Part 401. Title 7, Chapter 52, Part 402(2) provides that inter-division loans may be executed to provide funds for such projects, and requires that such loans be approved in advance by this office. Pursuant to this requirement, you have requested approval for the execution of an inter-division loan in the amount of $5,300,000 from the Electric Division to the Telecommunications Division of the Memphis Light, Gas and Water Division. The information you have submitted provides that the loan will be completely repaid in approximately six (6) years, and that the rate of interest on the loan will not be less than the highest rate earned on invested electric system funds, as required by Title 7, Chapter 52, Part 402(2).

Title 7, Chapter 52, Part 103(d) provides that a municipality, acting through the supervisory board of its municipal electric system, may enter into a joint venture with a third party for this type of project, provided that any contracts or agreements with such third parties are first approved by the Tennessee Regulatory Authority (TRA). You have advised us that since this project involves such a joint venture, this plan will be submitted to the TRA for their review and approval in accordance with this statute.

Subject to your receipt of approval for this project by the Tennessee Regulatory Authority, as required by Title 7, Chapter 52, Part 103(d), this constitutes approval by this office, pursuant to Title 7, Chapter 52, Part (402)(2), for an inter-division loan in an amount not to exceed $5,300,000 from the Electric Division to the Telecommunications Division of the Memphis Light, Gas and Water Division. We are hereby requesting that you provide this office with a copy of the report issued by the Tennessee Regulatory Authority.

Sincerely,

David H. Bowling

David H. Bowling
Acting Director

Question 10.1

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DIVISION OF LOCAL FINANCE
SUITE 1700 JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-0274
PHONE (615) 401-7976
FAX (615) 532-5232

January 22, 2002

Mr. John McCullough
Chief Financial Officer
Memphis Light, Gas and Water Division
PO Box 430
Memphis, Tennessee 38101-0430

Dear Mr. McCullough:

You have previously submitted your letter of December 18, 2001 enclosing documents regarding a plan to develop, construct and operate a telecommunications system pursuant to the provisions of Title 7, Chapter 52, Part 401, Tennessee Code Annotated. TCA 7-52-103(d) provides that a municipality, acting through the supervisory board of its municipal electric system, may enter into a joint venture with a third party for this type of project, provided that any contracts or agreements with such third parties are first approved by the Tennessee Regulatory Authority (TRA.) You have previously advised us that this plan includes such a joint venture and has been submitted to the TRA for its review. The documents you have now submitted contain the action of the Tennessee Regulatory Authority on August 9, 2001 approving the joint venture agreement.

TCA 7-52-402(2) provides that interdivision loans may be executed to provide funds for the development of a telecommunications system, subject to approval by our office. You have submitted a copy of the action taken on August 19, 1999, by the Board of Commissioners of the Memphis Light, Gas and Water Division authorizing an interdivision loan in the amount of $20,000,000 from the electric system to the telecommunications division. The document you have submitted with your December 18 letter includes a proposal for an interdivision loan, not to exceed $20,000,000, which will be loaned by the electric system to the telecommunications division. The plan indicates that all loaned funds will be completely repaid to the electric system within ten (10) years from the initial loan date.

This constitutes approval by this office, pursuant to the provisions of Tennessee Code Annotated Title 7, Chapter 52, Part 402(2), for an interdivision loan not to exceed $20,000,000 between the electric division and the telecommunications division. As required by TCA 7-52-402(2), the rate of interest on the loan must be not less than the highest rate earned on invested electric funds.

Sincerely,

David H. Bowling

David H. Bowling
Director

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DIVISION OF LOCAL FINANCE
SUITE 1700 JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-0274
PHONE (615) 401-7976
FAX (615) 532-5232

August 28, 2002

Mr. John W. McCullough
Chief Financial Officer
Memphis Light, Gas and Water Division
PO Box 430
Memphis, Tennessee 38101-0430

Dear Mr. McCullough:

We are in receipt of your letter of August 19, 2002 requesting approval by this office for an increase of $12,000,000 for the interdivision loan between the electric system and the telecommunications division. You have previously submitted your letter of December 18, 2001 enclosing documents regarding a plan to develop, construct and operate a telecommunications system pursuant to the provisions of Title 7, Chapter 52, Part 401, Tennessee Code Annotated. TCA 7-52-402(2) provides that interdivision loans may be executed to provide funds for the development of a telecommunications system, subject to approval by our office.

You have previously submitted a copy of actions taken on August 19, 1999, by the Board of Commissioners of the Memphis Light, Gas and Water Division authorizing an interdivision loan in the amount of $20,000,000 from the electric system to the telecommunications division, which our office approved on January 22, 2002. Your current letter includes actions taken by the Board of Commissioners on June 6 and July 11, 2002 authorizing an increase in the interdivision loan from $20,000,000 to $32,000,000. As in previous documents you have submitted to our office, you have included schedules which indicate that all loaned funds will be completely repaid to the electric system within ten (10) years from the initial loan date.

TCA 7-52-103(d) authorizes a municipality, acting through the supervisory board of its municipal electric system, to enter into a joint venture with a third party for this type of project, provided that any contracts or agreements with such third parties are first approved by the Tennessee Regulatory Authority (TRA.) You have also previously advised us that this plan was submitted to the TRA for its approval since it includes such a joint venture, and you provided us documentation indicating approval by the TRA on August 9, 2001.

This constitutes approval by our office, pursuant to the provisions of Tennessee Code Annotated Title 7, Chapter 52, Part 402(2), for an increase in the interdivision loan from $20,000,000 to $32,000,000 between the electric division and the telecommunications division. As required by TCA 7-52-402(2), the rate of interest on the loan must be not less than the highest rate earned on invested electric funds.

Sincerely,

David H. Bowling
Director

MLGW MEMPHIS LIGHT, GAS AND WATER DIVISION

June 27, 2007

(via e-mail only)

Mr. Tom Marshall
Chairman, Memphis City Council
125 North Main Street, Room 514
Memphis, TN 38103

Re: Pending Sale of MLGW's Interest in Networx

Dear Chairman Marshall:

As an MLGW Board member, I regret the delay in the release of Networx's information concerning the two competing offers for the purchase of MLGW interest in Networx. In order to expedite the release of information that is subject to non-disclosure agreements with the two competing firms, Networx's attorneys have request that those competing firms sign a waiver for the release of their "proposal to purchase Networx and related documents thereto".

Our goal was to secure those waivers this morning. We have such a wavier with American Fiber Systems and it is supplied in the release of documents associated with this e-mail transmittal. We were unsuccessful in directly securing a wavier from Bti, the other competing firm. I have included Bti's Mutual Non-Disclosure Agreement which was faxed to Networx's agent Tom Swanson from Bti Home Theater on March 28, 2007. Section 4 of the agreement allows for release of documents "that is disclosed pursuant to a requirement of a court or government agency". My understanding is that Bti has functionally accepted the waiver we sent them given that they have delivered to the City Council office a copy of their proposal. I have no way of determining whether what Bti sent to City Council is the same thing that Networx got. In addition, it would not include the various e-mails that better define what the proposal was after it was examined by the McLean Group. I assume that if the City Council wants the full set of BTi documents that they will send a subpoena to MLGW for such so that MLGW will not be violating the Mutual Non-Disclosure Agreement.

I have been on the Networx Board for only the past 29 months, and my position on that board is to represent MLGW's financial interest. As I have stated earlier and publicly, given the negative cash flow of the Networx, my orientation as a board member has been:

- Net Asset Preservation;
- Net Income Growth; and
- Net Asset Appreciation.

There has been a public outcry over the financial loss that MLGW now faces. The reality is that the loss began years ago. The MLGW Board now faces two issues:

1. An immediate issue of what to do regarding its investment in Networx, and

2. A more global issue addressing how and why such a substantial loss occurred.

What is the Business Issue that MLGW's Board now faces:

Basic Information:

1. Networx has accounts payable of $1.65 million, and requires further cash investment to supplement cash flow necessary to support continuing operations and business expansion.

2. Given the negative cash flow and only getting near positive EBITDA (earnings before interest, taxes, depreciation, and amortization), the firm either has to be put on life support to achieve positive near-term cash flow while at the same time limiting its ability to ever achieve long-term positive cash flow as well as a positive net equity, or a capital infusion of some sort must happen.

3. The only way for Networx to achieve positive net equity is to have a capital infusion which can address these issues:

    - Fund the negative working capital (which includes A/P) of $2,359,507.
    - Fund the estimated capital requirements for growth over the next twelve months of $6,200,000.
    - Fund an undetermined amount of net operating loss over the next twelve months.

4. Networx is owned by two entities, MLGW and Memphis Broadband. Earlier this year, it was determined that neither was interested in making additional capital or loan guarantees on behalf of Networx. Additional capital could be raised by other sources such as by mezzanine debt or the sale of a minority, majority, or entire interest in Networx. The Networx Board unanimously chose to pursue the sale of the entire interest in Networx as a means of returning to its present owners the maximum cash, while at the same time eliminating further liability of cash calls.

Core Business Decision that MLGW's Board Faces:

In summary, the courses of actions available to the Board are:

1. Sell MLGW's membership interest in Networx to CII for a return of capital of approximately $1,000,000, or 3% of its original investment.

2. Choose to invest additional capital in Networx, either in partnership with Memphis Broadband or by way of a capital reallocation. Note that the 12-month estimate would be approximately $8,500,000 without including an estimate for net operating losses. Please note that this investment is at the level of investing into a Stage 2 or Stage 3 pre-IPO entity.

3. Purchase Memphis Broadband's interest in Networx, which would require approximately $7,800,000 in cash or loan guarantees, and then MLGW would make the additional capital investment referenced above of approximately $8,500,000 for a total new exposure of $16,300,000.

4. Decide not to sell Networx or invest additional cash in Networx, thereby creating the likelihood that the senior secured creditors could foreclose on the assets of the company and leave the equity investors with nothing.

The Global Issue of How and Why Such a Substantial Loss Occurred

I am not an expert on the history of Memphis Networx, but I will share what I have learned over the past 29 months:

The Concept: The Memphis Networx concept was probably conceived in 1998, and the effort to start Memphis Networx began in 1999 at the height of the Internet and Telecommunications bubble. At the time, demand for broadband infrastructure was outpacing supply and thousands of new data networks were announced. In this environment, any organization that had right-of-way was viewed as a natural owner for a broadband data network. As a result, many municipalities, utilities, and railroads began deploying fiber networks.

Confirmation of Concept: It was in this environment that Memphis Light Gas & Water (MLGW) began an effort to study the feasibility of a metro area network in Memphis. They commissioned a reputable consulting firm, Arthur D. Little, to conduct a market opportunity study for the company. That study (dated May 11, 1999) confirmed the need for additional broadband capacity in Memphis and the opportunity for a fiber-optic-based entrant.

The Startup Stumbles on Capital Funding: Based on this confirmatory diligence, MLGW partnered with a long-time vendor to begin planning and deploying a network. The Memphis Networx, LLC was formed on November 8, 1999. About a year into that effort, it became evident that the initial private partner did not have sufficient capital to fulfill its obligation to fund half of the build-out of the network. At that time, MLGW engaged an investment banker to secure a new partner. In December 2000, Memphis Broadband bought out the original private partner's interest and committed $5.0 million to the build-out of the network. The new investor group also brought support from key local business leaders.

The Competitive Environment at the Tennessee Regulatory Authority (TRA): Although the company was founded in 1999 and the new private investor group closed on its partnership with MLGW in December 2000, the firm's ability to proceed was delayed. The primary reason for this lengthy delay was the opposition of Time Warner to the issuance of the required Tennessee Regulatory Authority Certificate of Convenience and Necessity ("CCN"). In an effort to keep competition out of the City, Time Warner pursued an aggressive legal effort to convince the TRA not to issue a certificate. This resulted in approval taking nearly two years instead of the traditional few months.

The TRA Approval: On August 9, 2001, the Tennessee Regulatory Authority (TRA) issued a final order approving the Company's amended and restated operating agreement (dated November 29, 2000) and granting a certificate of public convenience and necessity for the State of Tennessee. In addition, MLGW received approval from the State Comptroller's office to release funds from the previously approved $20,000,000 loan from the Electric Division to the Telecommunications Division.

The Internet / Telecom Bubble and Bust: As almost everyone who lived through the popping of the Internet Bubble knows, the telecom industry was particularly hard hit by the downturn in the technology industry. The demand for broadband bandwidth and the fiber infrastructure through which it travels was overestimated by a wide margin and was significantly overbuilt nationally. This led to an unprecedented recession in the telecom industry and the bankruptcy of thousands of telecom-related companies. It also led to the drying up of financing for telecom related investments at the time that Networx was scheduled to return to the market to secure outside financing to complete the build and reach profitability. Shortly after the TRA approval, the events of 9/11/01 occurred and ushered in a general business recession as well.

While the infrastructure in Memphis was not overbuilt like that in many larger cities, we nonetheless saw a dramatic and prolonged decrease in bandwidth pricing which challenged the Networx team by making it more difficult to build revenue as quickly as planned. Below are a few excerpts from the media describing the business events of that time period:

> *(NASDAQ)* Historically, the dot-com boom can be seen as similar to a number of other technology-inspired booms of the past, including railroads in the 1840s, automobiles and radio in the 1920s, transistor electronics in the 1950s, computer time-sharing in the 1960s, and home computers and biotechnology in the early 1980s.

Over 1999 and early 2000, the Federal Reserve had increased interest rates six times, and the runaway economy was beginning to lose speed. The dot-com bubble burst, numerically, on March 10, 2000, when the technology-heavy NASDAQ Composite index peaked at 5,048.62 (intra-day peak 5,132.52), **more than double its value just a year before.** (*Wikipedia*)

(International Perspective) **An unprecedented "boom and bust" investment cycle** occurred in the high-tech industries at the turn of the century, in particular in the telecommunications sector. Regulatory reforms and technological innovation fueled expectations of robust growth in traffic, revenue and earnings. Eventually, however, the volume of traffic expanded less than anticipated. *(Organization for Economic Co-operation and Development (OECD), After the Telecommunications Bubble, Economics Department Working Papers No.361)*

(The Telecom Bubble) Triggered by emergence of the Internet and its enormous growth, **companies all over the world tried to establish their own telecom backbone networks, expecting to recoup their future benefit in an information-rich era.** Wavelength Division Multiplexing (WDM) also accelerated the growth of capacity of the telecom backbone network by enabling high capacity for each optical fiber. In consequence, many telecom service providers heavily over invested in the backbone network. ....

Telecom bubble emerged from many causes including overly optimistic demand forecast (which induced a mismatch with real demand) and excessive fiber installation because of the high cost for construction. However, historically, bubbles have occurred many times in different industries. Such booms include the canal boom in the early nineteenth century, the railroad booms and busts in the late nineteenth century, and similar effects in industries such as electricity transmission and Interstate highways. All of these industries share certain characteristics: all are politically and economically important, and are affected by financial instability and/or government regulation. Telecom also experienced similar boom-and-burst dynamics, and has similar characteristics as other industries which have experienced bubbles. *(A System Dynamics Model for Analyzing Bubble Effects in the LD Telecom Industry, Kurebayashi Thesis 2004)*

(Internet Bubble –vs- Telecom Bubble) Seven years ago (in 2000) the communications business, made up of companies providing everything from phones to computer networks to routers and switches, was laid low by **the worst collapse to hit a U.S. industry since the Great Depression.**

With breathtaking speed and little advance warning, high-flying companies like Global Crossing Ltd. and WorldCom Inc., which had loaded up on debt to build out fiber-optic networks and buy up companies in anticipation of a never-ending e-commerce boom, collapsed into bankruptcy. Giants such as AT&T were ripped apart as they scrambled to recover from free-falling sales and profits.

Hundreds of thousands of workers lost their jobs. Prices of some inflated stocks--boasting price-to-earnings ratios that topped 400 in the most extreme cases--tumbled 95% or more. Investors saw some $2 trillion of market value vanish in a little more than two years – twice the damage caused by the parallel bursting of the Internet bubble. *(Businessweek, June 25, 2007)*

July 2002 Major Cash Call: It was during this period that the company sought external financing and was unable to find willing investors. An arrangement had been worked out between Broadband and MLGW whereby each would contribute an additional $6,000,000 into Networx. MLGW ultimately agreed to continue investing up to its approved internal limit to keep the company in business and growing (an additional $12,000,000 instead of $6,000,000). The private investors were diluted as the new capital was invested. It was anticipated that the capital available to invest by MLGW would be sufficient for the company to reach cash flow breakeven.

This was a pivotal point for Networx. In hindsight, the Internet & Telecom bust was still in process. That, combined with a business plan that was three years old, born of the Telecom Bubble and lacking "proof of concept", resulted in an initial additional investment of $6,000,000 on MLGW's part and then an increase in that additional investment to $12,000,000 evidently due to pressure from some City Council members (see *MCA 7-11-02 Concerns about Networx's Use of Funds May Arise at LG&W - Board Weighs Larger Outlay.pdf*).

Inability to Reach Positive Cash Flow by 2005: Amidst the prolonged slump in the telecom industry and continued downward pressure on pricing, Networx did not reach positive cash flow prior to running out of cash from the 2002 capital infusion by MLGW.

Offer to Purchase with Stock 11-23-04: The company again needed to raise additional capital. The management team, the Board, and the investor group again sought and considered outside financing. While the company was not successful in identifying external sources of minority equity capital at a reasonable valuation, they did consider and reject a $5.7 million offer for the company. This offer was to be paid for by stock in American Fiber Systems (AFS), a privately held corporation, and would constitute 6.9% of the ownership in AFS. This stock would be of value only after AFS went through an IPO and would receive return only after the preferred stockholders. At the time, those involved felt that the offer undervalued the asset, given the revenue growth and that the stock dilution would result in no ability to specifically grow Networx for the benefit of its present owners. In addition, the existing members would be responsible for the aged payables.

2005 Cash Call: Memphis Broadband guaranteed approximately $7,000,000 in loans in 2005 to attempt to resuscitate Networx while it responded to changes in the technology marketplace. MLGW requested that the City Council allow MLGW to guarantee its share of the loans in both May and June of 2005; the City Council chose not to allow such. That caused MLGW to lose 35.48% of its ownership in Networx. In late 2005, the private investors at this time injected an additional $6.6 million in capital through the guarantying of debt. The round of financing valued the company at $10.0 million prior to the transaction, which was a fair valuation in light of the current market price two years later. Again, this round of financing was expected to take the company to positive cash flow from operations.

MLGW's Due Diligence Concerning Loan Guarantees: In April of 2005 in preparation for considering whether MLGW should participate in the upcoming loan guarantees, MLGW's attorney engaged the CCG Consulting Group to evaluate the Fair Market Value of Networx and to offer insight from their experience regarding Networx's operation. (See "CCG Consulting's estimate of value of Networx 4-1-05.pdf".) CCG made an estimate of $9,200,000 based upon averaging the 2004 Book Value (minus depreciation and the OSS book value) and the NPV. In hindsight, it should be pointed out that the NPV model used projected 2005 revenues of $6,600,000, when in reality by the end of 2005, revenues were only $4,045,611 (61% of projected revenues). Without the actual spreadsheet model and knowledge of the growth rate, one cannot determine how this large variance would impact the Fair Market Calculation.

One should also note that for 12/31/05, Current Assets minus Current Liabilities is a deficit of $3,312,419. If the company were sold at that time, deductions would also need to be made for the investment banking fee and any required Net Working Capital Adjustment including payoff of debt and aged payables. It should also be noted that the 1999 Arthur D. Little Study's ProForma indicated a projected 2005 Revenue amount of $51,050,000, over 12 times what the actual revenue was for 2005. This difference in revenue projections shows the depth of the failure in the original business model.

Notification of Loss of Value to City Council June 2005: In a Memphis Commercial Appeal article of June 17, 2005, Charles Carpenter, MLGW's outside attorney in this matter at that time, is quoted as saying:

> They're (i.e. MLGW) even balking at what private investors say is the company's value. Memphis Broadband puts the value of Networx at $10 million. "Some people think that's pretty high," Carpenter said. "They've only had a potential offer earlier that was substantially less than that. It was not even a full cash offer."

I believe Joseph Lee stated to the Council that the top line value of Networx was in the $10,000,000 to $12,000,000 (without deduction for debt, etc.). The Council committee tape should show that there was clear communication to the City Council of the substantial loss that had occurred.

Post 2005 Experience: The publicity afforded the 2005 funding process hurt the company, resulting in slower sales growth than forecasted. Nevertheless from 2006 through today, the company has largely met the goals set out for it at the time of the 2005 round of financing. It steadily grew the top line revenue and aggressively trimmed its cost structure so that today it is cash flow neutral excluding capital needed for growth. In addition, due to the company's success providing wholesale capacity to other regional and national carriers, the company is faced with an array of growth opportunities. However, virtually every opportunity requires an upfront investment of capital to add customer premise equipment and to extend the network through the "last mile" to the customer location.

Ultimate Value is a Function of the Future: To illustrate the important role of capital's relationship to value, note this example of the typical contract. A carrier will sign an agreement with Networx to provide a circuit for a monthly price for a three- to five-year contracted period. These long-term contracts give Networx great stability and visibility to future revenue. However, on average, a new contract requires approximately 20-25% of the total contract value in upfront costs. If Networx gets a contract for three years which pays $5,000 per month, it has a total contract value of $180,000, but it might require $45,000 in upfront installation costs. That contract is profitable, but it requires an upfront cash expenditure which creates a working capital drain. It is this aspect of the business that requires the company to seek additional capital to fund future growth at this point in its maturation. As the company continues to mature and grow, more and more of its contracts are renewals where the upfront installation has occurred in the past, so the cost of growth should continue to come down in the future. It has a good future revenue model, but the model doesn't value the substantial investment that has already been made.

The Decision to Explore Sale of Networx: After deciding to explore capital infusion and sale opportunities, Memphis Networx engaged the McLean Group (www.mcleanllc.com) of McLean, Virginia, in December 2006 to conduct a sale process. This organization was chosen because of its prior familiarity with the company, its experience in smaller valuation and M&A transactions, and the telecom industry relationships of one of its principals.

Who is the McLean Group? The McLean Group describes themselves:

> As a private investment bank providing merger & acquisition, business valuation, capital formation, executive advisory and litigation support services. The firm focuses on serving middle-market businesses generating from $5 million and $300 million in revenues.
>
> The McLean Group's investment banking and valuation practice is headquartered in McLean, Virginia, just outside Washington, DC, in the center of Northern Virginia's technology, communications and government contracting corridor. The firm also has 20 offices located across the United States. The McLean Group's investment bankers are supported by a staff of research analysts and associates

> that leverages state-of-the-art, proprietary corporate information and transaction data on behalf of the firm's clients.
>
> The McLean Group serves clients both nationally and internationally with a broad resume of successfully consummated financial transactions. While The McLean Group's diverse client base spans numerous industries, the firm has particular expertise in technology, telecommunications, government contracting, travel, hospitality and renewable energy.

Who is Tom Swanson? The lead contact with the McLean Group is Tom Swanson, whose web bio states:

> Tom Swanson joined The McLean Group in 2006 and specializes in emerging technology, infrastructure and bio-technology companies. He is also President of TJSwanson Co., a revenue consulting firm focused on assisting early and exit stage companies with their revenue challenges. He has over 25 years of experience as a senior executive within technology companies, including over thirty capital formation, merger and acquisition transactions as an operating executive.
>
> Mr. Swanson was a Management Consultant with Deloitte Consulting, advising Global 1000 enterprises from a variety of industry segments. He was a senior Sales and Marketing executive with several premier Silicon Valley technology companies; leading them through multiple rounds of Venture Fund raising from Tier 1 West Coast VC's, through IPO, to over $100 million+ in revenue including multiple merger and acquisitions. Tom's consulting work with early and exit stage technology companies enables him to maintain a current network of Private Equity and Venture Capital Investors on the East and West Coast.
>
> Tom is a graduate of John Carroll University with a B.S.B.A in Finance and the University of Michigan, Ross School of Business Executive Program.
> Memphis Networx engaged the McLean Group in December 2006 to address the critical funding needs that Networx was going to face in 2007 and to address how to secure funding for the preservation of the entity. Such methods could involve the sale of a minority, majority or entire firm.

Who is Dennis Roberts? The oversight on the engagement rests with Dennis Roberts whose web bio states:

> Dennis Roberts is Chairman of The McLean Group, LLC. Mr. Roberts has more than 35 years of accounting and investment-banking experience involving a multitude of transactions across a wide variety of industries and markets.

Mr. Roberts was the founder, chairman, and CEO of a publicly held regional holding company from 1984 to 1992. Prior to that, he was founder and senior partner of a large Washington, DC-area accounting firm that he sold to his partners in 1987. While a practicing Certified Public Accountant, Mr. Roberts focused on M&A, commercial finance, and similar transactions. Until 1995, Mr. Roberts was the managing partner for the Washington, D.C. regional office of Matrix Capital Markets Group, a regional investment bank specializing in M&A representation and corporate finance.

A graduate of Benjamin Franklin University (subsequently merged with George Washington University), Mr. Roberts is also a Certified Valuation Analyst (CVA), is accredited in Business Valuation (ABV) by The American Institute of Certified Public Accountants, and is an enrolled Federal Tax Accountant. He teaches, lectures, and writes on M&A, business valuation, and corporate finance to national audiences. He is a National Association of Securities Dealers (NASD) registered representative and firm principal (Series 7, 24, 28, 63).

The Process of the McLean engagement is best described as:

- The McLean Strategic Funding Presentation, which was presented to the Networx board on 12/18/2006, outlining the process for raising capital or selling the company;

- The McLean Business Valuation study, which was presented to the Networx board on 1/31/07, indicating certain parameters regarding the current value of the company;

- McLean contacted approximately 50 firms as potential acquisition candidates. It was designed as a two-phased approach: contact and move many companies quickly through the process given Networx's precarious cash position.

- After conversation and qualification of potential bidders, there were ten organizations which signed NDAs (non-disclosure agreements) and requested a copy of the CIM (confidential investment memorandum).

- Of the ten organizations which signed the NDAs, eight organizations submitted bids for the company and two chose not to bid. The Buyer List Companies that were contacted were presented to the board. During two board presentations in February and March, the board was updated, discussion occurred concerning the acceleration strategy, and the board approved to go forward with the eight potential acquirers.

- The process identified three bidders that were in a range higher than the rest of the indications of interest. After negotiating with each of the three finalists to get their best terms, the management team and the Board in consultation with the investment banker analyzed the three offers. The decision process involved a set of key criteria:

    1. Net purchase price to equity owners once after factoring in working capital and other adjustments,
    2. Purchase price in cash, stock or combination including evaluation of near term marketability of any stock,
    3. Verifiable financial wherewithal of the bidder to complete the proposed transaction,
    4. Experience in the telecom industry and ability to effectively run and grow the network to insure the payment of aged payables, and
    5. Quality of due diligence performed which correlates with evaluating the amount to time required to close.

- The firm CII provided the highest cash offering and was selected by the board (from three final firms) as the firm which was the best for the current owners of Memphis Networx and its customers and employees.

Selection of Communications Infrastructure Investors (CII): Based on these criteria, the CII proposal was selected. The Networx team, including the Board, continued to vigorously negotiate elements of the terms and purchase agreement with CII through the signing of the contingent purchase agreement.

The transaction being submitted to the owners for approval is a sale of their membership interests in Networx for a gross purchase price of $11.5 million. After the payoff of debt, adjustments to working capital, and fees and expenses related to the transaction, this yields approximately $2.0 to $2.5 million to equity holders depending upon post-closing adjustments.

The buyer, Communications Infrastructure Investors, will continue to operate the network in the same manner as it is operated today so customers will see no change in service. The network will become part of a broader network which ultimately should provide greater opportunities to serve national and regional carriers seeking connection to customers in Memphis and enterprises in Memphis looking for connections to points outside of the region.

The Contract to Sell: The contract was finalized between CII, MLGW, and Memphis Broadband on June 7, 2007. A copy of that contract has been publicly distributed. In addition, the following documents have been distributed to the MLGW Board and the City Council:

Documents For Release #1 (June 11, 2007)	
#0	Nick Clark's e-mail of 6-11-07 to MLGW Board
#1a	1999-05-11 Networx – ADL Study for MLGW
#1b	ADL Proforma model.xls
#2	2000-05-00 Networx – Tennessee Digital Divide (TRA)
#3	2000-05-10 Networx – Telectrics (MSDW)
#4	2000-10-11 Networx – Value Creation Opportunities for Utilities in Telecom 2 (Navigant)
#5	TMG – Memphis Strategic Funding Presentation 12 18 2006.ppt
#6	2007-05-30 Networx – Sale Transaction Waterfall Projection v4
#7	Memphis Networx SPA Execution Version-2 (Executed)
#8	Allan Wade Opinion Liquidation of Investment in the Memphis Networx 6-8-07

Documents For Release #2 (June 18, 2007)	
#9	Questions & Answers Concerning Networx Sale Transaction
#10	Networx Historical Accounting Files
#11	1999-2001 Networx Annual Report
#12	2002 Networx Annual Report
#13	2003 Networx Annual Report
#14	2004 Networx Annual Report
#15	2005 Networx Annual Report
#16	Final Note #9 from MLGW 2006 Audited Statement
#17	Pole Attachment Contract between Networx & MLGW

Documents For Release #3 (June 19, 2007)	
#18	Questions & Answers Concerning Networx Sale Transaction #2
#19	MCA 7-11-02 Concerns about Networx's Use of Funds May Arise at LG&W – Board Weights Larger Outlay
#20	MBJ 7-26-02 Minority investors in Networx risk most
#21	Networx Capitalization Issues 6-05 & 3-06
#22	Final Note #9 from MLGW 2006 Audited Statement
#23	CCG Consulting's estimate of value of Networx 4-1-05
#24	Redacted Networx Operating Agreement MNETAROpAgv.2(Clean)
#25	MLGW Board Resolution of 6-2-05 Concerning Networx

Documents For Release #4 (June 27, 2006)	
#26	A System Dynamics Model for Analyzing Bubble Effects in the LD Telecom Industry, Kurebayashi Thesis 2004
#27	OCED After The Telecommunications Bubble, Economics Department Working Papers No.361, 6-25-03

#28	MCA 5-20-05 Networx vote challenged -- MLGW board asks reconsideration
#29	MCA 6-6-05 LGW re-pitches deal for Networx -- Give us $2.9 million, instead of $6 million, it asks City Council
#30	MCA 6-17-05 MLGW advised to sell Networx -- Attorney says pull out while utility is still majority owner
#31	BusinessWeek 6-25-07 Telecom - Back From The Dead.pdf
#32	AFS Letter to Rick Masson of 6-14-07 Concerning Networx Sale.pdf
#33	2007-02-22 Networx - AFS MemphisNetworx NDA 02262007 (executed).pdf
#34	2007-03-28 Networx - BTI NDA (executed).pdf
#35	Networx McLean LLC NDA with CII 032007.pdf
#36	2007-06-27 Networx - McLean Summary of Sales Transaction.pdf
#37	AFS Executed Consent to Disclose 06 27 07 with Documents.pdf
#38	Bti's Bid Document Disclosure – **Bti refused to sign the waiver, therefore the file is still missing.**

Documents Remaining to be Released: If there are any further documents that need to be released, please let me know.

Questions of Potential Conflict of Interest, etc.: The question has been raised on several occasions about compensation to Directors of Networx. Networx Directors are not compensated in any way by Memphis Networx. As for the private directors, there are two Directors who receive some form of "carried interest" from their respective investment partnerships which they represent.

Carried interest is the common form of compensation for investment fund managers and it pays a specified percentage of the investment profit that the investors reap after their initial capital is paid back to the manager. This compensation method is used throughout the investment world because it aligns the interests of the fund manager with that of the investors.

There are two important points to note in this regard as it relates to the proposed Networx transaction. First, this compensation is borne only by the private investors in their investment partnership and the terms were set at the time of the investment (years ago). Second, this type of compensation motivates the fund managers in their service as Networx Directors to seek the best and highest payback for the shareholders and does not motivate anyone to choose a specific offer as has been alleged.

Solicitation of Further Questions: At the MLGW Board meeting this past week, the Board requested and encouraged that the City Council as well as any citizen submit any questions concerning the pending sale of Networx by sending an e-mail to mlgwboard@mlgw.org. That e-mail address will forward such e-mail to each of the MLGW Board members and a board member will be responsible for publishing and answering those questions in writing prior to the

MLGW Board meeting of July 5, 2007. We request that these questions be submitted by noon on Monday, July 2nd.

Invitation to City Council for MLGW Board Meeting Presentation on Proposal Sale of Networx: The MLGW Board meetings are open to the general public at all times. It is the MLGW Board's special desire to invite City Council members to be present on July 5, 2007, at 2:30 p.m.. Given the critical timing of this transaction, if a City Council member desires to provide input on the business decision which MLGW needs to make, it is imperative that they provide questions in writing for the benefit of a written response prior to the MLGW Board meeting and that, if they wish to address the MLGW Board, they appear at the July 5 meeting at 2:30 p.m. Questions may be e-mail to mlgwboard@mlgw.com. While MLGW will be making the business decision as to whether to sell Networx at its July 5th meeting, it is more than pleased to appear before Council to review the issues and questions surrounding how this loss was incurred.

Sincerely,

Nick Clark
Commissioner

cc: Mayor Herenton
Memphis City Council *(via e-mail only)*
MLGW Board of Commissioners *(via e-mail only)*
Networx Board of Directors *(via e-mail only)*

LAW OFFICES
ALLAN J. WADE, PLLC
One Commerce Square, Suite 2275
Memphis, Tennessee 38103
Telephone (901) 322-8005
Facsimile (901) 322-8007

Allan J. Wade
Lori H. Patterson
Brandy S. Parrish

June 11, 2007

Rick Masson, Chairman
Board of Commissioners
MLGW
220 S. Main
Memphis, TN 38103

RE: Liquidation of Investment in the Memphis Networx

Dear Mr. Masson:

You have requested our opinion regarding the necessity for the Memphis City Council to approve the liquidation of MLGW's investment in Memphis Networx, LLC ("Networx").

Memphis Networx, LLC was organized under the Tennessee Limited Liability Act on November 8, 1999, to provide telecommunications services through the installation of broadband fiber optic cable in the Memphis, Tennessee area. On August 9, 2001, the TRA issued a final order approving the Company's amended and restated operating agreement (dated November 29, 2000) and granting a certificate of public convenience and necessity for the State of Tennessee. In addition, MLGW received approval from the State Comptroller's office to release funds from the previously approved $20,000,000 loan from the Electric Division to the Telecommunications Division. In the third quarter of 2002, MLGW's Board of Commissioners, at the request of management, increased the approved level of investment in the Company to $32,000,000.

Effective April 1, 2002, MLGW entered into a Capital Contribution Agreement with Memphis Broadband, LLC. The agreement established planned monthly capital contributions through 2004 for both members. MLGW continued to provide periodic investments of capital as requested by Memphis Networx. MLGW contributed $3,532,000 in 2004, which was equal to both members' required capital contributions. MLGW's share of total capital contributions was approximately 84% at December 31, 2004.

MLGW, through its Telecommunications Division, owns a capital investment in Networx. Under Tennessee law MLGW has no right to the underlying assets of Networx, but only a right to income and profits as a return on its capital investment. Networx has been reported on MLGW's books as an investment in a Tennessee limited liability company.

The funds for MLGW's investment in Networx were obtained from an interdivisional loan from MLGW's Electric Division to its then newly formed Telecommunications Division ("Interdivisional Loan"). The newly formed Telecommunications Division invested in Networx.

In 1980 the citizens of Memphis amended the City's Charter to provide amendments to the MLGW provisions. Specifically, the 1980 amendments provided in pertinent part:

> The Board of Light, Gas & Water Commissioners shall have power to establish different divisions of the Memphis Light, Gas & Water Division for assigning of the separate energy functions or for the efficient operation of the Memphis Light, Gas & Water Division and [to] provide for the keeping of such books and records as it may require to properly account for the equitable distribution of expenses. Each of such energy systems [is] to be financially separate with such joint or common expenses as shall be advisable and economical as determined by the Board of Commissioners.
>
> Nothwithstanding any other provision of the Charter, the monies and funds of any division may be loaned to another division in such amounts and upon such terms as the Board of Light, Gas & Water Commissioners may authorize and approve.
>
> The Board of Light, Gas & Water Commissioners shall provide for the investment and reinvestment of its funds and reserves as determined in the discretion of the Board of Commissioners and the funds of all divisions may be combined for the purpose of obtaining the best investment. The board shall not be limited as now provided but shall be able to make such investments as authorized by state law and as the Board of Light, Gas & Water Commissioners may deem best with such security as the Board may deem proper. Any profit or loss resulting from any such investment or reinvestment shall be credited or charged to the several divisions in proportion to the respective funds so invested and reinvested.

In addition, by Tenn. Pub. Acts, ch. 531, now codified at Tenn. Code Ann. § 7-52-401, et seq., the General Assembly authorized the City acting through its board having supervision of the City's electric plant to lend electric plant funds to provide working capital for a telecommunications system provided such loan was approved in advance by the state director of local finance.

The Tennessee Regulatory Authority approved Networx as a certificated public service telecommunications provider and the state director of local finance approved the investment by MLGW. While there are many differing views between Council members, the Council approved the budget for the year in which the loan was incurred, but did not specifically approve the loan itself.

In recent years, the Council has approved subsequent MLGW budgets in which additional investments in Networx and losses from Networx were recorded. It is my understanding that the investment has been written down to zero on MLGW's books.

Presently, MLGW owns an investment in Networx of about 56%. Under Tennessee law a member of a Tennessee limited liability company has no interest in specific LLC property, but is only entitled to share in profits and losses in proportion to the investment of all members. Tenn. Code Ann. § 48-215-101. Consequently, MLGW does not directly own any telecommunications systems, plant or properties. Tenn. Code Ann. § 7-52-403(b) distinguishes between an electric system and a telecommunications system; thus, a telecommunications system would not be considered an "energy system" subject to all of the rules and regulations appertaining thereto, but is instead a telecommunications company that must adhere to the 1995 Tennessee Telecommunications Act and rules of the Tennessee regulatory authority, from which MLGW's electric division activities are exempt. Further, any telecommunications system would not be considered a part of the Electric System under MLGW's contract with TVA or under the Electric System's Master Board Resolution. In fact, MLGW is required by § 688 of the Charter to operate each division independently of each other.

It is our opinion that the creation of the Telecommunications Division is authorized by the Charter within the province of the MLGW Board of Commissioners without Council approval. The investment in Networx is similarly within the province of the MLGW Board of Commissioners under the 1980 Charter Amendment governing investment of funds subject to approval of the State Director of Finance as required by Tenn. Code Ann. § 7-52-403. Therefore, it is our opinion that MLGW's investment in Networx may be liquidated by MLGW's Board of Commissioners without Council approval provided such liquidation is approved by the State Director of Finance and provided "any profit or loss resulting from such investment is credited or charged" in the manner provided in the 1980 amendments to the City's Charter.

The 1980 amendments also permitted the MLGW Board to make contracts concerning energy systems specified in Section 1. This section appears to be inapplicable to the issue at hand. As previously indicated, the telecommunications system was not so identified in Seciton 1 as an "energy system." Specific language of the state legislation sets forth MLGW's involvement as a lender/investor with state approval required. No such approval was required if MLGW owned and operated the telecommunications system outright. Thus, any conflict in the language of the Charter must be logically resolved in favor of the investment authority, which specifies accounting treatment and is consistent with state legislation.

Notwithstanding our opinion, we also strongly suggest, consistent with our opinion dated August 5, 2002 to Councilman Sammons, that the liquidation of the Divisions Networx investment be reported to the Mayor and the Chairman of the Council, who both have important oversight roles in the overall operation of MLGW.

I trust I have adequately responded to your inquiry.

Sincerely,

Allan J. Wade

AJW/tcp

cc W.W. Herenton, Mayor
Tom Marshall, Council Chairman