Continuing Disclosure Requirement
Electric Refunding Bonds Series 2002 - Section 2.2
Series 2003A, Series 2003B - Section 4(a)(iv)(A)
Historical and Projected System Use

The following table shows historical figures for Shelby County's population, the Electric Division's average number of customers, electric load and electric sales, as well as projections for such figures for the year 2010 developed by MLGW.

HISTORICAL AND PROJECTED ELECTRIC SYSTEM USE

Year	Shelby County Population[1]	Average Number of Customers	Peak Billing Demand[2]	Total Sales[3]
1975	726,774	284,826	1,877.0	7,828.3
1980	777,113	306,116	2,257.2	9,096.2
1985	812,358	326,069	2,178.7	9,449.8
1990	826,327	356,794	2,595.9	11,106.2
1995	853,994	379,638	2,651.3	12,379.4
2000	897,472	406,976	3,305.6	14,248.2
2005	911,655	422,251	3,390.0	14,828.6
2010	925,017	428,585[4]	3,832.0[5]	15,301.1[6]

(1) Source: U.S. Census Bureau, except for 2005 and 2010. The 2005 and 2010 population figures assume a 1.5% annual growth rate, which is the projected growth rate used by the Memphis Area Chamber of Commerce.

(2) In thousands of kW.

(3) In thousands of Mwh.

(4) Number of customers was derived from linear regression forecasting models which results in a five-year compound growth rate of 1.5%.

(5) Peak billing demand was obtained from the Master Plan For Future Development of the Electric System which uses a polynomial regression to identify a pattern between temperature and system gross load.

(6) Total sales were derived using the Peak Billing Demand and the historical annual load factor of 45.5%.

Continuing Disclosure Requirement
Electric Refunding Bonds Series 2002 - Section 2.2
Series 2003A, Series 2003B - Section 4(a)(iv)(A)
Historical and Projected System Use (continued)

UPDATED FOR 2005

The following table shows the energy usage of the Electric Division's ten largest customers for the twelve months ended December 31, 2005.

TEN LARGEST ELECTRIC CUSTOMERS

	Energy Sales to Customers [1] (kWh)	Sales to Customers as a % of Total Division Sales	Revenue from Customers	Revenue from Customers as a % of Total Division Operating Revenue[2]
1. Premcor Refining Group	449,182,292	3.029%	$17,122,424	1.719%
2. Cargill, Inc.	371,866,376	2.508%	15,558,597	1.562%
3. E.I. Dupont	205,822,797	1.388%	8,066,535	0.810%
4. Buckeye Technologies	103,248,888	0.696%	5,731,644	0.576%
5. Federal Express	101,744,270	0.686%	5,515,364	0.554%
6. Solae LLC	109,543,929	0.739%	5,145,596	0.517%
7. City of Memphis Public Works [3]	75,861,472	0.512%	3,863,697	0.388%
8. University of Memphis	62,427,509	0.421%	3,769,216	0.378%
9. K.T.G. USA LP	80,000,212	0.539%	3,516,930	0.353%
10. City of Memphis Public Works [4]	64,000,833	0.432%	3,295,815	0.331%
Total	1,623,698,578	10.950%	$71,585,819	7.188%

[1] Total Electric Division sales of energy for the twelve months ended December 31, 2005 were 14,828,673,906 kWh.

[2] Total Electric Division operating revenue for twelve months ended December 31, 2005 was $995,889,431.

[3] T.E. Maxson South Wastewater Treatment Plant.

[4] M.C. Stiles North Wastewater Treatment Plant.

Continuing Disclosure Requirement
Electric Refunding Bonds Series 2002 - Section 2.2
Series 2003A, Series 2003B - Section 4(a)(iv)(A)
Historical and Projected System Use (continued)

The following tables detail, for each of the years 1995 through 2005, (i) the average number of Electric Division customers in each category, (ii) the megawatt hours of electricity sold to each category of customers, and (iii) the historical power and energy requirements of the Electric System.

AVERAGE NUMBER OF ELECTRIC CUSTOMERS

Year	Residential	Commercial	Industrial[1]	Other[2]	Total
1995	325,954	37,825	175	15,684	379,638
1996	328,886	38,980	174	16,037	384,077
1997	331,618	39,710	167	16,409	387,904
1998	339,285	40,553	160	16,565	396,563
1999	343,212	41,195	140	16,934	401,481
2000	347,938	41,874	129	17,035	406,976
2001	351,112	42,662	128	16,955	410,857
2002	354,415	43,252	122	17,034	414,823
2003	353,721	50,700	234	16,755	421,410
2004	357,004	43,143	158	16,670	416,975
2005	361,948	43,278	161	16,864	422,251

(1) The increase in industrial customers for 2003 is due to the new customer information system meter count. The decrease in 2002 is due to the reclassification of certain customers from industrial to commercial.

(2) Includes outdoor lighting, traffic signals and interdepartmental customers.

MEGAWATT HOURS OF ELECTRICITY SOLD

Year	Residential	Commercial	Industrial	Other[1]	Total
1995	4,765,448	5,710,870	1,648,593	254,496	12,379,407
1996	4,864,617	5,676,291	1,734,028	265,506	12,540,442
1997	4,726,455	5,948,588	1,839,864	276,353	12,791,260
1998	5,380,910	6,406,677	1,775,599	274,441	13,837,627
1999	5,225,918	6,477,026	1,871,282	271,377	13,845,603
2000	5,433,925	6,614,579	1,911,202	288,490	14,248,196
2001	5,217,913	6,479,028	1,937,730	280,116	13,914,787
2002	5,447,195	6,719,600	1,838,186	287,859	14,292,840
2003	5,155,626	6,584,226	1,877,517	281,029	13,898,399
2004	5,260,624	6,709,839	1,925,431	277,362	14,173,256
2005	5,665,289	6,940,988	1,926,070	296,326	14,828,673

(1) Includes outdoor lighting, traffic signals and interdepartmental customers.

UPDATED FOR 2005

Continuing Disclosure Requirement
Electric Refunding Bonds Series 2002 - Section 2.2
Series 2003A, 2003B - Section 4(a)(iv)(A)
Historical and Projected System Use (continued)

HISTORICAL POWER AND ENERGY REQUIREMENTS

Year	Demand (In kW)	Increase	Total Sales (In MWh)	Increase	Annual Load Factor [1]
1994	2,608,297	-6.80%	11,942,312	1.49%	51.8%
1995	2,651,317	1.65%	12,379,407	3.66%	48.9%
1996	2,942,731	10.99%	12,540,442	1.30%	48.6%
1997	2,996,249	1.82%	12,791,260	2.00%	48.1%
1998	3,120,415	4.14%	13,837,627	8.18%	50.2%
1999	3,206,325	2.75%	13,845,603	0.06%	46.7%
2000	3,305,600	3.10%	14,248,196	2.91%	46.4%
2001	3,146,752	-4.81%	13,914,787	-2.34%	49.7%
2002	3,183,057	1.15%	14,292,840	2.72%	53.4%
2003	3,360,000	5.56%	13,898,399	-2.76%	47.2%
2004	3,397,000	1.10%	14,173,255	1.98%	47.6%
2005	3,390,000	-0.21%	14,828,673	4.62%	49.9%

(1) Annual Load Factor equals average hourly purchases divided by Peak Billing Demand.

The following table shows projected power and energy requirements of the Electric System for each of the years 2006 through 2010.

PROJECTED POWER AND ENERGY REQUIREMENTS

Year	Peak Billing Demand (In kW) [1]	Total Sales (In MWh) [2]	Annual Load Factor [3]
2006	3,558,000	14,207,094	46%
2007	3,618,000	14,446,674	46%
2008	3,682,000	14,702,226	46%
2009	3,757,000	15,001,701	46%
2010	3,832,000	15,301,176	46%

(1) Peak billing demand was obtained from the Master Plan For Future Development of the Electric System which uses a polynomial regression to identify a pattern between temperature and system gross load.
(2) Total sales were derived using the Peak Billing Demand and the historical annual load factor of 45.5%.
(3) Annual Load Factor equals average hourly purchases divided by Peak Billing Demand.

Continuing Disclosure Requirement
Electric Refunding Bonds Series 2002 - Section 2.2
Series 2003A, Series 2003B - Section 4(a)(iv)(C)
Electric Division
Statements of Income and Expenses
For the Fiscal Years Ended December 31, 2001-2005
(Amounts in thousands)

Updated for 2005

	2001 (1)	2002	2003 (2)	2004	2005
Operating Revenue					
Electric Sales Revenue	$813,130	$833,321	$831,973	$916,662	$980,613
Forfeited Discounts	7,439	7,257	8,095	9,415	10,360
Miscellaneous Service Revenue	7,860	9,583	10,861	12,906	8,122
Rent from Electric Property	737	737	737	737	2,525
Revenue Adjustment for Uncollectibles	(1,981)	(3,718)	(3,552)	(6,236)	(6,233)
Other Electric Revenue	65	42	316	450	502
Total Operating Revenue	827,250	847,222	848,430	933,934	995,889
Operating Expense					
Power Cost	658,770	676,281	669,358	707,136	751,055
Distribution	24,730	25,128	26,748	26,805	26,009
Transmission	2,701	2,838	2,933	3,227	3,240
Customer Accounts	10,109	10,662	12,143	12,793	13,159
Sales	942	929	1,003	875	754
Administrative and General	32,604	34,852	39,805	52,970	50,924
Customer Service and Information	1,186	1,368	1,387	1,053	1,119
Total Operating Expense	731,042	752,058	753,377	804,859	846,260
Maintenance Expense					
Transmission	1,665	1,532	1,670	1,463	1,600
Distribution	24,096	26,469	35,048	29,129	33,229
Administrative and General	3,425	3,612	3,520	3,832	3,915
Total Maintenance Expense	29,186	31,613	40,238	34,424	38,744
Other Operating Expense					
Depreciation	25,535	26,427	27,622	29,422	30,971
Payment in Lieu of Taxes	26,631	27,633	28,157	29,695	33,767
FICA Taxes	597	665	755	852	908
Total Other Operating Expense	52,763	54,725	56,534	59,969	65,646
Total Operating & Maintenance Expense	812,991	838,396	850,149	899,252	950,650
Operating Income (Loss)	14,259	8,826	(1,719)	34,682	45,239
Other Income (Expense)					
Other Income	11,928	5,938	12,140	55,460	57,968
Other Income - Transmission Credit	21,049	21,599	22,164	22,562	23,023
Equity in Earnings - Telecom	(2,032)	(4,153)	(4,625)	(5,541)	(6,248)
Interest Expense - Other	(867)	(802)	(732)	(774)	(573)
Contributions in Aid of Construction	15,871	18,679	31,768	21,216	18,458
Reductions of Plant Costs Recovered through Contributions in Aid of Construction	(15,871)	(18,679)	(31,768)	(21,216)	(18,458)
Net Income (Loss) Before Debt Expense	44,337	31,408	27,228	106,389	119,409
Debt Expense					
Interest on Long-Term Debt	6,133	4,479	6,819	64,233	63,898
Amortization of Debt Discount and Expense	216	165	(580)	(11,568)	(11,297)
Total Debt Expense	6,349	4,644	6,239	52,665	52,601
Increase in Net Assets	$37,988	$26,764	$20,989	$53,724	$66,808

(1) As of January 1, 2001, MLGW implemented the changes in financial reporting as directed by Governmental Accounting Standards Board Statement (GASB) 34. These changes apply to the classification and presentation of Revenue Adjustment for Uncollectibles and Contributions in Aid of Construction.

(2) In 2003, MLGW performed an analysis of its revenue recognition practices and began recording revenues and the associated cost of purchased power related to volumes delivered but not yet billed. Recording unbilled revenues changed the timing of revenue recognition from the cycle-billing method to the accrual method which is based on when the service is provided. Prior to 2003, MLGW recognized revenues from meters read on a monthly basis and deferred the cost of purchased power for volumes delivered but not yet billed. The effect of the change in revenue recognition methods increased net assets by $3,362 for the year ended December 31, 2003 and are reflected in the accompanying statement of income and expenses. The cumulative effect of the change resulting from years prior to January 1, 2003 was an increase of $5,770 and was treated as an adjustment to beginning net assets and is not reflected in the accompanying statement of income and expenses.

Continuing Disclosure Requirement
Electric Refunding Bonds Series 2002 - Section 2.2
Series 2003A, Series 2003B - Section 4(a)(iv)(C)
Electric Division
Selected Balance Sheet Data
As of December 31, 2001 through 2005
(Amounts in thousands)

	2001	2002	2003 [2][3]	2004 [3]	2005
Assets					
Utility Plant (Net)	$659,330	$695,062	$715,535	$741,683	$767,147
Restricted Funds	110,462	78,751	42,856	46,297	46,306
Current Assets [2][3]	213,251	202,549	295,883	296,753	344,093
Other Non-Current Assets [3]	15,780	20,855	1,448,371	1,360,738	1,269,013
TOTAL ASSETS	$998,823	$997,217	$2,502,645	$2,445,471	$2,426,559
Liabilities and Net Assets					
Net Assets	$690,262	$717,026	$743,785	$797,509	$864,317
Long-Term Debt [1][3]	101,776	70,655	1,483,290	1,395,891	1,305,359
Current Liabilities [3]	182,942	182,534	251,146	228,913	233,527
Other Non-Current Liabilities	23,843	27,002	24,424	23,158	23,356
TOTAL LIABILITIES AND NET ASSETS	$998,823	$997,217	$2,502,645	$2,445,471	$2,426,559

[1] Excludes Defeased Debt.

[2] In 2003, MLGW performed an analysis of its revenue recognition practices and began recording revenues and the associated cost of purchased power related to volumes delivered but not yet billed. Recording unbilled revenues changed the timing of revenue recognition from the cycle-billing method to the accrual method which is based on when the service is provided. Prior to 2003, MLGW recognized revenues from meters read on a monthly basis and deferred the cost of purchased power for volumes delivered but not yet billed. The amount of unbilled revenues included in current assets at December 31, 2003 was $40,890. The effect of the change in revenue recognition methods increased net assets by $3,362 for the year ended December 31, 2003 and are reflected in the accompanying statement of income and expenses. The cumulative effect of the change resulting from years prior to January 1, 2003 was an increase of $5,770 and was treated as an adjustment to beginning net assets.

[3] In 2004, MLGW changed the presentation of Unamortized Debt Premium to be a component of Long Term Debt. Certain amounts in the 2003 Financial Statements have been reclassified to conform to the 2004 presentation.

Updated for 2005

Continuing Disclosure Requirement
Electric Refunding Bonds Series 2002 - Section 2.2
Series 2003A, Series 2003B - Section 4(a)(iv)(D)
OUTSTANDING ELECTRIC DIVISION DEBT

The following tables present data on historical and projected debt service coverage for the Electric Division.

HISTORICAL DEBT SERVICE COVERAGE[1]
(In Thousands)
Fiscal Years Ended December 31,

	2001	2002	2003	2004	2005
Operating Revenues	827,250	847,222	848,429	933,934	995,890
Interest and Other Income[2]	30,945	23,384	29,680	72,481	80,991
Amortization of Principal Related to 2003A&B Series			4,357	82,743	80,405
Total Income	858,195	870,606	882,466	1,089,158	1,157,286
Operating and Maintenance Expense[3]	760,228	783,671	793,615	840,135	885,914
Net Revenues Available for Debt Service	97,967	86,935	88,851	249,023	271,372
Debt Service on Bonds[4]	(29,499)	(30,349)	(27,843)	(138,801)	(137,092)
Coverage for Debt Service	3.32x	2.86x	3.19x	1.79x	1.98x

(1) Includes revenues, expenses, and debt service.

(2) Includes other income, other income-transmission credit, prepay credit amortization, and equity in earnings-Telecom per the Statements of Income and Expenses.

(3) Includes Total Operating Expense and Total Maintenance Expense per the Statements of Income and Expenses.

(4) Excludes debt service on Long-term Notes Payable.

Updated for 2005

Continuing Disclosure Requirement
Electric Refunding Bonds Series 2002 - Section 2.2
Series 2003A, Series 2003B - Section 4(a)(iv)(D)
OUTSTANDING ELECTRIC DIVISION DEBT

PROJECTED DEBT SERVICE COVERAGE [1]
(In Thousands)

	Fiscal Years Ended December 31,[4][5][6]				
	2006	2007	2008	2009	2010
Operating Revenues [2]	972,422	978,942	986,405	993,925	1,001,500
Interest and Other Income	77,310	81,392	79,097	75,861	72,244
Amortization of Principal Related to 2003A&B Series	82,622	86,249	89,904	93,717	97,972
Total Income	1,132,354	1,146,583	1,155,406	1,163,503	1,171,716
Operating and Maintenance Expense [2][3]	890,879	907,166	920,555	934,366	948,618
Net Revenues Available for Debt Service	241,475	239,417	234,851	229,137	223,098
Debt Service on Series 2002 Bonds	6,160	6,145	6,145	6,153	5,635
Coverage for Debt Service	39.20	38.96	38.22	37.24	39.59
Debt Service on Series 2003 Bonds	130,946	131,389	132,494	133,480	133,400
Coverage for Debt Service	1.84	1.82	1.77	1.72	1.67
Total Debt Service	137,106	137,534	138,639	139,633	139,035
Coverage for Debt Service	1.76	1.74	1.69	1.64	1.60

[1] Includes revenues, expenses, and debt service.

[2] Assumes projected sales and projected O&M. Assumes growth rate of 0.76% per year for sales revenues and O&M expense growth rate of 5% per year.

[3] Excludes depreciation, amortization, and FICA taxes.

[4] Includes the Series 2003A Bonds and the Series 2003B Bonds. Assumes the Series 2003B Bonds bear interest at 4.4%. Actual rates may vary. Excludes Broker/Dealer and Auction Agent fees for the Series 2003B bonds.

[5] The projected information for the years 2006 through 2010 set forth above has been prepared by MLGW and has not been examined or complied by MLGW's independent auditors or any other independent accountant or financial advisor.

[6] The forecasted information is based on the following assumptions:
(i) Sales revenues are forecast to increase at a rate of 0.76% consistent with historical experience.
(ii) Operating and maintenance expense, excluding depreciation, amortization, and FICA taxes, are forecast to increase 5% per year after 2006.
(iii) The Electric Division's future capital expenditures will be financed in part out of the Renewal and Replacement Fund and forecasted Electric Revenues.

Updated for 2005

Series 2003A, Series 2003B - Section 4(a)(iv)(B)
System Improvements and Additions

ELECTRIC DIVISION
PROJECTED CAPITAL PROGRAM [1]
(Amounts in Thousands)

Year	Substation and Transmission	Distribution System	General Plant	Total
2006	21,375	35,136	15,477	71,988
2007	16,650	34,165	13,758	64,573
2008	12,350	32,873	12,668	57,891
2009	8,650	30,130	9,621	48,401
2010	12,825	31,273	9,386	53,484

Capital Plans area based on the combination of annual Master Plan, historical reviews, and growth rate projections. These estimates include a 4% average annual inflation factor.

ELECTRIC DIVISION
FUNDING OF PROJECTED CAPITAL PROGRAM [1]
(Amounts in Thousands)

Year	Renewal and Replacement Fund	Current Revenues	Bond Proceeds	Total
2006	22,922	49,066	-	71,988
2007	23,842	40,731	-	64,573
2008	24,511	33,380	-	57,891
2009	24,842	23,559	-	48,401
2010	25,269	28,215	-	53,484

Capital Plans area based on the combination of annual Master Plan, historical reviews, and growth rate projections.

Energy in motion

Power progressing toward service excellence

Hometown Energy • Working for You

Memphis Light, Gas and Water Division

2005 Annual Report

Table of Contents

About Memphis Light, Gas and Water Division

Memphis Light, Gas and Water is the nation's largest three-service municipal utility, serving more than 420,000 customers. Since 1939, MLGW has met the utility needs of Memphis and Shelby County residents by delivering reliable and affordable electricity, natural gas and water service.

Electricity is supplied to MLGW by the Tennessee Valley Authority, while natural gas is purchased from a variety of suppliers and transported by three pipeline companies, Texas Gas Transmission Corporation, CMS Trunkline Gas Company and ANR Pipeline Company. Memphis receives its water from one of the largest artesian water systems in the world.

MLGW is led by a President and a five-member Board of Commissioners who are appointed by the Mayor of Memphis and approved by the Memphis City Council.

MLGW's Vision:

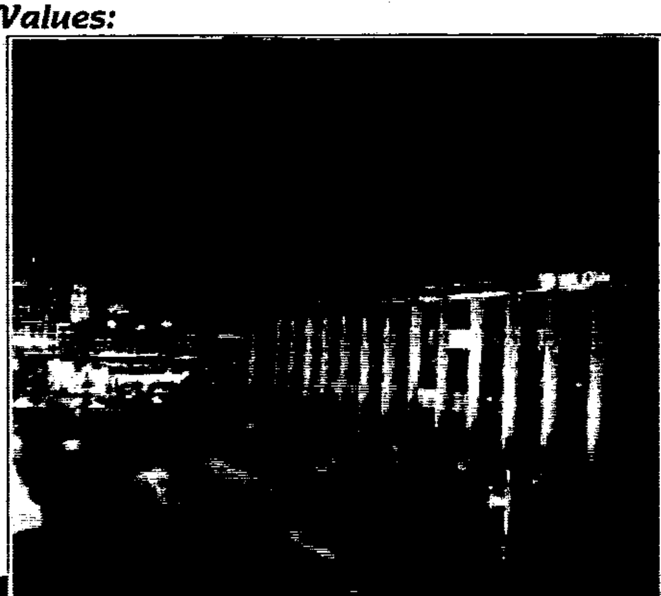
To be the best utility for our customers

MLGW's Mission:

To provide customer-focused, reliable, safe and cost-effective utility services to the Greater Memphis community

MLGW's Values:

Customers
Safety
Trust



Board of Commissioners

Rick Masson, Chairman
V. Lynn Evans, Vice Chairman
Nick Clark
James Russell
Bill Taylor

2005 Executive Leadership Team

Joseph Lee, III
President and CEO

Christopher Bieber
Vice President of Engineering

Odell Horton, Jr.
General Counsel

John McCullough
Vice President, CFO & Secretary-Treasurer

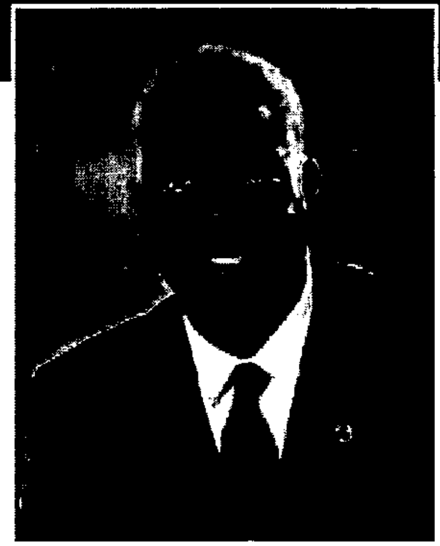
Linda Peppers
Vice President and Chief Technology Officer

Diana Veazey
Vice President of Construction and Maintenance

Armstead Ward
Vice President of Human Resources

Alonzo Weaver
Vice President of Customer Operation

Letter from the President



When I took the helm of MLGW in July 2004, I vowed to chart a new course for the utility – one in which our customers and the community would be at the epicenter of everything we do. I began by developing a dynamic leadership team consisting of some of the most dedicated and brightest minds in the community who shared my vision. Together we crafted a plan for success that includes a mission "to provide customer-focused, reliable, safe and cost-effective utility services to the Greater Memphis community" to be achieved through a three-pronged strategy that signifies our desire to strengthen our relationships, reliability and rates. Since its implementation, I'm delighted to say that our strategy encompassing a customer-stakeholder focus, core business focus and cost-control focus has proven to be a formula for success, yielding tremendous results.

Upon my first anniversary on July 7, 2005 as President and CEO, I held an event that will become an annual tradition: the MLGW annual stakeholder update. With local leaders present, including city council members, the mayor of Memphis, MLGW employees and local media representatives, I shared the details of this new plan and its resulting successes at that point. Many attendees of this function applauded MLGW for devising a plan that speaks to the heart of the community through efforts that respond to critical customer needs.

The proceeding pages of this report offer the shining results of our visionary efforts in 2005. Our endeavors encompass a broad range of initiatives that enhance our core services and help promote the welfare and wellbeing of citizens in our community. To determine if we were on the right track, we instituted the "Performance Scorecard" program in April to gauge our performance on a quarterly basis. Through random surveys, we have received feedback from our customers and employees that has enabled us to measure our compliance with MLGW's strategic plan. The scorecard rates performance in seven key areas covering the reliability of MLGW services, public perception and how MLGW's rates compared with those in other cities, among other measures. I'm proud to say that we ended 2005 with a total performance score of 93.5 percent – nearly 10 points higher than figures from the four preceding years. These results clearly indicate that we are on the right path and they are a testament to the effectiveness of our new strategic plan.

With our customers and community first and foremost in our operations, MLGW will continue to assess and modify our operations within the strategic plan structure so that we evolve with the changing needs of our community. Our ultimate goal as stated in our vision is "to be the best utility for our customers," and to remain one of the most respected utilities in the nation. As a dynamic and successful year, 2005 has served as a launching pad that is propelling us toward service and operational excellence in the future.

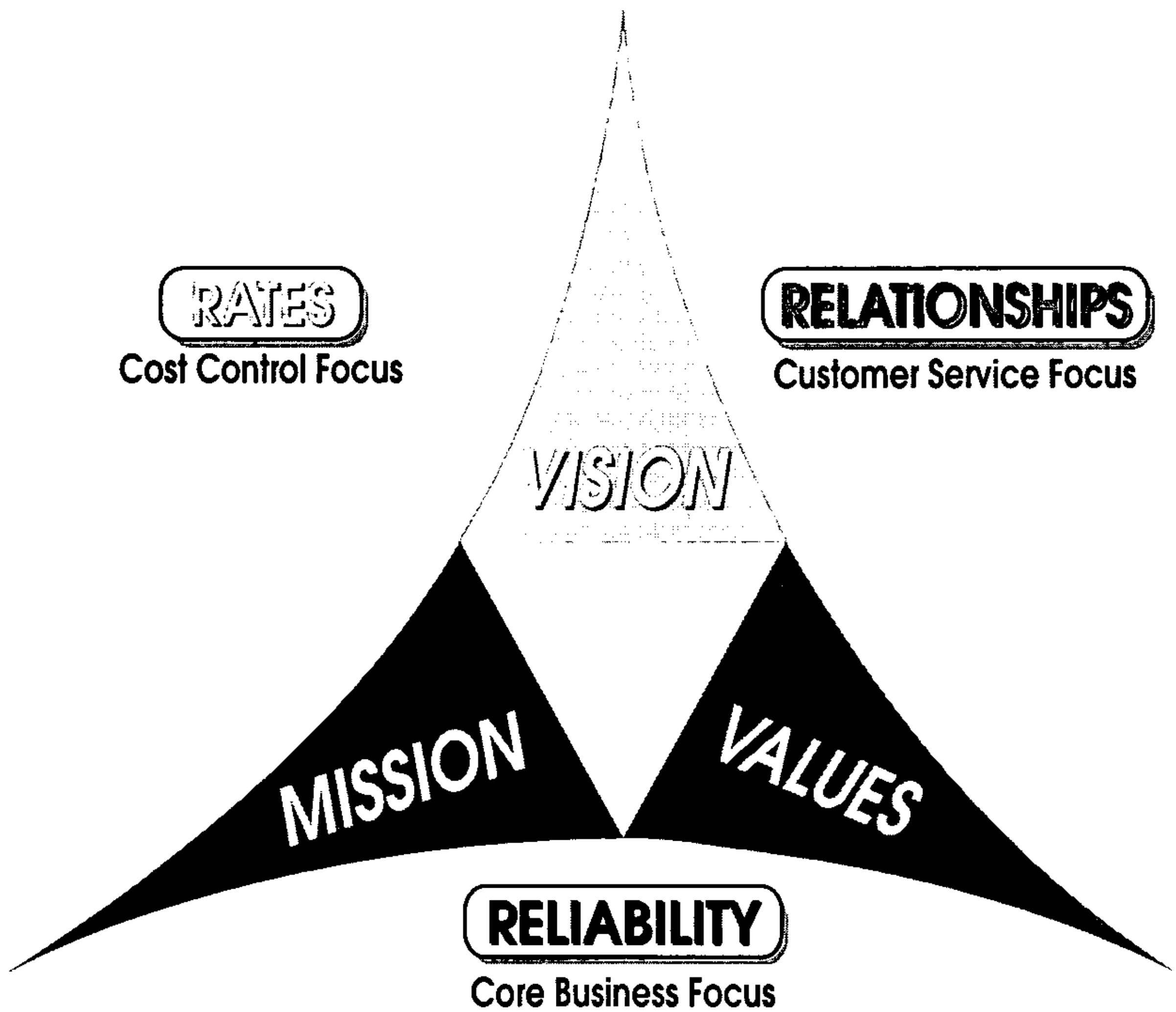
Joseph Lee, III
President and CEO

Energy in motion

Power progressing toward service excellence

Like the ever-flowing Mississippi River that races alongside the riverbanks bordering Shelby County, Memphis Light, Gas and Water is a constant, dynamic force in the Memphis community. Twenty-four hours a day, seven days a week, MLGW employees are at work in the community to ensure the utility's 420,000-plus customers receive a safe, uninterrupted supply of electricity, natural gas and water.

Everything we do reflects our vision to be the best utility for our customers. Our vision is being met through our business strategy that emphasizes cost control, customer service and core business functions and is exemplified through three simple areas: relationships, rates and reliability.



Relationships

In our quest to achieve our vision, we realize we cannot stand idle – or alone. Our success in meeting our community's needs depends on the cooperation of all of our stakeholders. In short, we must actively reach out to those who affect or are affected by our operations and garner their support to enhance our services. In the past year, we have invested much time in forging enduring relationships of trust and respect with our customers and other stakeholder groups.

Sparking a spirit of collaboration with our stakeholders

On a regulatory level, Mr. Lee has vigorously participated in industry organizations including the American Public Power Association (APPA) and the Tennessee Valley Public Power Association (TVPPA), just to name a couple. He also serves on the boards of the Large Public Power Council (LPPC), the National Petroleum Council (NPC) and the American Gas Association (AGA). While attending one of AGA's board meetings in Washington, D.C. last May, Mr. Lee also participated in a forum on "Natural Gas: Balancing Supply, Demand and the Environment," covered by media icons such as Chris Matthews of MSNBC's "Hardball." As the Tennessee Valley Authority's largest electric customer, we continue to seek representation on the organization's board to ensure that the needs of our community are fully considered in the decision-making process.

On a local level, we have sought the support of government officials in the Greater Memphis area through frequent meetings in which we provide updates of MLGW's progress and discuss plans to foster the economic health and social welfare of our community. In these interactions, we look for ways to build mutually beneficial relationships. In 2005 for example, we engaged in initiatives with the City of Memphis to reduce operating costs through jointly purchasing fuel, employee uniforms and shop towels in bulk. Moving forward, we will continue to seek new and innovative ways to save money for the benefit of our customers.

In an effort to keep our customers better informed, we added another venue to our existing communications regimen by launching a half-hour TV show on the Library Channel called "Memphis Energized." The show addresses a plethora of utility-related issues affecting our customers, from reports about rising energy prices to demonstrations of energy-saving home improvement techniques, as well as community service projects performed by MLGW.

But communication is not just a one-way street. With our customers at the forefront of our activities, we want to make sure they can reach us quickly and at a time that is convenient for them. With this in mind, we expanded the hours at our Customer Care Center (CCC) in May by one and one-half hours during the week so that the 100,000 callers who make service or billing requests each month through the Center would be addressed in a more timely fashion and able to reach us in the evening. As a result, our average customer hold time over the course of the year dropped to less than 30 seconds.

Expending energy to heal the afflicted

As MLGW customers themselves, the utility's employees feel a unique commitment to their fellow citizens that translates into tremendous contributions beyond power provision. Their concern for the downtrodden and those afflicted with illnesses or other debilitating challenges spurred them toward countless acts of generosity in 2005 as follows:

- Our employees walked their way to contributions of nearly $1,000 in the March of Dimes WalkAmerica event and $20,698 in the American Heart Association's annual Heart Walk.
- In April, nearly 50 volunteers served as line judges, scorekeepers and performed many other duties to ensure that special needs kids were champions for the day during the 17th Annual MLGW/IBEW Special Olympics Sportsfest.
- In a longstanding tradition to support the local blood supply, MLGW employees filled the Lifeblood bank with 615 units of blood and infused the community with another life-sustaining substance as they collected and donated $13,444.40 in cash and 314,323 points worth of food to The Food Bank during its Operation Feed the Need campaign.
- MLGW employees raised more than $20,000 for Junior Achievement during MLGW's annual Bowl-A-Thon.
- In December, our employees braved the cold and expanded their Christmas gift-giving by raising $278 and providing gifts to nearly 100 less-fortunate children and seniors through the Salvation Army's Christmas Kettle and Adopt-An-Angel programs.
- This spirit of giving reached a climax in December as MLGW presented a check to United Way for $771,082.14 generated from the donations and fundraising efforts of our employees. In a continuing trend of surpassing its corporate donations from each preceding year, MLGW remains the largest per capita contributor in the region.

MLGW also provided 370 participants with budgeting education, energy-conservation information and personalized repayment plans in 2005 with our On Track program. The program helps customers with limited incomes to manage debt and pay off their bills over a period of time.

Charitable giving is just one of many ways MLGW reaches out to its fellow-citizens. For 21 years, MLGW employees have sacrificed their free time to weatherize and build wheelchair ramps for the homes of the elderly and impoverished through the utility's Project MAX program. Anticipating unprecedented increases in winter utility costs due to rising natural gas prices, 140 MLGW volunteers worked relentlessly to make energy-saving improvements to as many homes as possible, ultimately helping 125 customers.

MLGW strives to improve the quality of life for local residents. One way we try to achieve this is through our annual Neighborhood Leaders Conference – a public event designed to give neighborhood leaders the knowledge and social tools to improve the quality of their neighborhoods. A record total of 185 community leaders attended the conference in August, expanding the number of neighborhoods benefiting from the program and contributing to the quality of life in the community.

Exerting our power to drive community prosperity

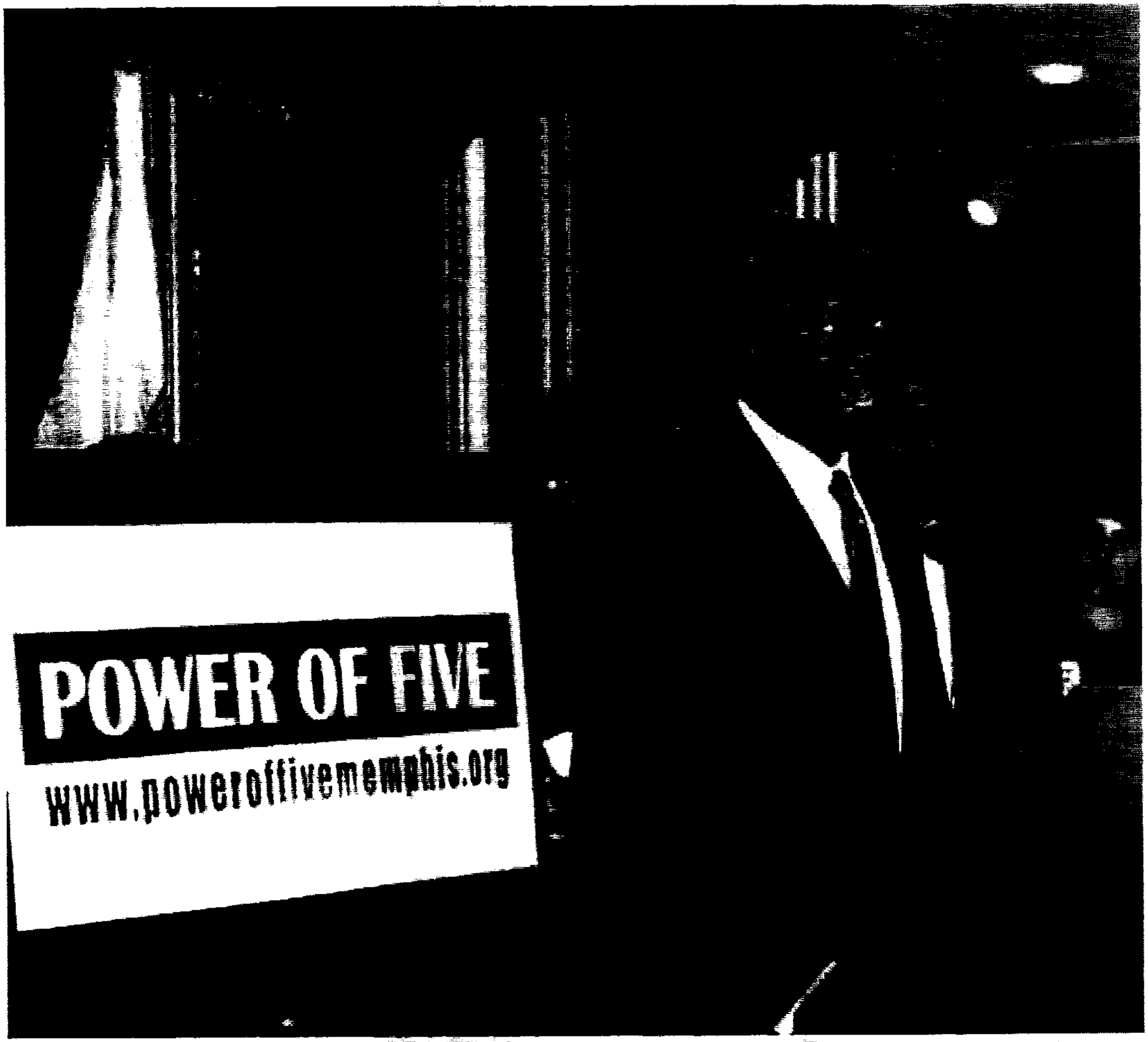
Demonstrating our philosophy that true community enhancement requires the participation and success of all its inhabitants, MLGW sponsors many programs to facilitate growth in key aspects of the community. For instance, MLGW established the Community Advisory Council (CAC) as a means of obtaining vital input about our services from local leaders who are in touch with the pulse of the community. The CAC is comprised of a diverse group of community and civic leaders who meet with us periodically in a focus group setting to share their perspective on MLGW's performance regarding customer service, communications and operations. As a result of these meetings in 2005, we recently adopted an action plan that is currently being implemented. Among faith-based groups, MLGW sponsors an annual event called "The Business of Being a Church" seminar. In October, many local ministers and administrative personnel from their congregations attended the event to learn about community resources and business growth strategies to strengthen their own religious outreach efforts.

In an effort to bolster the success of minority, women- and small, local-owned businesses, MLGW also seeks to do business with these enterprises through its Supplier Diversity program. In 2005, MLGW spent $20,848,701 for the contracted or subcontracted services of such companies, representing 20 percent of the utility's procurement expenditures and resulting in an investment surpassing $180 million dollars since the program's inception in 1997.

On a broader scale, MLGW has a longstanding partnership with the Memphis Regional Chamber to foster the expansion of local commercial and industrial businesses and the relocation of external enterprises to the Memphis community. In fact, MLGW is the largest contributor to the Chamber's economic development program. As a partner in the city's growth initiatives, MLGW offers many resources that can be conveniently viewed online at www.mlgw.com by businesses considering expansion or relocation.

MLGW's economic development staff works in offices housed at the Chamber. This close relationship helped facilitate the relocation of 23 major companies to Memphis and plans for the expansions of 107 existing businesses during 2005, creating 7,755 new jobs and generating $840 million in capital investment. Included in these victories is International Paper's announcement in August that it will relocate its global headquarters to Memphis. The move will not only bring another Fortune 500 company to Memphis, but it will also create another large utility customer for MLGW. As a result of these and numerous other efforts, Industrialinfo.com ranked Shelby County in a tie for 10th place with 31 industrial projects worth nearly $700 million among more than 3,000 counties.

Rates



While utility services are basic needs that many people take for granted, the resulting bills for these services are the unavoidable by-products often contemplated by budget-conscious customers. With this in mind, MLGW has employed strategic cost-containment measures and efficient resource management plans that have enabled us to continue providing our three services at among the lowest costs in the nation. Despite our efforts, outside factors beyond our control have profoundly impacted our customers' utility costs.

Waging proactive efforts to contain utility costs

Over 80 cents of every dollar that MLGW collects from its customers goes to pay for wholesale electricity and natural gas. Rising energy costs were of major significance in 2005. In fact, the single largest factor affecting costs has been the nationwide trend of rising natural gas prices in recent years. With the continued volatility in the natural gas market, our customers have experienced progressive and unprecedented spikes in this commodity, translating into extreme winter utility costs for many in the community. Also, recent rate increases imposed by TVA, our electric power supplier, have also impacted the electric costs we must pass on to customers. In October 2005, TVA implemented a 7.5 percent rate increase soon followed by a 9.95 percent increase in April 2006.

To help customers minimize their utility costs, MLGW launched a communications campaign in October urging them to prepare for the approaching winter season. For the next several months, we worked diligently to inform our customers about predictions of higher winter heating costs. We repeatedly offered ideas for energy-saving tips and home improvements through every means available including MLGW's website and bill insert, and local media outlets for which we often conducted live interviews on radio and TV.

To reduce the price risk inherent in the purchase of natural gas, MLGW also continued the practice of fixing the price of portions of gas in advance by purchasing futures, options and swaps. Some portions are purchased a year and a half in advance and the rest throughout the course of the year. This prudent and disciplined natural gas buying strategy yielded a customer benefit of nearly $30 million during the 2005-2006 winter season.

Generating utility aid for the less fortunate

Acknowledging the potential hardship facing our less-fortunate customers during the winter, MLGW launched many initiatives to raise funds for winter utility assistance. Learning that emergency assistance provided to Hurricane Katrina victims had depleted the resources of many local charities, MLGW and the City of Memphis introduced an initiative called "The Power of Five" to restore some of these vital resources. As a result of our aggressive fundraising efforts, employees, fellow citizens and local businesses contributed $370,000 which was distributed among the five targeted organizations: the Metropolitan Inter-Faith Association, the Salvation Army, the American Red Cross, The Memphis Food Bank and Associated Catholic Charities.

In addition to the Power of Five, MLGW actively solicited funds for its Plus-1 Utility Assistance program that is administered by MIFA. By encouraging employees and customers to add $1 or more to their monthly utility bills, MLGW generated $37,506.25 in 2005 for Plus-1 recipients who have benefited from the cumulative

Jackie Royston, an MLGW energy technician, speaks to a group of senior citizens about practical tips for lowering home energy costs.

donations of more than $5 million since the program's inception in the mid-'80s. During the Christmas season, MLGW launched a new utility assistance program called "Gift of Comfort," which provides a means for individuals to make a payment toward a customer's utility bill as a gift. By the year's end, $7,012 had been paid on customers' accounts by charitable "Gift of Comfort" participants, and another $1,250 had been paid during the first quarter of 2006.

Escalating energy costs have even prompted MLGW, along with utilities nationwide, to seek support on a federal level. As part of a concerted nationwide effort, Mr. Lee and other top MLGW executives, and their industry counterparts, spent countless hours lobbying in Washington, D.C. in 2005 for more federal funds to be funneled into the Low Income Home Energy Assistance Program (LIHEAP). As a result, the LIHEAP program received an additional $2 billion for distribution among communities across the country. Such efforts, along with our attempts to gain representation for West Tennessee on the TVA Board, illustrate just a couple of many endeavors we have undertaken to meet the needs of our community.

Controlling rates through prudent management

MLGW announced in December that its budget for 2006 had been approved without the need for any rate increases for MLGW operations. This was good news for customers and a testament to MLGW's efforts to control costs, but it also rendered a 2006 budget with features that further bolster the utility's stability and service reliability including reducing long-term debt by $79.6 million and spending 26 percent of the electric, gas and water capital budget on reliability-related projects.

Despite the impact of external forces, MLGW is continuing to maintain rate stability through exceptional fiscal and operational management, and is making appropriate business decisions to defer a rate increase as far into the future as possible.

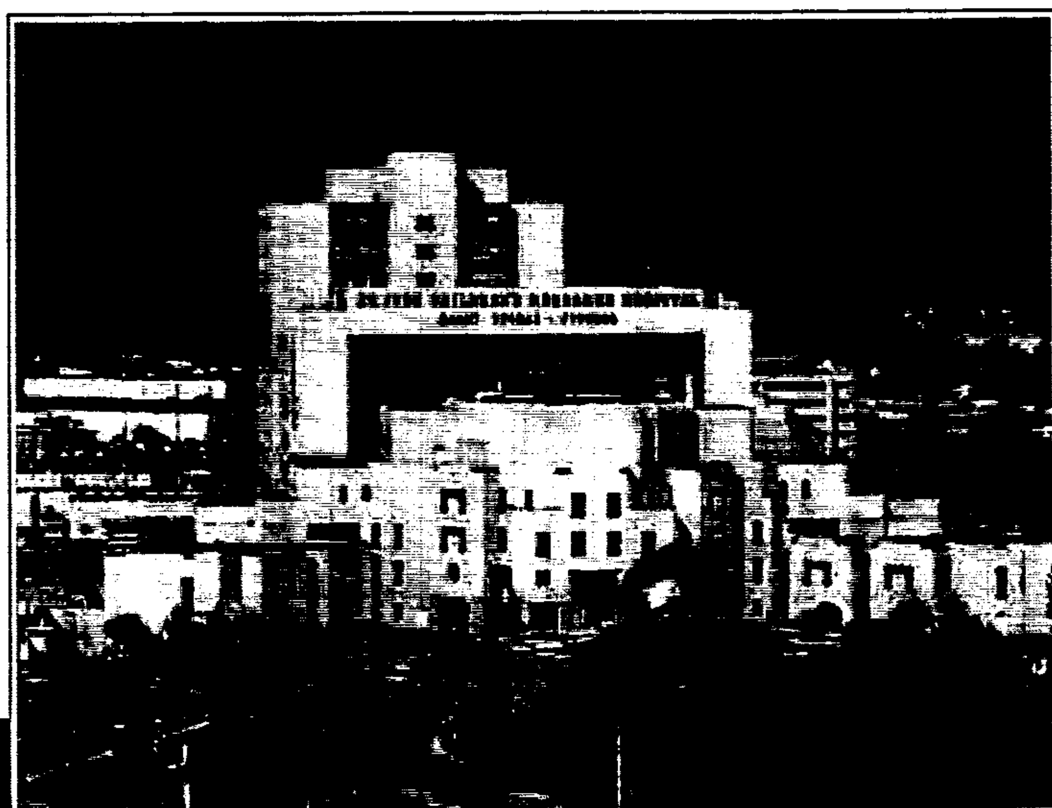
Reliability

We understand the vital role that electricity, natural gas and water play in the daily lives of our customers. For some, the continuous flow of these resources is merely a matter of convenience. But for others, as in the case of critical care facilities such as hospitals and nursing homes, utility services are life-sustaining necessities. In either case, MLGW is dedicated to properly maintaining its infrastrucute for current utility needs, as well as responding to growth through facility expansion.

Bolstering energy for sustained community growth

Rising to the utility needs of booming growth in downtown Memphis, MLGW built an additional substation (substation #76) in 2005 – the first network substation to be built in 50 years. The new facility is providing for the increased power demands from customers it serves. The largest benefactor of this project is the St. Jude Children's Research Hospital campus. Thanks to MLGW's foresight in determining future power needs, St. Jude is continuing to receive ample power to sustain its world-renowned work in finding cures for childhood illnesses. Additional circuits are also being added in 2006 to better support other customers in the area.

To keep pace with the growing power needs in Southeast Memphis, MLGW built another substation (substation #9). The $2.65 million facility was constructed as a temporary means to relieve circuits from neighboring substations and supply more than 6,000 customers in the area with electricity. The decision to build a temporary facility resulted in a cost savings of more than $4 million.

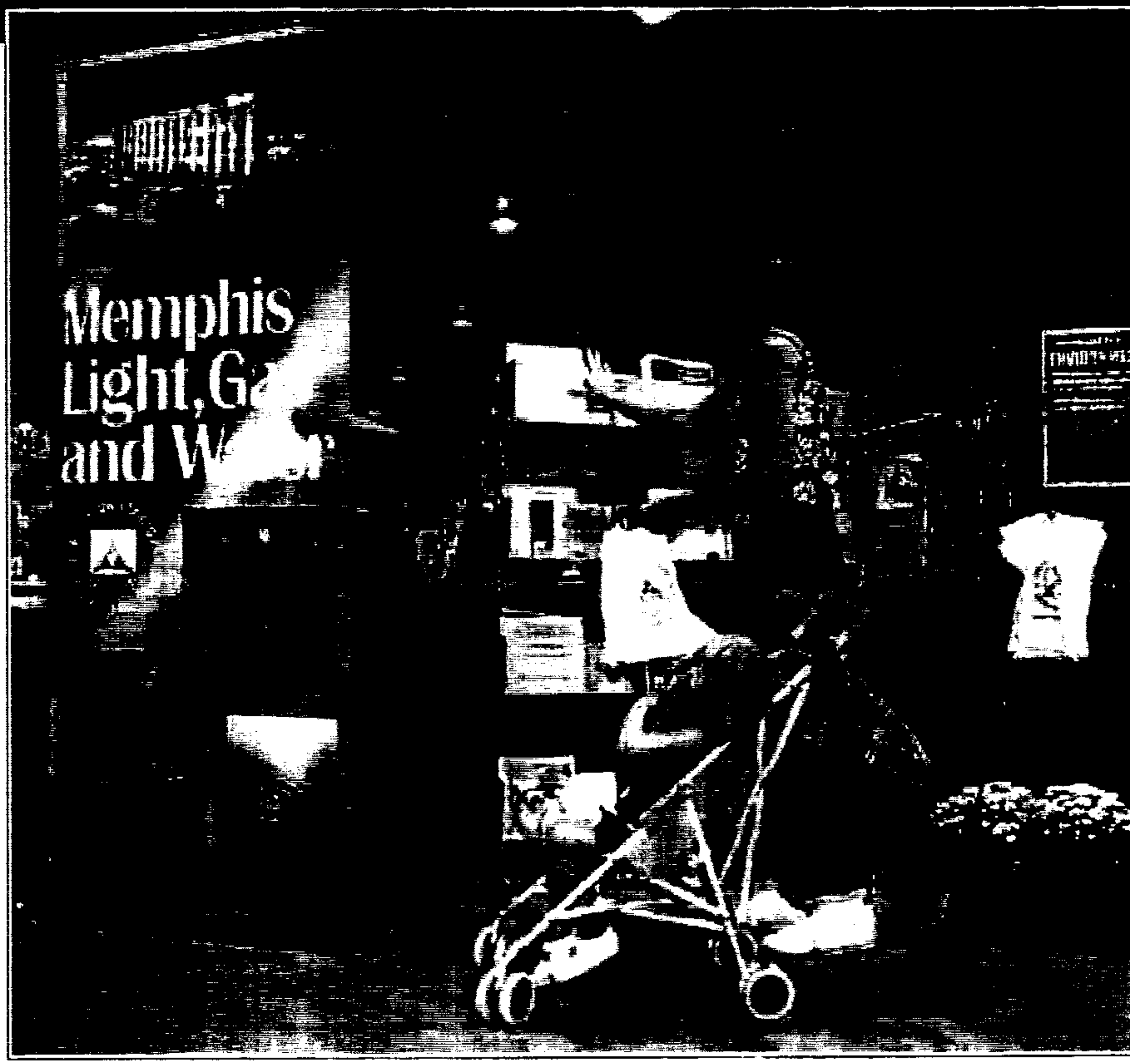


Enhancing our Emergency Response Plan to strengthen service

While 2005 was a busy year for MLGW on the construction front, it was also a year of tremendous introspection and enhancements to its emergency response procedures. In February, our Electric Crisis Team took proactive measures to enhance our Emergency Response Plan prior to the approaching spring storm season. Among the many changes, the emergency response teams were reorganized according to functional makeup, rather than by degree of expertise, to help activate a quicker and better-coordinated response effort. Realizing that radio is the communications lifeline for most customers during a power outage, we made arrangements with a local non-commercial radio station, WUMR-FM 91.7, to broadcast vital, uninterrupted information in emergency situations. MLGW also evaluated ways to better coordinate our response plan with that of the city and county governments, and we expanded our plan to address issues such as homeland security and dedicated resources. Furthermore, we adjusted our response priorities to restore power to crucial customers such as hospitals, and water and wastewater facilities more quickly and effectively.

Little did we know that such improvements would be tested in August when our community suffered 40 mph winds and driving rain caused by the remnants of inland-moving Hurricane Katrina. Anticipating the arrival of the storm, MLGW activated its Emergency Response Plan the weekend prior, placing crews on standby for their rapid deployment and mobilizing all available resources. As 74,000 customers sat without power in the storm's wake, MLGW crews worked 16-hour shifts around the clock to clear debris and reconstruct downed poles and power lines. In just three days, power was restored to all customers. During the restoration efforts, MLGW held frequent press conferences, escorted media around work sites and provided multiple daily updates via phone, e-mail and our website to keep our customers abreast of our progress. Although we clocked extraordinary response time, we continue to review and revise our Emergency Response Plan in an effort to reduce the burden widespread outages may place on our customers in the future.

The integrity of our utility structures was also greatly tested in 2005, not only with the passage of the typical summer thunderstorms, but also through seismic activity as an earthquake rumbled through town in February. While the quake was strong enough to be felt by many citizens, it did not compromise the strength or operability of our well-constructed power facilities. Immediately following the quake, MLGW inspected all substations, transmission lines, LNG plants and water pumping stations and performed random inspections of gas meters in high rise buildings – all of which revealed no electric outages, gas leaks or water main breaks. To further ensure the safety and wellbeing of our customers and infrastructure, we stayed abreast of the situation by maintaining close contact with the University of Memphis Earthquake Center, TVA and the Emergency Management Agency.



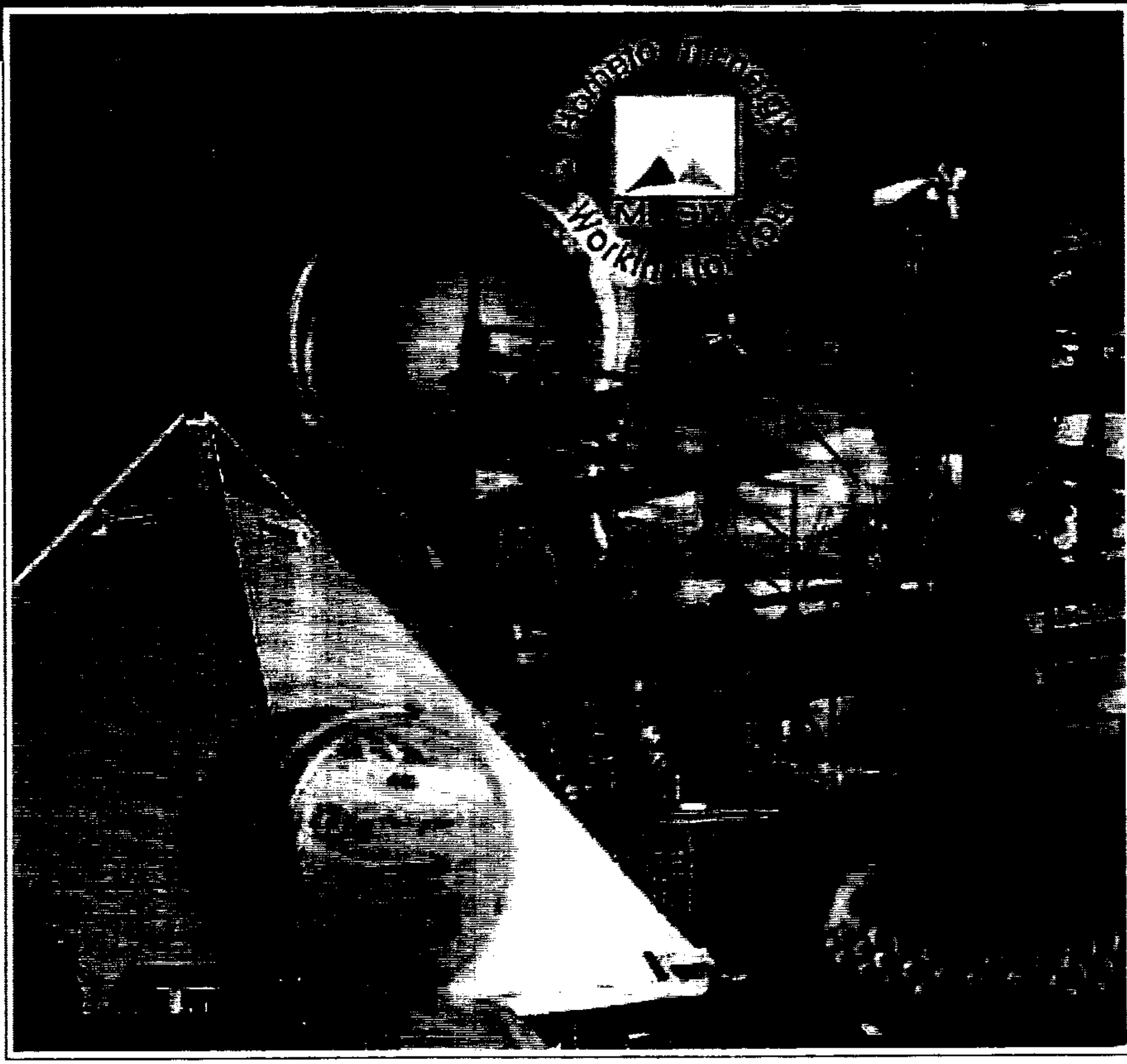
Environmental Stewardship

Enlightening the community on environmental sensitivity

As a consumer of natural resources, MLGW respects the environment and is committed to fostering programs that preserve and protect the earth's valuable assets. One striking example of MLGW's leadership in this realm can be seen in the utility's EcoBUILD program. Eager to encourage the use of environmentally friendly and energy-efficient home construction materials, MLGW established the program in 2003 in the wake of a recent housing boom and escalating energy prices. The program incorporates energy and environmental measures into the design, site orientation, construction and operation of homes, rendering structures that use 30 percent less energy than those built to standard local practices. To date, 98 homes have been certified through EcoBUILD, with another 20 under construction. Most new construction in 2006 will occur in Uptown, where a unique commitment between developers and builders will ultimately produce some 400 single-family homes certified through EcoBUILD. The Memphis Housing Authority also adopted EcoBUILD for construction of a 25-home subdivision this year. MLGW showcased this innovative program at the Vesta Home Expo sponsored by the Memphis Area Home Builders Association and ran two print advertising campaigns to create homebuyer awareness.

MLGW is also encouraging the use of renewable energy sources such as wind, solar and methane gas through TVA's "Green Power" program. In April, MLGW began offering its customers the opportunity to make the "Green Power Switch," enabling them to invest in "blocks" of renewable power for $4 each. With the proceeds, TVA produces the amount of green power purchased and places it on the TVA power grid which helps offset electricity produced by coal and natural gas plants. TVA dedicated its Memphis solar site, at the BRIDGES Center, in April as part of the program launch. The generation system is designed to produce 45,000 kilowatt-hours annually – or enough green power to meet the annual needs of three average Memphis households. Customers can track the system's daily solar generation online at www.greenpowerswitch.com. In August, just five months after program launch, MLGW customers were purchasing 2,156 blocks of green power per month, elevating MLGW to third highest position (based on blocks sold) among 85 participating TVA distributors. By the end of 2005, more than 300 MLGW customers had enrolled.

This home, in Uptown Memphis, was built under MLGW's EcoBUILD program. The home is designed and built to use 30% less energy than one built to typical local construction practices. MLGW inspects and conducts performance testing on each home as part of the EcoBUILD certification process.



Power on the horizon

Building on our strengths to sustain power for the future

The many successes of 2005 further strengthened MLGW's foundation enabling us to pursue endeavors in the future that will enhance our service and our ability to invest in our community on many other fronts. Because of MLGW's secure financial status, it continues to hold the highest bond ratings from two of the most prestigious bond rating agencies: AAA from Standard and Poor's and Aaa from Moody's Investors Service. Our continued emphasis on relationships, reliability and rates, combined with the effective management of our resources, will help ensure power stability for our customers and generate a brighter future for our community.

MEMPHIS LIGHT, GAS, AND WATER DIVISION

To The Board of Commissioners and Valued Stakeholders:

We are pleased to submit the Annual Report of Memphis Light, Gas and Water Division (MLGW) for the fiscal year ended December 31, 2005, as required by the Charter Provisions of the City of Memphis (City) creating the Memphis Light, Gas and Water Division. This report has been prepared in conformity with generally accepted accounting principles (GAAP) under the rules and regulations of the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB).

Responsibility for the accuracy and presentation of the information provided is the full responsibility of the management of MLGW. Disclosures necessary to assist the reader in the understanding of the financial statements have been included.

MLGW's financial statements have been audited by Watkins Uiberall, PLLC and Banks, Finley, White and Company, licensed certified public accountants. The goal of the independent audit was to provide reasonable assurance that the financial statements of MLGW for the fiscal year ended December 31, 2005 are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by Management; and evaluating the overall financial statement presentation. The independent auditors concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that MLGW's financial statements for the fiscal year ended December 31, 2005, are fairly presented in conformity with generally accepted accounting principles. The independent auditor's report is presented as the first component of the financial section of the report.

Generally accepted accounting principles require that Management provide a narrative introduction, overview and analysis to accompany the basic financial statements in the form of a Management Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. MLGW's MD&A can be found immediately following the report of the independent auditors.

Profile of the Government--MLGW was created by an amendment to the City Charter by Chapter 381 of the Private Acts of the General Assembly of Tennessee, adopted March 9, 1939, as amended (the "Private Acts"). MLGW is an enterprise fund of the City of Memphis and operates three separate utilities, as divisions, providing electricity and gas in the City and Shelby County. Water service is provided by MLGW in the City and, together with other municipal systems, in Shelby County. Each division operates as a separate entity for accounting and financial purposes in accordance with the Private Acts. For economic reasons, activities common to all three divisions are administered jointly and costs are prorated monthly among the divisions. A 1981 amendment to the City Charter permits the establishment of additional divisions to provide other energy services.

MLGW controls the administration of its activities and business affairs. It operates independently, manages its own finances and is responsible for obligations incurred in such operations, including indebtedness payable from operations of the Division. MLGW must have the approval of the City Council before incurring certain obligations. The annual budget is subject to approval by the City Council.

MLGW is managed by a Board, which consists of five members nominated by the Mayor and approved by the City Council. Under the Private Acts, the Board is responsible for the oversight of MLGW's management. The members of the Board serve staggered terms of three years each. The Board elects annually a Chairman and a Vice Chairman whose terms begin June 1 of each year.

The daily operation of MLGW is managed by the President and Chief Executive Officer, who is nominated for a five-year term by the Mayor and approved by the City Council. Under the Private Acts, the President generally supervises the operation of MLGW and all of its officers and employees.

Local Economy--(Information provided by Memphis Regional Chamber Website)--Memphis, Tennessee, located in the southwest corner of Tennessee on the Mississippi River, is the nation's 17th largest city. The 2000 Census reported a Shelby County population of 897,472, of which, all households utilize some or all of MLGW's services. The Memphis Metro area provides a diverse range of employers which contribute to the overall stability of the area and to MLGW's customer base. As of 2005, government employment (15%) comprised the largest percentage of non-farm employment, followed by professional and business services and educational and health services (each adding 12% respectively); retail trade and leisure and hospitality (11% each); and transportation, warehousing and utilities (10%) rounding out sectors of 10 percent or greater. Forty-seven major companies relocated to Memphis and 270 existing businesses announced major expansion projects during 2004 and 2005, including International Paper, which announced the relocation of its global headquarters in Stamford, Connecticut to Memphis, Tennessee in August 2005. Due to such vigorous activity, Memphis has been ranked a top 10 location for business investment for four consecutive years in major national economic development rankings by the following entities: www.Industrialinfo.com in 2004 and 2005, *Expansion Management* magazine in 2003 and by *Site Selection* Magazine in 2002.

Memphis is known for its expertise and growth in the healthcare industry, and MLGW has served a vital role in expanding its power infrastructure to meet the needs of the growing medical community. When St. Jude Children's Research Hospital, a world-renowned center for research and treatment of catastrophic diseases in children, announced a billion-dollar expansion, MLGW responded by constructing a new substation which was completed in 2005. The substation is supporting the growth of the St. Jude facility and surrounding area and will also energize a state-of-the-art biotechnology research park that is under construction. Upon completion, the biotech center is expected to add to the existing $5 billion plus contribution that the healthcare industry generates for Shelby County's economy.

National Economy—The continued increase in energy prices, resulting from volatility in the natural gas market and a series of rate increases imposed by MLGW's wholesale electric provider, Tennessee Valley Authority, continues to put financial pressure on MLGW customers. The Tennessee Valley Authority increased its wholesale electric rates 7.5 percent on September 26, 2005 and 9.95 percent on March 27, 2006, and is considering the implementation of a fuel cost adjustment system to compensate for fluctuations in the price of fuel used in the generation of electric power. MLGW continues to implement strategies and plans to help shape the direction of federal and state electric restructuring to ensure continued access to reliable, low-cost electricity supplies.

Wholesale natural gas prices have tripled over a ten-year period and continue to rise. The Gas Division purchases its gas requirements in the open market from a variety of producers and marketers. The cost of the wholesale gas supply is controlled using combinations of spot market purchases, short-term contracts, long-term contracts, hedging, and management of storage and LNG supplies.

Financial Policies and Major Initiatives--MLGW maintains a comprehensive cash flow model which assesses the growth of the separate divisions and projects future rate increase requirements. MLGW also incorporates a 10-year capital financial plan in its budgeting process. MLGW's Electric, Gas and Water Engineering Departments develop detailed master plans which are then correlated with the financial plan for their respective systems. The 10-year capital plans are updated periodically during the year in order to provide the most current cash flow projections.

Among the three divisions, MLGW averages more than $100 million in capital expenditures throughout the year. In preparation for residential and industrial growth, major electric projects planned for the 10-year period include construction of three substations and one switching station in South Collierville and East Shelby County. Gas division plans include installation of approximately 17 miles of transmission main, 200 miles of distribution main, and 8 regulator stations over the next 10 years. The Water division plans for the continuation of seismic retrofit to pumping facilities and the construction of an additional plant in the projected growth area of Northeast Shelby County.

MLGW has a five-year Strategic Plan that is committed to cost control, core business, and customer/shareholder focus. MLGW works with the City of Memphis, TVA, and other stakeholders when possible to streamline costs through collaborative efforts.

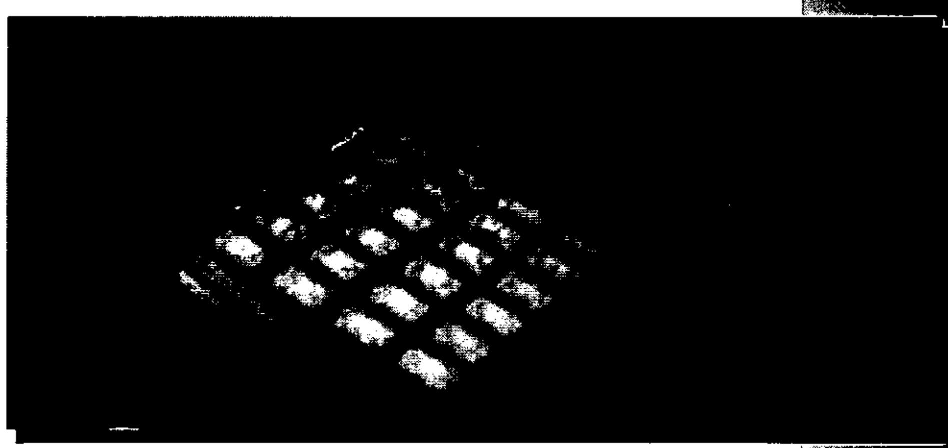
Acknowledgements--The preparation of this report was made possible by the overall dedication of MLGW's Finance Division. We would like to express our appreciation to all members of the Finance Division who assisted and contributed to the preparation of this report. Special recognition is extended to Watkins Uiberall, PLLC and Banks, Finley, White and Company for their efficient and timely completion of this year's audit.

Respectfully submitted

Joseph Lee, III
President and CEO

John McCullough
Vice President, CFO and Secretary-Treasurer

Financial Section Contents



WATKINS UIBERALL

Watkins Uiberall, PLLC
Certified Public Accountants & Financial Advisors
Independent Member of BKR International

BANKS, FINLEY, WHITE & CO.
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners and Management
Memphis Light, Gas and Water Division
Memphis, Tennessee

We have audited the accompanying financial statements of the Electric, Gas and Water divisions (the Divisions) of Memphis Light, Gas and Water Division, an enterprise fund of the City of Memphis, Tennessee as of and for the years ended December 31, 2005 and 2004, as listed in the table of contents. These financial statements are the responsibility of the Divisions' management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in Note 1, the financial statements of the Electric, Gas and Water divisions of Memphis Light, Gas and Water Division are intended to present the financial position and changes in financial position and cash flows of only that portion of the Memphis Light, Gas and Water Division that is attributable to the transactions of the Electric, Gas and Water divisions. They do not purport to, and do not present fairly the financial position of the Memphis Light, Gas and Water Division as of December 31, 2005 and 2004, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Electric, Gas and Water Divisions of Memphis Light, Gas and Water Division as of December 31, 2005 and 2004, and the changes in their financial position and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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In accordance with *Government Auditing Standards*, we have also issued our report dated April 7, 2006 on our consideration of the Divisions' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements of each of the Divisions. The introductory section and supplementary information as shown in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supplementary information shown as the Schedule of Additions and Retirements to Utility Plant, Schedule of Deposits and Investments, and Schedule of Long Term Debt, Principal, and Interest Requirements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory section and the supplementary information shown as the Schedule of Current Utility Rates and Schedule of Insurance have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Watkins Uiberall, PLLC
Banks, Finley, White & Co.

Memphis, Tennessee
April 7, 2006

This discussion and analysis is intended to be an introduction to the financial statements and notes that follow this section and should be read in conjunction with them.

Highlights

- Rising energy costs were of major significance in 2005. Nationwide, wholesale electricity and natural gas prices exhibited sizable increases. Memphis Light, Gas and Water Division's ("MLGW") wholesale electric supplier, the Tennessee Valley Authority ("TVA"), approved a 7.5% wholesale electric rate increase, effective with retail meters read on or after September 26, 2005. TVA management cited rising fuel costs, purchased power costs, and other expenses as reasons for this rate increase. MLGW is required by the power contract with TVA to pass wholesale increases in power costs to retail customers. The average residential customer's electric bill increased $4.89 per month due to this rate increase. TVA also approved a 9.95% wholesale electric rate increase, effective March 27, 2006. This rate increase will raise the average residential bill by about $6.75 per month.

- Wholesale natural gas prices for MLGW increased an average of 30.6% in 2005, going from $7.48 per MCF (MCF = one thousand cubic feet) to $9.76 per MCF. Variations in wholesale natural gas prices are passed through to retail customers on a monthly basis via a purchased gas adjustment to the retail rates. In addition, MLGW implemented a 6.1% rate increase for its customers effective with meters read on or after December 30, 2004. This rate increase was enacted to generate additional funds to cover increases in general operating expenses, excluding the cost of wholesale natural gas. This represented the first rate increase for MLGW's general operating expenses since April 1, 1994. The average residential customer's natural gas bill increased $4.37 per month due to this increase.

- Leaders for MLGW and IBEW Local 1288 reached a four-year agreement that will give the bargaining unit employees a 3% raise each year in 2006 and 2007, with 2% raises in 2008 and 2009. The new agreement is part of a cost containment plan designed to give the utility greater financial flexibility in order to maintain low, stable rates while providing excellent customer service and fair compensation to its employees.

- A new substation was built to serve the increased power load at St. Jude Children's Research Hospital, as well as the growing residential and commercial development in the downtown area. In addition, a temporary substation in east Memphis was energized to increase reliability to the area.

Bond Ratings Reaffirmed

In 2005, MLGW's Water Division AAA bond rating was reaffirmed from Standard & Poor's after an annual review of financial management practices. The Water Division holds the highest possible bond ratings--Aaa from Moody's Investors Service as well as the AAA from Standard & Poor's. The Electric Division's AA rating was also reaffirmed (see Figure 1 for all bond ratings). The Gas Division currently has no debt. In issuing bond ratings, agencies typically look at financial operations, management practices, rates, and debt ratios. Higher ratings result in the ability to issue and refinance debt at lower interest costs than companies with lower ratings.

The following tables show MLGW bond ratings and debt administration for the Electric and Water Divisions in 2005:

Figure 1: Bond Ratings and Debt Administration for Electric and Water Divisions

MLGW Bond Ratings			
	S&P	**Moody's**	**Fitch**
Electric			
2002 Revenue Bonds	AA	Aa3	AA
2003A and 2003B	AA	Aa3	AA
Water	AAA	Aaa	

Debt Administration *(In Thousands)*		
	Outstanding Balance	**Coverage**
Electric	$1,283,225	1.98
Water	$19,710	2.99

Overview of the Financial Statements

The financial statements of MLGW herein are comprised of the Balance Sheets; the Statements of Revenues, Expenses, and Changes in Net Assets; the Statements of Cash Flows; and the accompanying Notes. This report also contains required supplementary information in addition to the basic financial statements.

MLGW is an Enterprise Fund of the City of Memphis, Tennessee. MLGW's statements are provided to the City of Memphis and reformatted to conform to the City's format for Enterprise Funds. The City of Memphis incorporates MLGW's statements ending December 31 into its statements ending June 30.

MLGW, the nation's largest three-service municipal utility, accounts separately for its electric, gas and water divisions. Costs are allocated to the three divisions in a manner that ensures results of operations and changes in financial position of each division are presented fairly and consistently from year to year.

Analysis of the Electric Division's Balance Sheet

Condensed financial information comparing the Electric Division's net assets for the past three fiscal years is presented below:

Table 1
Electric Division Condensed Balance Sheet
December 31
(In Thousands)

	2005	2004	FY05 - FY04 Percentage Change	2003	FY04 - FY03 Percentage Change
Current assets (excluding restricted funds)	$ 344,093	$ 296,753	16.0%	$ 295,883	0.3%
Restricted assets	46,306	46,297	0.0%	42,856	8.0%
Other assets	19,479	28,244	-31.0%	34,674	-18.5%
Prepaid power costs - long term	1,249,534	1,332,494	-6.2%	1,413,697	-5.7%
Utility plant	767,147	741,683	3.4%	715,535	3.7%
Total assets	2,426,559	2,445,471	-0.8%	2,502,645	-2.3%
Current liabilities payable from current assets	208,168	202,864	2.6%	230,172	-11.9%
Current liabilities payable from restricted assets	25,359	26,049	-2.6%	20,974	24.2%
Long-term debt	1,305,359	1,395,891	-6.5%	1,483,290	-5.9%
Non-current liabilities	23,356	23,158	0.9%	24,424	-5.2%
Total liabilities	1,562,242	1,647,962	-5.2%	1,758,860	-6.3%
Net assets:					
Invested in utility plant, net of related debt	740,054	710,217	4.2%	679,848	4.5%
Restricted	13,454	12,996	3.5%	13,119	-0.9%
Unrestricted	110,809	74,296	49.1%	50,818	46.2%
Total net assets	$ 864,317	$ 797,509	8.4%	$ 743,785	7.2%

Assets

Total assets for fiscal year 2005 decreased by $18.9 million (-0.8%) compared to fiscal year 2004. Current assets increased by approximately $47.3 million, due in part to higher levels of cash and current accounts receivable resulting from the TVA rate increase in October 2005. Prepaid power costs decreased by $83.0 million, driven largely by amortization (see also Note 10). Total assets for fiscal year 2004 decreased by $57.2 million (-2.3%) compared to fiscal year 2003. The decrease resulted chiefly from an $81.2 million increase in the amortization of prepaid power costs, partially offset by a $26.1 million increase in the Electric Division's utility plant assets.

Capital Assets and Construction Activities

The Electric Division had approximately $767.1 million in utility plant assets net of accumulated depreciation at December 31, 2005, an increase of 3.4% over fiscal year 2004. During 2005, the Electric Division expended $59.3 million on construction activities. Major Electric Division capital projects included: substation and transmission projects ($13.6 million), relocation of facilities to accommodate road improvements ($1.5 million), purchase of transportation and power operated equipment ($3.2 million), purchase of communication equipment ($7.7 million which included an upgrade for radios), street light and leased outdoor lighting installations ($6.4 million), extensions to serve new customers ($17.0 million), purchase of meters and equipment ($2.1 million), purchase of transformers ($3.4 million), and mainframe system replacement project ($2.5 million).

The Electric Division had approximately $741.7 million in utility plant assets net of accumulated depreciation at December 31, 2004, an increase of 3.7% over fiscal year 2003. During 2004, the Electric Division expended $55.9

million on construction activities. Major Electric Division capital projects included: substation projects ($7.3 million), purchase of transportation and communication equipment ($4.7 million), street lighting installations ($6.2 million), extensions to serve new customers ($14.3 million), purchase of meters and equipment ($2.3 million), replacement of feeder cables ($2.1 million), and purchase of transformers ($5.0 million).

Liabilities

Total liabilities decreased by $85.7 million (-5.2%) at December 31, 2005 compared to 2004. The primary decrease was due to the annual payment of long-term debt associated with the prepaid power transaction. Long-term debt decreased by $90.5 million in 2005. This decrease was partly offset by a $4.6 million increase in current liabilities. Total liabilities decreased by $110.9 million from $1.8 billion at December 31, 2003 to $1.6 billion at December 31, 2004. The primary decrease was in prepaid power liabilities; long-term debt decreased by $87.4 million in 2004. In addition, current liabilities payable from current assets decreased 11.9% as a result of the prepaid bond agreement with TVA, which lowers MLGW's purchased power costs by approximately $13.0 million each year for 15 years.

Net Assets

At December 31, 2005, the Electric Division's total net assets (total assets less total liabilities) were $864.3 million, an increase of $66.8 million, or 8.4%, from $797.5 million at December 31, 2004. Over 86% of the net assets were related to utility plant, which include property, plant, and construction work in progress. The Electric Division's total net assets increased by $53.7 million, or 7.2%, at December 31, 2004 compared to 2003.

Analysis of the Electric Division's Statement of Revenues, Expenses, and Changes in Net Assets

Condensed financial information comparing the Electric Division's revenues, expenses, and changes in net assets for the past three fiscal years is presented below:

Table 2
Electric Division
Condensed Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended December 31, 2005, 2004 and 2003
(In Thousands)

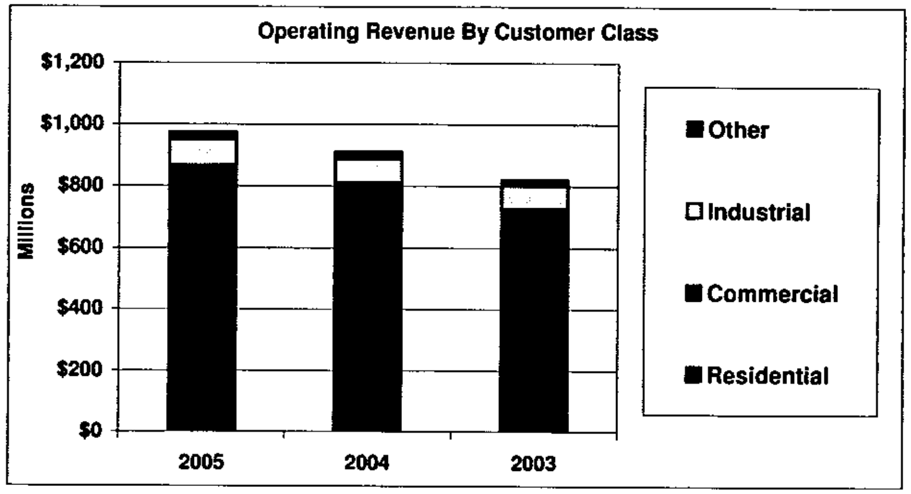
	2005	2004	FY05 - FY04 Percentage Change	2003	FY04 - FY03 Percentage Change
Revenues:					
Operating revenues	$ 995,891	$ 933,934	6.6%	$ 848,430	10.1%
Non-operating revenues	80,991	78,022	3.8%	34,304	127.4%
Total revenues	1,076,882	1,011,956	6.4%	882,734	14.6%
Expenses:					
Depreciation expense	30,971	29,422	5.3%	27,622	6.5%
Purchased power	751,055	707,136	6.2%	669,358	5.6%
Other operating expense	135,373	133,490	1.4%	125,484	6.4%
Non-operating expense	59,422	58,980	0.7%	11,596	408.6%
Total expenses	976,821	929,028	5.1%	834,060	11.4%
Income (loss) before contributions in aid of construction and transfers	100,061	82,928	20.7%	48,674	70.4%
Contributions in aid of construction	18,458	21,216	-13.0%	31,768	-33.2%
Reduction of plant costs recovered through contributions in aid of construction	(18,458)	(21,216)	-13.0%	(31,768)	-33.2%
Transfers to City	(33,253)	(29,204)	13.9%	(27,685)	5.5%
Changes in net assets	66,808	53,724	24.4%	20,989	156.0%
Beginning net assets	797,509	743,785	7.2%	717,026	3.7%
Cumulative effect of change in accounting principle	-	-	0.0%	5,770	-100.0%
Beginning net assets as adjusted	797,509	743,785	7.2%	722,796	2.9%
Ending net assets	$ 864,317	$ 797,509	8.4%	$ 743,785	7.2%

The change in net assets increased 24.4%, or $13.1 million, to $66.8 million at December 31, 2005 from $53.7 million at December 31, 2004. Continued growth in operating revenue over operating expenses contributed to this gain. For 2004, the change in net assets increased 156%, or $32.7 million, from $21.0 million at December 31, 2003. This increase is due primarily to higher operating revenue from the implementation of an MLGW electric rate increase, effective December 30, 2003.

Total revenues were $1.1 billion for the fiscal year 2005, an increase of 6.4% over fiscal year 2004. Operating revenue was up $62.0 million from 2004 to $995.9 million. Electricity sales to customers were up 4.6% in 2005 from 2004, accounting for an additional $51 million in operating revenue. An additional $13.0 million increase in operating revenue is attributable to TVA's wholesale power rate increase in October 2005. Other operating revenues decreased by $2.0 million. Figure 2 shows operating revenue by customer class. Non-operating revenues increased by 3.8% as a result of an increase in investment income. Total revenues were $1.0 billion for the fiscal year 2004, an increase of 14.6% over fiscal year 2003. The increase resulted from both the Electric Division's rate increase in January 2004 and TVA's rate increase in October 2003, which increased operating revenue by $40 and

$45 million, respectively. Furthermore, non-operating revenues increased by $43.7 million, or 127.4%, due to a $43.3 million increase in other income by implementing the prepay credit in the last quarter of 2003.

Figure 2: Electric Division's Operating Revenue



Total expenses were $976.8 million for the fiscal year 2005, an increase of 5.1% over 2004. The majority of the increase was attributable to increased wholesale purchased power costs. Depreciation expense increased due to the use of higher depreciation rates for selected accounts, which resulted from an evaluation completed in 2003 and implemented in 2004. For 2004, total expenses were $929.0 million, an increase of 11.4% over fiscal year 2003. The primary increase was in non-operating expenses due to the prepay power agreement with TVA which resulted in a $46.4 million increase in interest expense on long-term debt. In addition, purchased power costs increased $37.8 million, or 5.6%.

Contributions in aid of construction ("CIAC") were $18.5 million in 2005, a decrease from 2004 of $2.8 million (-13.0 %) as a result of contributions from Federal Emergency Management Agency ("FEMA") received in 2004. CIAC were $21.2 million in 2004, a decrease from 2003 of $10.6 million (-33.2 %). CIAC in 2003 reflected accrual of contributions in aid from FEMA for reimbursement of expenses due to the major windstorm in July 2003.

MLGW's transfer to the City of Memphis is based on the formula provided by the State of Tennessee Municipal Electric System Tax Equivalent Law of 1987. The formula includes a property tax equivalency calculation plus 4% of operating revenue less power costs (three-year average). Transfers to the City represent the Electric Division's in lieu of tax payment of $33.3 million in 2005. This amount represents a 13.9% increase over 2004, with 2004 being 5.5% higher than 2003. Of the $4.0 million increase in 2005, $2.4 million is due to increased net plant and revenues and $1.6 million is due to an increase in tax and equalization rates.

In 2003, MLGW began recording unbilled revenues which changed the timing of revenue recognition from the deferred cost method to the accrued revenue method which is based on when the service is provided. The cumulative effects of the change resulting from years prior to January 1, 2003, increased net assets by $5.8 million.

Analysis of the Gas Division's Balance Sheet

Condensed financial information comparing the Gas Division's net assets for the past three fiscal years is presented below:

Table 3
Gas Division Condensed Balance Sheet
December 31
(In Thousands)

	2005	2004 As Restated	FY05 - FY04 Percentage Change	2003	FY04 - FY03 Percentage Change
Current assets (excluding restricted funds)	$ 201,367	$ 137,595	46.3%	$ 127,854	7.6%
Restricted assets	33,689	35,802	-5.9%	32,444	10.4%
Other assets	16,549	18,262	-9.4%	19,974	-8.6%
Utility plant	324,562	322,743	0.6%	326,757	-1.2%
Total assets	576,167	514,402	12.0%	507,029	1.5%
Current liabilities payable from current assets	152,609	95,368	60.0%	72,117	32.2%
Current liabilities payable from restricted assets	6,447	6,395	0.8%	6,074	5.3%
Non-current liabilities	13,256	14,749	-10.1%	15,904	-7.3%
Total liabilities	172,312	116,512	47.9%	94,095	23.8%
Net assets:					
Invested in utility plant, net of related debt	324,562	322,743	0.6%	326,757	-1.2%
Restricted	24,463	26,573	-7.9%	23,780	11.7%
Unrestricted	54,830	48,574	12.9%	62,397	-22.2%
Total net assets	$ 403,855	$ 397,890	1.5%	$ 412,934	-3.6%

Assets

Total assets for fiscal year 2005 increased by $61.8 million, or 12.0%, compared to fiscal year 2004. This related directly to the $63.8 million increase in current assets, in part the result of an increase in unbilled revenues and higher current accounts receivable due to the rising cost of natural gas. Restricted assets decreased by $2.1 million as a result of a decline in restricted construction funds, offset partly by an increase in futures margin requirement. Also, other assets decreased by $1.7 million due to the decrease in notes receivable, related to a pipeline lease (see Note 3). Total assets for fiscal year 2004 increased by $7.4 million, or 1.5%, compared to fiscal year 2003. The slight increase was due to a 7.6% increase in current assets, largely a result of an increase in unbilled revenue due to higher natural gas prices. Restricted assets increased by $3.4 million as a result of an increase in restricted construction funds, offset partially by a decrease in futures margin requirement. These increases were offset by a $4.0 million decrease in utility plant assets and $1.7 million decrease in other assets due to the decrease in notes receivable.

Capital Assets and Construction Activities

The Gas Division had approximately $324.6 million in utility plant assets net of accumulated depreciation at December 31, 2005, an increase of 0.6% over fiscal year 2004. During 2005, the Gas Division expended $20.0 million on construction activities. Major Gas Division capital projects included: extensions to serve new customers ($4.3 million), cast iron pipe replacement project ($1.0 million), buildings and structures upgrades ($2.6 million), purchase of transportation and power operated equipment ($5.1 million), purchase of furniture and fixtures ($1.5

million), customer information system development project ($1.2 million), and purchase of meters and equipment ($859 thousand).

The Gas Division had approximately $322.7 million in utility plant assets net of accumulated depreciation at December 31, 2004, a 1.2% decrease from fiscal year 2003. During 2004, the Gas Division expended $13.4 million in construction costs. Included in the construction costs were cast iron system retrofits ($1.7 million), purchase transportation, tools and equipment ($1.6 million), improvements to buildings and structures ($1.2 million), and extensions to serve new customers ($3.4 million).

Liabilities

Total liabilities increased by $55.8 million, or 47.9%, at December 31, 2005 compared to 2004. The primary increase was in current liabilities payable from current assets that consisted of a $37 million increase in other accounts payable, accrued expenses, and deferrals and a $24 million increase in purchased gas payable due to the increased wholesale natural gas price. Non-current liabilities decreased by $1.5 million as a result of the recognition of earned interest income related to the pipeline leases. Total liabilities increased by $22.4 million from $94.1 million at December 31, 2003 to $116.5 million at December 31, 2004. Current liabilities payable from current assets increased 32.2% as a result of a $22.6 million increase in purchased gas payable. The increase was offset by an ($-0.8) million decrease in other accounts payable, accrued expenses, and deferrals related to the purchased gas adjustment ("PGA"), gas futures, and storage of gas.

Net Assets

At December 31, 2005, the Gas Division's total net assets (total assets less total liabilities) were $403.9 million, a $6.0 million, or 1.5%, increase from $397.9 million at December 31, 2004. Over 80% of the nets assets were related to utility plant, which include property, plant, and construction work in progress. The Gas Division's total net assets decreased by $15.0 million (-3.6%) at December 31, 2004 compared to 2003.

Analysis of the Gas Division's Statement of Revenues, Expenses, and Changes in Net Assets

Condensed financial information comparing the Gas Division's revenues, expenses, and changes in net assets for the past three fiscal years is presented below:

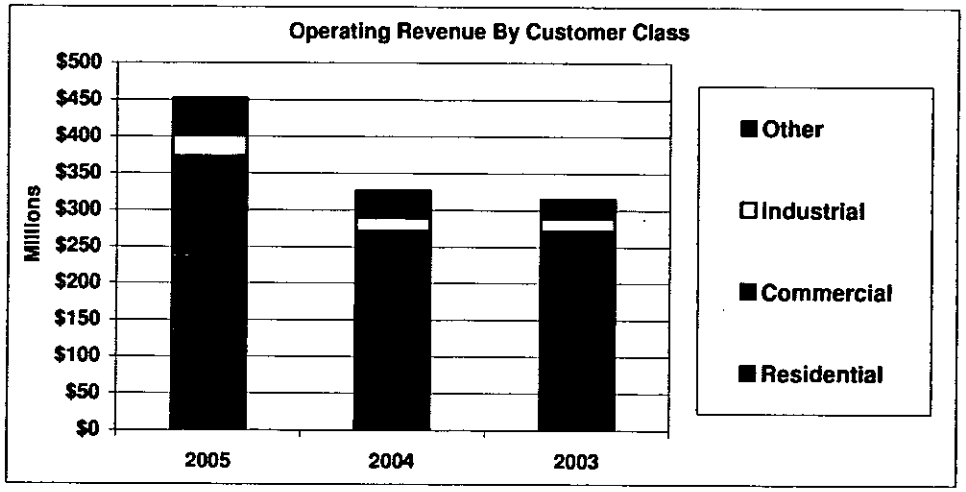
Table 4
Gas Division
Condensed Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended December 31, 2005, 2004 and 2003
(In Thousands)

	2005	2004 As Restated	FY05 - FY04 Percentage Change	2003	FY04 - FY03 Percentage Change
Revenues:					
Sales, service and other operating revenues	$ 479,798	$ 360,306	33.2%	$ 338,520	6.4%
Transported gas revenue	3,828	2,390	60.2%	14,379	-83.4%
Non-operating revenues	2,877	4,973	-42.1%	3,177	56.5%
Total revenues	486,503	367,669	32.3%	356,076	3.3%
Expenses:					
Depreciation expense	14,814	14,803	0.1%	12,591	17.6%
Purchased gas	381,036	283,535	34.4%	260,102	9.0%
Other operating expense	69,331	63,427	9.3%	59,709	6.2%
Non-operating expense	-	-	0.0%	-	0.0%
Total expenses	465,181	361,765	28.6%	332,402	8.8%
Income (loss) before contributions in aid of construction and transfers	21,322	5,904	261.1%	23,674	-75.1%
Contributions in aid of construction	2,518	3,270	-23.0%	2,483	31.7%
Reduction of plant costs recovered through contributions in aid of construction	(2,518)	(3,270)	-23.0%	(2,483)	31.7%
Transfers to City	(15,357)	(14,395)	6.7%	(14,302)	0.7%
Changes in net assets	5,965	(8,491)	170.3%	9,372	-190.6%
Beginning net assets	397,890	412,934	-3.6%	398,338	3.7%
Prior period adjustment	-	(6,553)	-100.0%	-	0.0%
Cumulative effect of change in accounting principle	-	-	0.0%	5,224	-100.0%
Beginning net assets as adjusted	397,890	406,381	-2.1%	403,562	0.7%
Ending net assets	$ 403,855	$ 397,890	1.5%	$ 412,934	-3.6%

The change in net assets increased by $14.5 million from $-8.5 million at December 31, 2004 to $6.0 million at December 31, 2005. This increase is due primarily to higher operating revenue from the implementation of an MLGW gas rate increase, effective December 28, 2004. The change in net assets decreased by $17.9 million from $9.4 million at December 31, 2003 to $-8.5 million at December 31, 2004, largely due to a decline in sales and transported volumes.

Total revenues were $486.5 million for the fiscal year 2005, an increase of 32.3% over fiscal year 2004. The increase resulted in part from the Gas Division's rate increase of approximately 6.1%. This added $18.7 million to sales, service and other operating revenue. Increased natural gas prices were also recovered from customers through a purchased gas adjustment, increasing revenues by $87.3 million. Gas sales to customers were up 2.9% in 2005 from 2004, accounting for an additional $10 million in operating revenue. Figure 3 shows the operating revenue by customer class. Non-operating revenues decreased $2.1 million due in part to the termination of construction contribution payments from Trunkline Gas Company pursuant to a natural gas transportation contract. Total revenues were $367.7 million for the fiscal year 2004, an increase of 3.3% over fiscal year 2003. This was due to higher wholesale gas prices, offset partially by a 17.7% decline in sales and transport volumes. Non-operating revenue increased by $1.8 million as a result of an increase in investment income.

Figure 3: Gas Division's Operating Revenue



Total expenses were $465.2 million for the fiscal year 2005, an increase of 28.6% over fiscal year 2004. Purchased gas costs increased $97.5 million, or 34.4%, due largely to escalating wholesale gas prices. Additionally, other operating expenses increased by $6.0 million, or 9.3%, as a result of an increase in operations and maintenance costs. Total expenses were $361.8 million for the fiscal year 2004, an increase of 8.8% over fiscal year 2003. The increase was due primarily to increases in purchased gas cost and operations.

Contributions in aid of construction were $2.5 million in 2005, a decrease from 2004 of $0.8 million (-23.0%). CIAC increased $0.8 million in 2004 compared to 2003.

MLGW's transfer to the City of Memphis is based on the formula provided by the State of Tennessee Municipal Gas System Tax Equivalent Law of 1987. The formula includes a property tax equivalency calculation plus 4% of operating revenue less gas costs (three-year average). Transfers to City represent the Gas Division's in lieu of tax payment of $15.4 million in 2005. This amount represents a 6.7% increase over 2004, with 2004 being 0.7% higher than 2003. Of the $1.0 million increase in taxes over 2005, $0.2 million is attributable to increased revenues and the remaining $0.8 million is attributable to increased tax rates and equalization rates during 2005.

A prior period adjustment was made to net assets, beginning of the year balance for 2004. Also, a restatement was made to sales and service revenues and other accounts payable, accrued expenses, and deferrals for 2004.
(See Note 1).

In 2003, MLGW began recording unbilled revenues which changed the timing of revenue recognition from the deferred cost method to the accrued revenue method which is based on the service is provided. The cumulative effects of the change resulting from years prior to January 1, 2003, increased net assets by $5.2 million.

Analysis of the Water Division's Balance Sheet

Condensed financial information comparing the Water Division's net assets for the past three fiscal years is presented below:

Table 5
Water Division Condensed Balance Sheet
December 31
(In Thousands)

	2005	2004	FY05 - FY04 Percentage Change	2003	FY04 - FY03 Percentage Change
Current assets (excluding restricted assets)	$ 36,920	$ 42,633	-13.4%	$ 45,440	-6.2%
Restricted assets	26,109	26,521	-1.6%	29,406	-9.8%
Other assets	646	149	333.6%	1,240	-88.0%
Utility plant	244,492	242,852	0.7%	237,177	2.4%
Total assets	308,167	312,155	-1.3%	313,263	-0.4%
Current liabilities payable from current assets	9,500	13,048	-27.2%	13,462	-3.1%
Current liabilities payable from restricted assets	9,748	11,547	-15.6%	11,679	-1.1%
Long-term debt	13,721	19,431	-29.4%	26,808	-27.5%
Non-current liabilities	1,927	1,978	-2.6%	2,182	-9.3%
Total liabilities	34,896	46,004	-24.1%	54,131	-15.0%
Net assets:					
Invested in utility plant, net of related debt	225,001	215,982	4.2%	203,289	6.2%
Restricted	21,587	21,964	-1.7%	24,253	-9.4%
Unrestricted	26,683	28,205	-5.4%	31,590	-10.7%
Total net assets	$ 273,271	$ 266,151	2.7%	$ 259,132	2.7%

Assets

Total assets for fiscal year 2005 decreased by $4.0 million (-1.3%) compared to fiscal year 2004. The decrease resulted primarily from a decline in investments and current accounts receivable. For fiscal year 2004, total assets decreased by $1.1 million (-0.4%) compared to 2003.

Capital Assets and Construction Activities

The Water Division had $244.5 million in utility plant assets net of accumulated depreciation at December 31, 2005, an increase of 0.7% over fiscal year 2004. During 2005, the Water Division expended $12.0 million on construction activities. Major Water Division capital projects included: extensions to serve new customers ($3.2 million), 16" main extension project from Weaver Road to Riverport ($1.1 million), seismic mitigation of buildings and equipment at Lichterman Pumping Station ($1.1 million), seismic retrofit of wells at McCord Pumping Station ($565 thousand), purchase of data processing equipment ($2.1 million), purchase of meters ($1.0 million), and purchase of transportation and power operated equipment ($738 thousand).

The Water Division had approximately $242.9 million in utility plant assets net of accumulated depreciation at December 31, 2004, an increase of 2.4% over fiscal year 2003. The Water Division expended $13.7 million in construction activities during 2004. Major projects for 2004 included distribution work at I-40/I-240 ($3.9 million), purchase of data processing equipment ($3.8 million). The Water Division was in the construction phase of two seismic mitigation projects at McCord Pumping Station ($2.1 million) and Lichterman Pumping Station ($1.8 million).

Liabilities

Total liabilities decreased by 24.1% from $46.0 million at December 31, 2004 to $34.9 million at December 31, 2005. Long-term debt decreased as a result of the continued payment of principal on the existing outstanding debt. Additionally, the decrease in current liabilities payable from restricted assets was attributed to the $2.0 million decrease in principal payments for the current portion of revenue bonds payable. Total liabilities decreased by $8.1 million from $54.1 million at December 31, 2003 to $46.0 million at December 31, 2004. The decrease was due primarily to the $7.4 million decrease in long-term debt.

Net Assets

At December 31, 2005, the Water Division's total net assets (total assets less total liabilities) were $273.3 million, an increase of $7.1 million, or 2.7%, from $266.2 million at December 31, 2004. Over 82% of the nets assets were related to utility plant, which include property, plant, and construction work in progress. The Water Division's total net assets at December 31, 2004, increased by 2.7%, from $259.1 million at December 31, 2003.

Analysis of the Water Division's Statement of Revenues, Expenses, and Changes in Net Assets

Condensed financial information comparing the Water Division's revenues, expenses, and changes in net assets for the past three fiscal years is presented below:

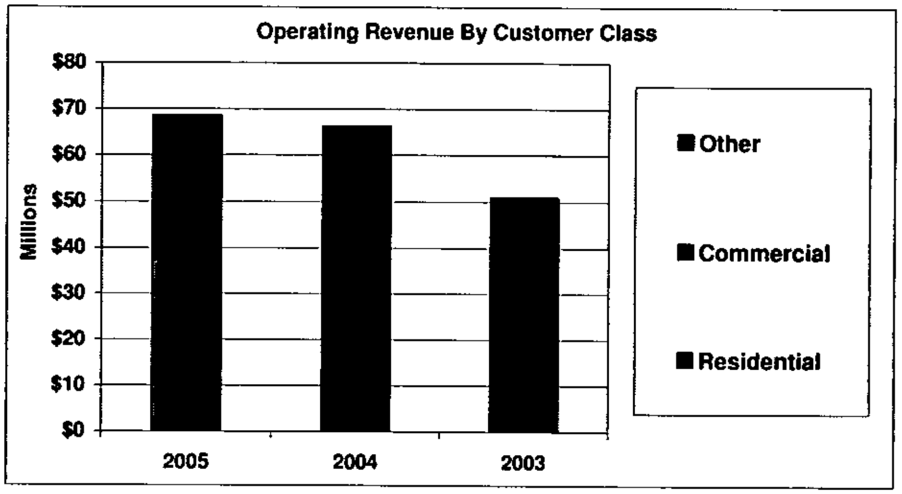
Table 6
Water Division
Condensed Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended December 31, 2005, 2004 and 2003
(In Thousands)

	2005	2004	FY05 - FY04 Percentage Change	2003	FY04 - FY03 Percentage Change
Revenues:					
Operating revenues	$ 74,020	$ 70,365	5.2%	$ 55,812	26.1%
Non-operating revenues	1,259	637	97.6%	2,383	-73.3%
Total revenues	75,279	71,002	6.0%	58,195	22.0%
Expenses:					
Depreciation expense	9,493	7,797	21.8%	7,479	4.3%
Other operating expense	55,158	52,289	5.5%	45,617	14.6%
Non-operating expense	1,008	1,397	-27.8%	1,763	-20.8%
Total expenses	65,659	61,483	6.8%	54,859	12.1%
Income (loss) before contributions in aid of construction and transfers	9,620	9,519	1.1%	3,336	185.3%
Contributions in aid of construction	6,106	9,833	-37.9%	4,174	135.6%
Reduction of plant costs recovered through contributions in aid of construction	(6,106)	(9,833)	-37.9%	(4,174)	135.6%
Transfers to City	(2,500)	(2,500)	0.0%	(2,103)	18.9%
Changes in net assets	7,120	7,019	1.4%	1,233	469.3%
Beginning net assets	266,151	259,132	2.7%	256,452	1.0%
Cumulative effect of change in accounting principle	-	-	0.0%	1,447	-100.0%
Beginning net assets as adjusted	266,151	259,132	2.7%	257,899	0.5%
Ending net assets	$ 273,271	$ 266,151	2.7%	$ 259,132	2.7%

The change in net assets increased slightly by 1.4% at December 31, 2005 compared to 2004, reflecting similar growth rates in revenues and expenses. The change in net assets increased $5.8 million, from $1.2 million at December 31, 2003 to $7.0 million at December 31, 2004. This growth was primarily due to the increase in operating revenue resulting from the implementation of a water rate increase, effective December 30, 2003.

Total revenues were $75.3 million for the fiscal year 2005, an increase of 6.0% over fiscal year 2004. Water sales to customers were up 3.6% in 2005 from 2004, accounting for an additional $2.2 million in operating revenue. Revenue from water property (property owned by the water division and rented to the other divisions) contributed an additional $1.7 to the increase in operating revenue. Figure 4 shows operating revenue by customer class. Non-operating revenue increased by $0.6 million due to the increase in investment income. For fiscal year 2004, total revenues were $71.0 million for an increase of 22.0% over fiscal year 2003. Operating revenue increased by 26.1% primarily due the Water Division's rate increase in January 2004, which generated $13.9 million. Non-operating revenue decreased by $1.7 million due to a decrease in investment and other income.

Figure 4: Water Division's Operating Revenue



Total expenses were $65.7 million for the fiscal year 2005, an increase of 6.8% over fiscal year 2004. The primary increase was due to a $2.9 million increase in other operating expenses as a result of an increase in production, operations, and maintenance costs. Depreciation expense increased by 21.8% due to the use of higher depreciation rates resulting from an evaluation completed in 2003 and implemented in 2004. However, non-operating expenses decreased by 27.8% due to $0.4 million decrease in interest expense on long-term debts. Total expenses were $61.5 million for the fiscal year 2004, an increase of 11.3% over fiscal year 2003. This increase was due to an increase of $6.3 million increase in operations costs.

Contributions in aid of construction were $6.1 million in 2005, decreased from 2004 by $3.7 million (-37.9%) due to the completion of a state highway project and the receipt of federal award funds. These factors impacted CIAC in 2004, resulting in a $5.7 million increase (135.6%), compared to 2003.

Transfers to the City for the Water Division are per an agreement with the City of Memphis to provide payments in the amount of $2.5 million per year. The agreement is effective through the year 2028.

In 2003, MLGW began recording unbilled revenues which changed the timing of revenue recognition from the deferred cost method to the accrued revenue method which is based on when the service is provided. The cumulative effects of the change resulting from years prior to January 1, 2003, increased net assets by $1.4 million.

Additional Financial Information

This discussion is designed to provide MLGW's customers, investors and other interested parties with a general overview of financial position and results of operations. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Manager of General Accounting, Memphis Light, Gas and Water Division, P.O. Box 430, Memphis, TN 38101, or call 901-528-4221.

BALANCE SHEETS
(Dollars in Thousands)
DECEMBER 31, 2005 AND 2004

	Electric Division		Gas Division		Water Division	
	2005	2004	2005	2004 As Restated	2005	2004
Assets						
Current assets:						
Cash and cash equivalents	$ 70,092	$ 37,778	$ 14,850	$ 15,258	$ 11,043	$ 9,251
Investments	41,235	36,636	23,961	3,083	6,508	9,005
Restricted funds - current	25,359	26,051	26,552	28,661	10,717	11,717
Accounts receivable, less allowance for doubtful accounts	63,691	56,233	48,775	24,665	12,030	13,505
Unbilled revenues	52,776	46,029	67,913	54,880	3,297	3,341
Prepaid power cost	82,961	80,405	-	-	-	-
Unrecovered purchased gas cost	-	-	16,668	9,986	-	-
Inventories	16,986	16,193	14,961	9,717	1,722	1,709
Collateral held in trust for securities on loan	13,982	20,242	6,314	9,889	2,320	5,822
Other current assets	2,370	3,237	7,925	10,117	-	-
Total current assets	369,452	322,804	227,919	166,256	47,637	54,350
Non-current assets:						
Restricted funds:						
Futures margin deposits	-	-	8,198	6,020	-	-
Construction	2,198	1,686	13,136	17,109	1,748	882
Insurance reserves - injuries and damages	2,012	2,709	1,044	1,053	1,015	844
Insurance reserves - casualties and general	13,454	12,996	4,359	4,306	5,684	5,482
Medical benefit	4,856	5,686	2,430	2,694	1,363	1,596
Customer deposits	12,283	11,890	4,522	4,620	891	737
Bond reserve and debt service	11,503	11,330	-	-	15,408	16,980
Total restricted funds	46,306	46,297	33,689	35,802	26,109	26,521
Less restricted funds - current	(25,359)	(26,051)	(26,552)	(28,661)	(10,717)	(11,717)
Restricted funds – non-current	20,947	20,246	7,137	7,141	15,392	14,804
Other assets:						
Prepaid power cost – long term	1,249,534	1,332,494	-	-	-	-
Unamortized debt expense	10,638	12,153	-	-	-	-
Notes receivable	5,630	6,676	16,549	18,262	646	149
Investment in Memphis Networx	3,211	9,415	-	-	-	-
Total other assets	1,269,013	1,360,738	16,549	18,262	646	149
Utility plant	1,198,403	1,157,444	535,626	519,535	389,584	378,445
Less accumulated depreciation	(431,256)	(415,761)	(211,064)	(196,792)	(145,092)	(135,593)
Utility plant, net	767,147	741,683	324,562	322,743	244,492	242,852
Total non-current assets	2,057,107	2,122,667	348,248	348,146	260,530	257,805
Total assets	$ 2,426,559	$ 2,445,471	$ 576,167	$ 514,402	$ 308,167	$ 312,155

See accompanying notes.

BALANCE SHEETS
(Dollars in Thousands)
DECEMBER 31, 2005 AND 2004
(Continued)

	Electric Division		Gas Division		Water Division	
	2005	2004	2005	2004	2005	2004
				As Restated		
Liabilities						
Current liabilities:						
Accounts payable - purchased power and gas	$ 88,890	$ 74,562	$ 90,200	$ 66,295	$ –	$ –
Other accounts payable, accrued expenses, and deferrals	34,386	40,176	56,095	19,184	7,180	7,226
Bonds and notes payable	70,910	67,884	–	–	–	–
Collateral subject to return to borrowers	13,982	20,242	6,314	9,889	2,320	5,822
Total current liabilities payable from current assets	208,168	202,864	152,609	95,368	9,500	13,048
Current liabilities payable from restricted assets:						
Construction	2,198	1,686	1,229	862	778	713
Customer deposits	4,790	4,637	1,744	1,786	348	287
Medical benefit accrual	4,856	5,686	2,430	2,694	1,363	1,596
Insurance reserves - injuries and damages	2,012	2,709	1,044	1,053	1,015	844
Bonds payable – accrued interest	4,941	5,176	–	–	474	667
Bonds payable – principal	6,562	6,155	–	–	5,770	7,440
Total current liabilities payable from restricted assets	25,359	26,049	6,447	6,395	9,748	11,547
Total current liabilities	233,527	228,913	159,056	101,763	19,248	24,595
Non-current liabilities:						
Customer advances for construction	8,972	8,530	554	571	–	–
Customer deposits	7,493	7,253	2,778	2,835	544	450
Other	6,891	7,375	9,924	11,343	1,383	1,528
Long-term debt	1,305,359	1,395,891	–	–	13,721	19,431
Total non-current liabilities	1,328,715	1,419,049	13,256	14,749	15,648	21,409
Total liabilities	1,562,242	1,647,962	172,312	116,512	34,896	46,004
Net assets						
Invested in capital assets, net of related debt	740,054	710,217	324,562	322,743	225,001	215,982
Restricted for debt service and construction	13,454	12,996	24,463	26,573	21,587	21,964
Unrestricted	110,809	74,296	54,830	48,574	26,683	28,205
Total net assets	864,317	797,509	403,855	397,890	273,271	266,151
Total liabilities and net assets	$ 2,426,559	$ 2,445,471	$ 576,167	$ 514,402	$ 308,167	$ 312,155

See accompanying notes.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
(Dollars in Thousands)
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

	Electric Division		Gas Division		Water Division	
	2005	2004	2005	2004 As Restated	2005	2004
Operating revenues:						
Sales and service revenues	$ 974,380	$ 910,426	$ 465,661	$ 348,828	$ 67,732	$ 65,550
Transported gas revenue	-	-	3,828	2,390	-	-
Other revenues	21,511	23,508	14,137	11,478	6,288	4,815
Total operating revenues	995,891	933,934	483,626	362,696	74,020	70,365
Operating expenses:						
Purchased power and gas for resale	751,055	707,136	381,036	283,535	-	-
Production	-	-	-	-	12,875	11,914
Operation	96,115	98,575	59,465	54,764	35,754	34,791
Maintenance	38,744	34,424	9,673	8,467	6,529	5,584
Depreciation	30,971	29,422	14,814	14,803	9,493	7,797
Payments in lieu of taxes	514	491	193	196	-	-
	917,399	870,048	465,181	361,765	64,651	60,086
Operating income (loss)	78,492	63,886	18,445	931	9,369	10,279
Non-operating revenues (expenses):						
Contributions in aid of construction	18,458	21,216	2,518	3,270	6,106	9,833
Reduction of plant costs recovered through contributions in aid of construction	(18,458)	(21,216)	(2,518)	(3,270)	(6,106)	(9,833)
Transmission credits	23,023	22,562	-	-	-	-
Investment and other income	57,968	55,460	2,877	4,973	1,259	637
Interest expense	(53,174)	(53,439)	-	-	(1,008)	(1,397)
Telecommunications division loss	(6,248)	(5,541)	-	-	-	-
Total non-operating revenues (expenses)	21,569	19,042	2,877	4,973	251	(760)
Income before transfers	100,061	82,928	21,322	5,904	9,620	9,519
Transfer out	(33,253)	(29,204)	(15,357)	(14,395)	(2,500)	(2,500)
Change in net assets	$ 66,808	$ 53,724	$ 5,965	$ (8,491)	$ 7,120	$ 7,019
Net assets, beginning of year	$ 797,509	$ 743,785	$ 397,890	$ 412,934	$ 266,151	$ 259,132
Prior Period Adjustment	-	-	-	(6,553)	-	-
Net assets, beginning of year as adjusted	797,509	743,785	397,890	406,381	266,151	259,132
Change in net assets	66,808	53,724	5,965	(8,491)	7,120	7,019
Net assets, end of year	$ 864,317	$ 797,509	$ 403,855	$ 397,890	$ 273,271	$ 266,151

See accompanying notes.

STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

	Electric Division		Gas Division		Water Division	
	2005	2004	2005	2004 As Restated	2005	2004
Cash flow from operating activities:						
Receipts from customers and users	$ 1,001,904	$ 949,178	$ 448,740	$ 344,277	$ 77,302	$ 73,046
Receipts from federal grants	–	3,875	–	–	–	–
Payments to suppliers	(656,557)	(634,783)	(419,196)	(297,448)	(31,430)	(37,107)
Payments to employees	(78,216)	(79,997)	(34,295)	(34,273)	(25,756)	(24,456)
Payments from (to) other Division funds	(4,868)	(3,732)	4,119	5,280	749	(1,548)
Payments for taxes	(461)	(447)	(193)	(198)	–	(397)
Other receipts	717	2,623	45,853	1,424	38	10
Net cash provided by (used in) operating activities	262,519	236,717	45,028	19,062	20,903	9,548
Cash flows from noncapital financing activities:						
Transfers to City	(33,253)	(29,204)	(15,357)	(14,395)	(2,500)	(2,500)
Decrease (increase) in unamortized debt expense	12	(112)	–	–	–	–
Principal payments on long-term debt	(67,975)	(68,200)	–	–	–	–
Interest expense on bonds	(62,910)	(68,603)	–	–	–	–
Net cash provided by noncapital financing activities	(164,126)	(166,119)	(15,357)	(14,395)	(2,500)	(2,500)
Cash flows from capital and related financing activities:						
Purchase and construction of utility plant	(79,598)	(79,827)	(22,054)	(16,662)	(17,811)	(21,275)
Contributions in aid of construction	18,458	20,081	2,518	3,270	6,106	7,296
Receipts from federal grants	–	14,789	–	–	2,000	–
Principal payments on long-term debt	(6,064)	(20,837)	–	–	(7,440)	(7,080)
Interest expense on debt	(1,780)	(2,124)	–	–	(1,141)	(1,516)
Net cash used in capital and related financing activities	(68,984)	(67,918)	(19,536)	(13,392)	(18,286)	(22,575)
Cash flows from investing activities:						
Sales and maturities of investments	27,812	32,703	3,113	16,619	6,247	15,707
Purchase of investments	(29,848)	(32,238)	(15,630)	(12,785)	(6,145)	(8,370)
Payments received on notes receivable	1,708	2,020	1,713	1,712	513	1,091
Investment income earned on investments	5,202	2,103	2,359	834	1,071	546
Investment in Memphis Networx	67	(3,636)	–	–	–	–
Net cash provided by (used in) investing activities	4,941	952	(8,445)	6,380	1,686	8,974
Increase (decrease) in cash and cash equivalents	34,350	3,632	1,690	(2,345)	1,803	(6,553)
Cash and cash equivalents, beginning of year	75,498	71,866	39,978	42,323	32,217	38,770
Cash and cash equivalents, end of year	$ 109,848	$ 75,498	$ 41,668	$ 39,978	$ 34,020	$ 32,217

See accompanying notes.

STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
(Continued)

	Electric Division		Gas Division		Water Division	
	2005	2004	2005	2004	2005	2004
				As Restated		
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:						
Operating income (loss)	$ 78,492	$ 63,886	$ 18,445	$ 931	$ 9,369	$ 10,279
Adjustments to reconcile operating income (loss)						
Net cash provided by operating activities:						
Depreciation of utility plant	33,241	33,598	17,717	17,406	10,065	8,304
Transmission credits	23,023	22,562	-	-	-	-
Prepay power credits	50,840	49,957	-	-	-	-
Other income	1,363	2,751	518	4,140	188	91
(Increase) decrease in assets:						
Accounts receivable	(7,458)	(3,039)	(24,110)	827	1,475	(7,503)
Unbilled revenues	(6,747)	(5,139)	(13,033)	(13,345)	44	(214)
Prepaid power cost	80,404	82,744	-	-	-	-
Deferred purchase power and gas cost	-	-	(6,682)	(6,954)	-	-
Inventories	(793)	484	(5,244)	(622)	(13)	(375)
Other assets	2,766	1,170	2,192	(6,649)	-	-
Increase (decrease) in liabilities:						
Accounts payable - purchased power and gas	14,328	(9,135)	23,905	22,647	-	-
Other accounts payable and accrued expenses	(5,513)	(2,543)	33,127	1,317	(174)	(1,186)
Customer deposits	393	(2,020)	(99)	538	155	(142)
Insurance reserves	(697)	732	(9)	(126)	171	4
Medical benefit accrual	(830)	742	(264)	352	(233)	208
Other	(293)	(33)	(1,435)	(1,400)	(144)	82
Total adjustments	184,027	172,831	26,583	18,131	11,534	(731)
Net cash provided by (used in) operating activities	$ 262,519	$ 236,717	$ 45,028	$ 19,062	$ 20,903	$ 9,548
Reconciliation of cash and cash equivalents per statements of cash flows to the balance sheets:						
Restricted funds	$ 46,306	$ 46,297	$ 33,689	$ 35,802	$ 26,109	$ 26,521
Less investments included in restricted funds	(6,550)	(8,577)	(6,871)	(11,082)	(3,132)	(3,555)
Cash and cash equivalents included in restricted funds	39,756	37,720	26,818	24,720	22,977	22,966
Current assets - cash and cash equivalents	70,092	37,778	14,850	15,258	11,043	9,251
Total cash and cash equivalents	$ 109,848	$ 75,498	$ 41,668	$ 39,978	$ 34,020	$ 32,217

See accompanying notes.

1. Summary of Significant Accounting Policies

Organization

Memphis Light, Gas and Water Division ("MLGW"), a division of the City of Memphis, Tennessee (the "City"), was created by an amendment to the City Charter by Chapter 381 of the Private Acts of the General Assembly of Tennessee (the "Charter"), adopted March 9, 1939, as amended. MLGW is managed by its President and a five member Board of Commissioners that are nominated by the City Mayor and approved by the Memphis City Council (the "Council"). MLGW, through its three divisions, provides electricity, gas and water to customers in Shelby County, Tennessee, which includes the City. MLGW's annual budget and electric, gas and water rates require the approval of the Council. MLGW must also obtain the approval of the Council before incurring certain obligations.

Basis of Presentation

The financial statements present only the Electric, Gas and Water Divisions of MLGW in conformity with accounting principles generally accepted in the United States applicable to a proprietary fund of a government unit. The accompanying financial statements present the separate financial position, results of operations, and the cash flows of each of the three divisions--Electric, Gas and Water--(the Divisions) of MLGW, but do not present the financial position, results of operations, and the cash flows of MLGW, an enterprise fund of the City of Memphis. Accordingly, the accompanying disclosures relate separately to the Divisions, as applicable, and not collectively to MLGW. Unless expressly stated, each disclosure, including references to "MLGW" herein, applies solely to each of the separate divisions on a departmental basis. These statements are not intended to present the financial position of the City and the results of the City's operations and the cash flows of the City's funds, nor do they represent the financial position, results of operations, or cash flows of MLGW's Retirement and Pension System discussed in Note 5 and the Trust for Retiree Medical and Life Insurance Benefits discussed in Note 6.

Basis of Accounting

MLGW is required by state statute and the Charter to maintain separate accounting for each division and to allocate among the divisions, on an equitable basis, joint expenses, including those related to common facilities. MLGW utilizes direct cost methods where applicable. For expenses not directly charged to a specific division, internally developed cost allocation methods are used based on the function performed. Each division is separately financed, and its indebtedness is repayable from its net revenues.

MLGW's accounting policies are in conformity with accounting principles generally accepted in the United States. Where applicable, the Federal Energy Regulatory Commission's (FERC) (Electric and Gas Divisions) and the National Association of Regulatory Utility Commissioners' (NARUC) (Water Division) Uniform Systems of Accounts are used. MLGW is not subject to the jurisdiction of federal or state regulatory commissions with the exception of the Electric Division's investment in Memphis Networx, which is regulated by the Tennessee Regulatory Authority (TRA). See Note 9.

1. Summary of Significant Accounting Policies (continued)

Basis of Accounting (continued)

Under Governmental Accounting Standards Board ("GASB") Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* MLGW has elected to apply all Financial Accounting Standards Board ("FASB") statements and interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements, to MLGW's accounting and financial reporting.

Recent Accounting Standards

In April and June 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* and Statement No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pension,* respectively. Other Postemployment Benefits (OPEB) are benefits, other than pension, received by employees (e.g., medical, life insurance). GASB 43 establishes uniform financial reporting standards for OPEB plans. GASB 45 attempts to match the cost of OPEB with the period in which service is rendered and report such benefit. MLGW is required to adopt GASB Statements No. 43 and 45 for financial statements beginning after December 15, 2005 and 2006, respectively. MLGW has not elected early implementation of these statements, and is in the process of evaluating the financial impacts.

GASB issued Statement No. 46, *Net Assets Restricted by Enabling Legislation—an amendment of GASB No. 34 in December 2004.* The statement clarifies the definition of a legally enforceable enabling legislation restriction on net assets. MLGW will adopt this statement on January 1, 2006. Management does not believe this statement will have a material effect on the financial statements.

In December 2004, FASB issued Statement No. 153, *Exchanges of Nonmonetary Assets- an amendment of APB Opinion No 29.* The guidance in APB Opinion No. 29, *Accounting for Nonmonetary Transactions,* is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. This statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of this statement have an effective date for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. MLGW has not elected early implementation of this statement, and does not believe it will have a material effect on the financial statements.

In May 2005, FASB issued Statement No. 154, *Accounting Changes & Error Corrections- a replacement of APB Opinion No. 20 & FASB Statement No. 3.* This statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transaction provisions, those provisions should be followed. This statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impractical.

1. Summary of Significant Accounting Policies (continued)

Recent Accounting Standards (continued)

The provisions of this statement have an effective date for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Management does not believe this statement will have a material effect on the financial statements.

Gas Division Prior Period Adjustment and Restatement

A prior period adjustment was made to the net assets, beginning of the year balance, in the Gas Division's Statement of Revenues, Expenses and Changes in Net Assets for 2004. Also, a restatement was made to sales and service revenues and other accounts payable, accrued expenses, and deferrals for 2004. These adjustments are related to the valuation of Liquefied Natural Gas (LNG) inventory. MLGW owns and operates two LNG plants for the storage of natural gas. Typically, these facilities are filled/refilled during periods of relatively low gas consumption and gas is withdrawn from storage and injected into the gas distribution system for use by customers during high demand periods.

Prior to 2005, during a refill month, MLGW recognized revenue collected from customers related to the cost of refill. However, gas cost was reduced by the cost of refill, and an inventory asset was recognized. During a withdrawal month, there was no recognition of revenue related to the sale of gas withdrawn from LNG, but gas cost was recognized and the value of inventory was reduced. To match sales revenue and gas costs, an adjustment was made to decrease net assets at the beginning of 2004. A restatement was also made to decrease sales and service revenues by $650 for 2004 and increase the liability in other accounts payable, accrued expenses, and deferrals by $7,203 ($6,553 + $650).

Regulatory Accounting

MLGW prepares its financial statements in accordance with the provisions of Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation* (SFAS 71). In general, SFAS 71 recognizes that accounting for rate regulated enterprises should reflect the relationship of costs and revenues introduced by rate regulation. As a result, a regulated utility may defer recognition of a cost (a regulatory asset) or recognize an obligation (a regulatory liability) if it is probable that through the rate making process, there will be a corresponding increase or decrease in future revenues. Accordingly, MLGW has recognized certain regulatory assets and regulatory liabilities in the accompanying balance sheets. In the event operations are no longer subject to the provisions of SFAS 71 as a result of a change in regulation or the effects of competition, MLGW would be required to recognize the effects of any regulatory change in assets or liabilities in its statement of revenues and expenses. The following are the regulatory assets and liabilities included on the balance sheets:

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

Regulatory Accounting (continued)

		2005	2004
Assets			As Restated
Gas Division	Deferred loss on futures/swaps	$ 5,627	$ 7,860
Gas Division	Unrecovered purchased gas cost	16,668	9,986
Liabilities			
Gas Division	Deferred gains-gas futures/swaps	$ 16,096	$ –
Gas Division	Deferred credits-PGA/storage	27,349	10,182

Use of Estimates

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, investments, restricted fund investments, accounts receivable and accounts payable are a reasonable estimate of their fair values. The estimated fair values of MLGW's other financial instruments have been determined by MLGW using available market information. However, considerable judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the fair values are not necessarily indicative of the amounts that MLGW could realize in a current market exchange. The use of different market assumptions may have a material effect on the estimated fair value amounts.

The estimated fair value of long-term debt for the Electric Division and the Water Division based on quoted market prices is as follows as of December 31, 2005 and 2004:

	2005	2004
Electric Division	$1,361,284	$1,469,214
Water Division	20,240	28,362

Investments

Investments are carried at their fair value based on quoted market prices. See Note 2. All changes in the fair value of investments are included in investment income in the accompanying statements of revenues, expenses and changes in net assets.

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

Accounts Receivable

As of December 31, 2005 and 2004, accounts receivable and allowances for doubtful accounts were as follows:

	Electric Division		Gas Division		Water Division	
	2005	2004	2005	2004	2005	2004
Accounts receivable	$ 72,473	$ 63,804	$ 50,489	$ 26,683	$ 12,963	$ 14,404
Less: Allowance for doubtful accounts	(8,782)	(7,571)	(1,714)	(2,018)	(933)	(899)
TOTAL	$ 63,691	$ 56,233	$ 48,775	$ 24,665	$ 12,030	$ 13,505

MLGW performs a monthly analysis of outstanding trade receivables to assess the likelihood of collection. For aged receivable balances, MLGW records an allowance to adjust the trade receivable to MLGW's best estimate of the amount it will ultimately collect. Such allowances are netted against operating revenues. MLGW's policy is to write off trade receivables after 120 days of non-payment. The bad debt expense amounts netted against operating revenues are as follows:

	2005	2004
Electric	$ 6,233	$ 6,236
Gas	2,738	2,378
Water	753	846

Concentration of Credit Risk

MLGW's financial instruments that are potentially exposed to concentrations of credit risk primarily consist of trade receivables. MLGW's trade receivables result from its operations and include wholesale, commercial, industrial and government customers in the Memphis, Tennessee, geographic area. As a general policy, customer deposits are required for receivables unless or until the customer has established good credit history. Customers' financial condition and credit worthiness are evaluated regularly.

Management of MLGW does not believe that it has a significant credit risk on its derivative instruments, which are transacted through the New York Mercantile Exchange or with counter parties meeting established collateral and credit criteria.

1. Summary of Significant Accounting Policies (continued)

Prepaid Power Cost

Electric Division prepaid power cost represents the unamortized amount of prepaid power under the prepaid electricity agreement signed with Tennessee Valley Authority ("TVA") on November 19, 2003. See Note 10. Under the prepay agreement, MLGW issued revenue bonds with a face value of $1,392,170 and a premium of $121,247 to make an upfront payment of $1,500,000 to TVA. Under the terms of the agreement, MLGW receives a fixed discount on the monthly power purchased for the fifteen year term of the agreement. The total fixed discount under the agreement is sufficient to meet the debt service requirements and yield approximately $13,000 in annual power cost savings. The monthly fixed discount is allocated to prepaid power cost and other income under the interest method based on the debt service requirements of the associated debt.

Inventories

Inventories, consisting primarily of materials and supplies inventory and stored natural gas, are valued at the lower of cost or market using the average cost method.

Property

The costs of additions and replacements of units of property are capitalized. Costs include contracted work, direct labor and materials, allocable overhead and, where applicable, allowances for borrowed funds used during construction and are reduced by contributions in aid of construction. When property units are retired, original cost, plus removal cost, less salvage is charged to accumulated depreciation. The units of property adopted are related to those suggested by FERC for the Electric and Gas Divisions and NARUC for the Water Division, which allow for the reduction of plant cost recovered through contributions in aid of construction as opposed to recovery of costs through future regulatory rates.

An allowance for borrowed funds used during construction is computed at actual interest rates to the extent major projects are financed by specific long-term debt. In 2005 and 2004, no construction projects were financed with specific long-term debt. Interest on other debt is not capitalized as it is recovered through current revenues.

Depreciation is computed by the straight-line method based on estimated service lives of various classes of property at rates equivalent to annual composite rates of approximately 3% for each division. Computations of the estimated service lives are the result of various depreciation studies and comparisons with industry standards.

For assets owned by one division, but jointly used by more than one division, the other divisions share the costs by paying rent to the owning division to cover depreciation, interest, in lieu of taxes, and transfers.

1. Summary of Significant Accounting Policies (continued)

Bond Premiums, Discounts and Issuance Costs

Bond premiums and discounts, as well as issuance costs, are deferred and amortized by the interest method over the lives of the applicable bond issues. Long-term debt is reported net of the applicable bond premium or discount. Bond issue costs are reported as deferred charges and amortized over the term of the related debt.

Reserves and Related Restricted Funds

Certain MLGW assets are restricted for specific purposes. Legal and contractual agreements restrict amounts for debt service, refund of customer deposits, futures margin requirements, and capital improvements while Board of Commissioners enacted provisions restrict funds for self-insurance and additional capital improvements.

The Gas Division maintains a cash margin account with its futures clearing member. The clearing member requires that a minimum cash margin be maintained based on the value of the Gas Division's outstanding futures positions. The minimum cash margin requirements are considered restricted and are reflected in restricted assets in the accompanying balance sheets. The amounts of cash in excess of the minimum cash margin requirement are included in cash and cash equivalents.

Construction funds are maintained for the purpose of paying certain repairs and capital additions and improvements. The respective bond resolutions of the Electric, Gas and Water Divisions provide for a certain level of funding for future construction. Additional construction funds are periodically authorized by the Board of Commissioners.

The insurance reserves for injuries and damages are maintained for estimated liabilities incurred and risks assumed on claims for injuries and damages and on recurring property losses. The insurance reserves for casualties are maintained at discretionary amounts to partially cover losses of a catastrophic nature which are not ordinarily insurable or which are not insurable on an economical basis. Since MLGW is self-insured for these liabilities, the Board of Commissioners has authorized the restriction of assets equal to the computed reserves.

Medical benefit reserves are maintained for MLGW's medical insurance program, which serves employees and retirees. The medical benefit reserves represent the estimated costs incurred but not yet paid for in providing medical benefits to employees and retirees which are not insured by third party providers. Since MLGW is self-insured for these costs, the Board of Commissioners has authorized the restriction of assets equal to the computed reserves.

Customer deposit funds are maintained for the future repayment of deposits collected from customers without adequate credit history in accordance with MLGW's policy and the respective customer service agreement.

1. Summary of Significant Accounting Policies (continued)

Reserves and Related Restricted Funds (continued)

Bond reserve and debt service funds are restricted under the terms of the respective bond indentures to pay current bond principal and interest as they become due.

Futures, Options and Swap Contracts

The Gas Division enters into futures contracts, swaps, and options on futures contracts to manage the risk of volatility in the market price of gas on anticipated purchase transactions. Open futures, swaps, and option contracts as of December 31, 2005 and 2004, are reported at market values of $9,324 and ($3,608) respectively. Notional values of the open futures as of December 31, 2005 and 2004 were $36,996 and $47,860, respectively. Margin account balances with MLGW's New York Mercantile Exchange clearing member as of December 31, 2005 and 2004, were $405 and $14,402, respectively. Gains or losses on futures contracts and swaps are included in deferred purchased gas costs until they are charged to gas costs through the purchased gas adjustment. Gains or losses on futures contracts entered into on behalf of specified customers are charged to that specific customer.

Net Assets

Net assets are classified into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

- Restricted net assets – This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), contributors, or laws or regulations of governments or constraints imposed by law through constitutional provisions or enabling legislation.

- Unrestricted net assets – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

1. Summary of Significant Accounting Policies (continued)

Revenues and Expenses

Revenues are recognized when earned. Customer meters are read and bills are rendered monthly. MLGW records an estimate for unbilled revenues earned from the dates its customers were last billed to the end of the month.

MLGW distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with an enterprise fund's principal operations. The principal operating revenues of MLGW consist of electric, gas and water sales and related activities. Non-operating revenues consist of transmission credits, the non-power cost portion of the prepaid electricity discount, investment income and other ancillary activities. Transmission credits are fees paid by Tennessee Valley Authority (TVA) for its use of the Electric Division's power transmission facilities in supplying power to MLGW. Operating expenses include the cost of purchased power and gas, water production costs, operation and maintenance expenses, depreciation on capital assets and payments in lieu of taxes. Expenses not meeting this definition are reported as non-operating expenses.

Investment and other income includes prepay credit income related to the prepaid power agreement with TVA of $50,840 and $49,957 for the years ended December 31, 2005 and 2004, respectively.

Customer Deposits

Customers that do not have adequate credit history are required to make a utility deposit before services are provided. Deposits are refunded or applied toward the customer's bill after a 36 month good pay status. Deposits are allocated to the Electric, Gas and Water Divisions based upon each division's percentage of total sales revenue of the previous year end.

Statements of Cash Flows

MLGW considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents.

Reclassifications

Certain amounts in the 2004 financial statements have been reclassified to conform to the 2005 presentation.

(Dollars in Thousands)

1. Summary of Significant Accounting Policies (continued)

Related Parties

MLGW conducts business with its related parties as "arm's length" transactions. Major related party entities include the City of Memphis Government and Memphis Networx. Generally, MLGW provides utility and related services to these parties and receives payments in the same manner as other customers. The only free service provided to the City, under the Charter, is water for public purposes, such as Memphis City Schools and fire hydrants. The free water provided to the City is estimated to be $1,740 and $2,164 for 2005 and 2004, respectively.

2. Deposits and Investments

On January 1 2005, MLGW adopted the provision of GASB Statement No. 40, *Deposit and Investment Risk Disclosures, an amendment of GASB Statement No. 3.* This statement establishes and modifies disclosure requirements for state and local governments related to deposit and investment risks. As of December 31, 2005, the bank balances of MLGW cash deposits were fully insured or collaterized with securities held by MLGW or its agent in MLGW's name. MLGW had the following investments:

Investment	Fair Value	Maturities < 1 year	Maturities 1 to 5 years
U.S. Treasuries	$ 21,229	$ 3,215	$ 18,014
Federal Agency (Fixed Rate)	28,522	8,049	20,473
Federal Agency (Callable)	5,973	1,719	4,254
Commercial Paper (Rated AA or higher)	133,488	133,488	-
Corporate Bonds/Notes	9,066	3,024	6,042
Certificates of Deposit	19,000	19,000	-
Tennessee LGIP and Mutual Funds	28,317	28,317	-
Asset – Backed Securities	12,531	-	12,531
TOTAL	$ 258,126	$ 196,812	$ 61,314

Credit Risk

MLGW's general investment policy is to apply the prudent investor rule: Investments shall be made with judgment and care, under circumstances then prevailing which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

Repurchase agreements have a term to maturity of no greater than ninety (90) days and, commercial paper maturity is no greater than two hundred-seventy (270) days. If the corporation has senior long term debt it must have a minimum rating of "AA" or equivalent and a short term debt minimum rating of "A" or equivalent as provided by a majority of the rating services that rate the issuer. Municipal obligations are rated in either of the two highest rating categories by a nationally recognized statistical rating

(Dollars in Thousands)

2. Deposits and Investments (continued)

Credit Risk (continued)

organization. Asset-backed securities are defined as debt securities that have specifically pledged collateral. Each holding shall be rated "Aaa" by Moody's Investors Services or "AAA" by Standard & Poor's.

Concentration of Credit Risk

MLGW's charter specifies that the Board of Commissioners shall be able to make such investments as authorized by state law and as it deems proper. The following investments shall be permitted investments and such portfolio shall be diversified by security type and institution:

U.S. Treasuries	100% maximum
Federal Agency (fixed rate)	100% maximum
Federal Agency (callable)	50% maximum
Repurchase Agreements	50% maximum
Commercial Paper (rated AA or higher)	90% maximum
Bankers' Acceptances (rated AA or higher)	60% maximum
Corporate Notes (medium term)	15% maximum
Certificates of Deposit	20% maximum
Municipal Obligations	20% maximum
Tennessee LGIP and Mutual Funds	40% maximum
Asset – Backed Securities	50% maximum

MLGW's portfolio will be further diversified to limit the exposure to any one issuer. No more than 10% of the portfolio will be invested in the securities of any single issuer except U.S. Government obligations with a maximum percentage of 100%. Furthermore, MLGW is prohibited from investing in the following securities: (1) purchases on margin or short sales, (2) investment in reverse repurchase agreements, and (3) "exotic" derivatives such as range notes dual index notes, inverse floating rate notes and deleveraged notes, or notes linked to lagging indices or to long-term indices.

Interest Rate Risk

MLGW's investment policy does not limit investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. However, the portfolio shall be managed to accomplish the following hierarchy of investment objectives: (1) preservation of principal, (2) maintenance of liquidity, and (3) maximize return (within the context and parameters set forth in 1 and 2). Those responsible for the day to day management of the portfolio will routinely monitor the contents of the portfolio, the available markets and the relative values of competing instruments, and will adjust the portfolio as necessary to meet the investment objectives. Further, no investment will have a maturity of greater than five (5) years from date of purchase, except U.S. Treasury Securities which shall have a maturity not to exceed ten (10) years.

(Dollars in Thousands)

2. Deposits and Investments (continued)

Custodial Credit Risk

MLGW has authorized The Northern Trust Company ("the Agent") to enter into, on behalf of MLGW, securities lending transactions comprised of loans of securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. Initial collateral, consisting of cash and securities, levels must be at least 102% of the market value of borrowed securities, or at least 105% if the borrowed securities and collateral are denominated in different currencies. The borrower is required to deliver additional collateral when necessary so that the total collateral held by the Agent for all loans to the borrower will at least equal the market value of the securities without a borrower default. The Agent shall issue a safekeeping receipt to MLGW listing the specific instrument, rate, maturity and other pertinent information. On a monthly basis, the Agent will also provide reports which list all securities held for MLGW, the book value of holdings and the market value as of month-end. Appropriate MLGW officials and representatives of the Agent responsible for, or in any manner involved with, the safekeeping and custody process of MLGW shall be bonded in such a fashion as to protect MLGW from losses from malfeasance and misfeasance. In addition, MLGW will not deposit funds through third parties or money brokers.

MLGW has a cash management program that provides for the investment of excess cash balances in short-term investments and the investment of debt service funds in instruments maturing as the related debt matures. The policy is authorized by the Charter, the MLGW Board of Commissioners, and as set forth in the bond resolutions of each division. Restricted funds, cash, cash equivalents and investments consisted of the following as of December 31, 2005 and 2004:

	Electric Division		Gas Division		Water Division	
	2005	2004	2005	2004	2005	2004
Restricted funds:						
Common account	$ 17,664	$ 17,391	$ 18,539	$ 22,469	$ 8,446	$ 7,208
Cash and cash equivalents	28,642	28,906	15,150	13,333	17,663	19,313
Total restricted funds	$ 46,306	$ 46,297	$ 33,689	$ 35,802	$ 26,109	$ 26,521
Cash and cash equivalents:						
Common account	$ 69,968	$ 37,643	$ 22,643	$ 6,875	$ 11,043	$ 9,251
Cash	124	135	(7,793)	8,383	–	–
Total cash and cash equivalents	$ 70,092	$ 37,778	$ 14,850	$ 15,258	$ 11,043	$ 9,251
Investments:						
Common account	$ 41,235	$ 36,636	$ 13,344	$ 6,691	$ 6,508	$ 9,005
Fair value of futures contracts	–	–	10,617	(3,608)	–	–
Investments – common account	$ 41,235	$ 36,636	$ 23,961	$ 3,083	$ 6,508	$ 9,005

(Dollars in Thousands)

3. Long-Term Receivables

The Electric Division has an unsecured note receivable from a government agency, which amounted to \$6,676 and \$7,820 as of December 31, 2005 and 2004, respectively. Interest is earned at a fixed rate of 7.723% per annum. The note provides for monthly payments of principal and interest and has a maturity date of November 1, 2010. The note receivable secures an Electric Division note payable (see Note 7).

Scheduled maturities of the note receivable are as follows for the years ending December 31:

2006	$ 1,236
2007	1,335
2008	1,442
2009	1,557
2010	1,106
	$ 6,676

The government agency note receivable is included in notes receivable in the accompanying 2005 Electric Division balance sheet, except for the current portion of \$1,236, which is included in other current assets.

In 2002, MLGW and The Valero Refining Group ("Valero") (formerly Premcor Refining Group, Inc. and Williams Refining and Marketing, LLC) entered into an agreement, whereby MLGW would provide for the construction of two pipelines and lease them to Valero for the purpose of transporting crude oil and refinery products. The lease provides for monthly payments of principal and interest and has an initial term of 15 years, ending on October 1, 2016.

Scheduled lease payments receivable are as follows for the years ending December 31:

2006	$ 1,712
2007	1,712
2008	1,712
2009	1,712
2010	1,712
Thereafter	9,702
	$ 18,262

The Valero lease receivable is included in notes receivable in the accompanying 2005 Gas Division's balance sheet, except for the current portion of \$1,712, which is included in other current assets.

(Dollars in Thousands)

4. Utility Plant

Utility plant activity for the years ended December 31, 2005 and 2004 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Year ended December 31, 2005				
Electric Division				
Capital assets not being depreciated:				
Land	$ 27,229	$ 2,715	$ (2,435)	$ 27,509
Construction in progress	63,504	59,425	(63,933)	58,996
Total capital assets not being depreciated	90,733	62,140	(66,368)	86,505
Capital assets being depreciated:				
Structures and improvements	39,586	8,170	(242)	47,514
Transmission and distribution plant equipment	948,073	39,567	(7,403)	980,237
General plant equipment	79,052	13,480	(8,385)	84,147
Total capital assets being depreciated	1,066,711	61,217	(16,030)	1,111,898
Less accumulated depreciation	(415,761)	(33,240)	17,745	(431,256)
Total capital assets being depreciated, net	650,950	27,977	1,715	680,642
Total capital assets, net	$ 741,683	$ 90,117	$ (64,653)	$ 767,147
Gas Division				
Capital assets not being depreciated:				
Land	$ 7,601	$ (17)	$ -	$ 7,584
Construction in progress	16,188	19,950	(14,640)	21,498
Plant held for future use	212	-	-	212
Total capital assets not being depreciated	24,001	19,933	(14,640)	29,294
Capital assets being depreciated:				
Structures and improvements	47,214	1,627	(105)	48,736
Processing and distribution plant equipment	365,040	8,234	(750)	372,524
General plant equipment	83,080	4,797	(3,005)	84,872
Non-utility plant equipment	200	-	-	200
Total capital assets being depreciated	495,534	14,658	(3,860)	506,332
Less accumulated depreciation	(196,792)	(17,717)	3,445	(211,064)
Total capital assets being depreciated, net	298,742	(3,059)	(415)	295,268
Total capital assets, net	$ 322,743	$ 16,874	$ (15,055)	$ 324,562

(Dollars in Thousands)

4. Utility Plant (continued)

	Beginning Balance	Increases	Decreases	Ending Balance
Year ended December 31, 2005				
Water Division				
Capital assets not being depreciated:				
Land	$ 3,215	$ (4)	$ -	$ 3,211
Construction in progress	19,640	11,561	(13,066)	18,135
Total capital assets not being depreciated	22,855	11,557	(13,066)	21,346
Capital assets being depreciated:				
Structures and improvements	40,951	2,573	(1)	43,523
Pumping, transmission and distribution plant equipment	272,832	5,595	(478)	277,949
General plant equipment	55,778	4,903	(908)	59,773
Total capital assets being depreciated	369,561	13,071	(1,387)	381,245
Less accumulated depreciation	(135,593)	(11,029)	1,530	(145,092)
Less acquisition adjustment	(13,971)	-	964	(13,007)
Total capital assets being depreciated, net	219,997	2,042	1,107	223,146
Total capital assets, net	$ 242,852	$ 13,599	$ (11,959)	$ 244,492

	Beginning Balance	Increases	Decreases	Ending Balance
Year ended December 31, 2004				
Electric Division				
Capital assets not being depreciated:				
Land	$ 24,232	$ 2,997	$ –	$ 27,229
Construction in progress	46,418	55,852	(38,766)	63,504
Total capital assets not being depreciated	70,650	58,849	(38,766)	90,733
Capital assets being depreciated:				
Structures and improvements	31,123	8,560	(97)	39,586
Transmission and distribution plant equipment	936,001	23,564	(11,492)	948,073
General plant equipment	75,884	3,645	(477)	79,052
Total capital assets being depreciated	1,043,008	35,769	(12,066)	1,066,711
Less accumulated depreciation	(398,123)	(33,598)	15,960	(415,761)
Total capital assets being depreciated, net	644,885	2,171	3,894	650,950
Total capital assets, net	$ 715,535	$ 61,020	$ (34,872)	$ 741,683

(Dollars in Thousands)

4. Utility Plant (continued)

	Beginning Balance	Increases	Decreases	Ending Balance
Year ended December 31, 2004				
Gas Division				
Capital assets not being depreciated:				
Land	$ 7,601	$ –	$ –	$ 7,601
Construction in progress	16,660	13,368	(13,840)	16,188
Plant held for future use	212	–	–	212
Total capital assets not being depreciated	24,473	13,368	(13,840)	24,001
Capital assets being depreciated:				
Structures and improvements	45,845	1,480	(111)	47,214
Processing and distribution plant equipment	355,110	10,777	(847)	365,040
General plant equipment	82,044	1,582	(546)	83,080
Non-utility plant equipment	200	–	–	200
Total capital assets being depreciated	483,199	13,839	(1,504)	495,534
Less accumulated depreciation	(180,915)	(16,561)	684	(196,792)
Total capital assets being depreciated, net	302,284	(2,722)	(820)	298,742
Total capital assets, net	$ 326,757	$ 10,646	$ (14,660)	$ 322,743

	Beginning Balance	Increases	Decreases	Ending Balance
Water Division				
Capital assets not being depreciated:				
Land	$ 3,215	$ –	$ –	$ 3,215
Construction in progress	31,598	13,706	(25,664)	19,640
Total capital assets not being depreciated	34,813	13,706	(25,664)	22,855
Capital assets being depreciated:				
Structures and improvements	37,360	3,815	(224)	40,951
Pumping, transmission and distribution plant equipment	264,253	9,303	(724)	272,832
General plant equipment	43,243	12,546	(11)	55,778
Total capital assets being depreciated	344,856	25,664	(959)	369,561
Less accumulated depreciation	(127,558)	(11,163)	3,128	(135,593)
Less acquisition adjustment	(14,934)	–	963	(13,971)
Total capital assets being depreciated, net	202,364	14,501	3,132	219,997
Total capital assets, net	$ 237,177	$ 28,207	$ (22,532)	$ 242,852

(Dollars in Thousands)

4. Utility Plant (continued)

Total net capital asset changes include additions to construction in progress, transfers to or from other accounts, depreciation and amortization and the effects of sales, retirements, and contribution in aid of construction.

MLGW's planned construction program expenditures for 2006 are estimated as follows (unaudited):

Electric Division	$ 70,663
Gas Division	20,260
Water Division	20,947

In June 1999, the Water Division purchased the Shelby County Water Distribution System and related assets from Shelby County, Tennessee. The difference between the purchase price and the net book value of the assets acquired (the "acquisition adjustment") is being amortized over twenty years by the Water Division. Under the purchase agreement, MLGW agreed to decrease the water rates for the acquired customers by 3% per year through the year 2003 and committed to expenditures of at least $15 million over the next twenty years to upgrade and extend the acquired water system.

5. Employee Retirement System

Plan Description

The Memphis Light, Gas and Water Division Pension Board is the administrator of a single-employer retirement system established by MLGW to provide retirement benefits for its employees through the Memphis Light, Gas and Water Division Retirement and Pension System (the "MLGW Pension Plan"). MLGW issues separate audited financial statements for the retirement system as of and for its fiscal year ended December 31. The financial statements may be obtained by writing to the MLGW Pension Plan, P.O. Box 430, Memphis, Tennessee 38101-0430.

The MLGW Pension Plan covers full time employees and appointed officials of MLGW. Membership consisted of the following as of December 31, 2005 and 2004:

	2005	2004
Retirees and beneficiaries receiving benefits	**2,443**	2,401
Terminated plan members entitled to but not yet receiving benefits	**18**	21
Active plan members	**2,672**	2,653
	5,133	5,075

5. Employee Retirement System (continued)

Plan Description (continued)

The MLGW Pension Plan provides retirement, disability and death benefits to participants and their beneficiaries. The MLGW Pension Plan also provides for a cost of living adjustment beginning at age 56 for retirees, disabled retirees and surviving spouses on a graded scale up to 5% per annum based on the Department of Labor's consumer price index.

Method Used to Value Investments

All investments of the MLGW Pension Plan are reported at fair value by the plan. Short-term investments are reported at cost, which approximates fair value. All other investments are valued based upon quoted market prices except for investments in certain limited partnerships, which are valued at estimated fair value based on amounts derived from the partnerships' financial statements. For certain investments consisting of corporate bonds and notes that do not have an established fair value, MLGW's Treasury Management Department has established a fair value based on yields currently available on comparable securities of issuers with similar credit ratings. The MLGW Pension Plan has no investment in any one organization that represents more than 5% of plan assets.

Contributions

Substantially, all members under the MLGW Pension Plan are required to contribute 8% of their compensation to the MLGW Pension Plan. Such amounts are withheld from employee compensation each pay period. MLGW funds the required 8% employee contributions on behalf of certain executive employees. During 2005 and 2004, MLGW was required under the Pension Plan to contribute 8% of the benefit compensation of all active participants. MLGW's required contribution was based on an actuarial study and approved by the Board of Commissioners. Investment costs of the MLGW Pension Plan are financed through investment earnings.

Actuarial Methods and Assumptions

As of December 31, 2005 and 2004, the Pension Plan valuation dates, the asset valuation method used is the five-year weighted index method. The aggregate actuarial cost method is used in determining the funding requirements. Significant actuarial assumptions include (a) a rate of return on the investment of present and future assets of 8% per year compounded annually, (b) projected salary increases ranging from 4.50% to 8.16% per year compounded annually, and (c) pensioner cost of living adjustments of 1.05% – 2.63% compounded annually.

(Dollars in Thousands)

5. Employee Retirement System (continued)

Schedule of Funding Progress

The aggregate cost method does not identify or separately amortize unfunded actuarial liabilities. These liabilities are amortized through the normal cost. Under the aggregate cost method, the actuarial accrued liability equals the actuarial value of assets. As of December 31, 2005 and 2004, the actuarial value of assets was $1,126,577 and $1,082,324, respectively.

Schedule of Contributions from all Sources

Employee and employer contributions for the past three years are shown below:

Plan Year	Annual Required Employee Contribution	Actual Contribution	Percentage Contributed	Annual Required Employer Contribution	Actual Contribution	Percentage Contributed
2005	$ 11,576	$ 11,576	100%	$ 18,683	$ 19,204	103%
2004	10,711	10,711	100%	18,241	16,133	88%
2003	10,476	10,476	100%	15,890	10,696	67%

6. Deferred Compensation and Other Post-Employment Benefits

MLGW offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all MLGW employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

During 1997, the plan was amended to meet the requirements of Internal Revenue Code Section 457. The amended plan provides that assets or income of the plan shall be used for the exclusive purpose of providing benefits for participants and their beneficiaries or defraying reasonable expenses of administration of the plan. Since the assets of the amended plan are held in custodial and annuity accounts for the exclusive benefit of plan participants, the related assets of the plan are not reflected on MLGW's balance sheets.

MLGW has post-employment major medical and life insurance benefits available to all employee groups as a continuation of those benefits that were available prior to retirement. Currently, 2,443 retirees and beneficiaries are eligible for post-employment benefits. Life insurance premiums are paid monthly and medical coverage is paid as claims are filed through the medical benefit fund (a restricted fund). The costs of future post-employment benefits are provided for through the insurance reserves for employee benefits to the extent recovered through current revenues.

(Dollars in Thousands)

6. Deferred Compensation and Other Post-Employment Benefits (continued)

MLGW has established a grantor trust to accumulate funds that will be used to partially pay future post-employment medical benefits for all three divisions. The value of assets in the trust as of December 31, 2005 and 2004 was $56,163 and $52,136, respectively, and are not included in the accompanying balance sheets.

Post-employment benefit costs for the years ended December 31, 2005 and 2004 are as follows:

	Electric Division		Gas Division		Water Division	
	2005	2004	2005	2004	2005	2004
Premium payments	$ 10,898	$ 10,237	$ 5,162	$ 4,849	$ 3,059	$ 2,874

7. Debt

Long-term debt as of December 31, 2005 and 2004 consists of the following:

	Interest Rates	2005	2004
Electric Division:			
Electric System Revenue Bonds:			
Series 2002, due serially 2003-2010	3.00-5.00%	$ 27,230	$ 32,170
Series 2003A, due serially 2004-2018	2.00-5.00%	1,155,995	1,223,970
Series 2003B, due 2017-2018	Variable	100,000	100,000
Premium on revenue bonds		93,324	107,133
Unamortized deferred cost on bond refunding		(668)	(1,417)
Total		1,375,881	1,461,856
Note payable with bank, due serially through 2010	7.58%	6,950	8,074
		1,382,831	1,469,930
Less: current portion of bonds and notes payable		(77,472)	(74,039)
		$ 1,305,359	$ 1,395,891
Water Division:			
Revenue Refunding Bonds:			
Series 1992, due serially 1993-2006	3.35-6.00%	$ 2,920	$ 5,670
Series 1998, due serially 2000-2012	3.30-5.25%	9,910	11,100
Series 2001, due serially 2002-2009	4.00-5.00%	6,880	10,380
Premium on revenue bonds		114	172
Unamortized deferred cost on bond refunding		(333)	(451)
		19,491	26,871
Less: current portion of bonds and notes payable		(5,770)	(7,440)
		$ 13,721	$ 19,431

(Dollars in Thousands)

7. Debt (continued)

Principal payments on bonds are due annually on January 1 or December 1. Debt service requirements, including notes payable, as of December 31, 2005, are as follows:

	Electric Division		Water Division	
	Principal	Interest	Principal	Interest
2006	$ 77,473	$ 61,212	$ 5,770	$ 795
2007	81,343	57,453	2,975	579
2008	85,260	53,531	3,100	446
2009	89,366	49,326	3,235	311
2010	93,848	44,923	1,465	205
2011-2018	862,885	184,289	3,165	169
Total	$ 1,290,175	$ 450,734	$ 19,710	$ 2,505

MLGW, at its option, may redeem bonds prior to maturity at premiums and prices specified in the indentures. The Series 2003A and Series 2003B bonds are subject to mandatory redemption upon early termination of the Supplement to the Power Contract ("Supplement") with TVA as discussed in Note 10.

Bonds are secured by the pledge of the respective division's revenues, by funds established by the bond resolutions and, in certain circumstances, proceeds from the sale of certain division assets.

During 2003, the Electric Division issued $1,292,170 of Series 2003A and $100,000 of Series 2003B revenue bonds to prepay future power purchases from TVA under the Supplement. See Note 10. The Series 2003A revenue bonds bear interest at annual fixed rates ranging from 2.00% to 5.00%. The Series 2003B revenue bonds are auction rate securities and bear interest for 35-day auction periods. The auction period rate as of December 31, 2005 for the Series 2003B-1, 2003B-2, and 2003B-3 revenue bonds were 3.13%, 3.15 % and 3.20%, respectively.

During 2003, the Electric Division deposited $26,658 with an escrow agent to satisfy the future principal and interest requirements of the remaining $25,015 of Series 1992 refunding bonds. The escrowed funds plus future interest are sufficient to meet the debt service requirements of the Series 1992 bonds and the bonds are considered to be defeased. Therefore, the liability for such bonds has been removed from the accounts of the Electric Division. The difference between the reacquisition price and the net carrying amount of the old debt of $1,067 is reflected as a decrease to bonds payable and is being charged to operations over the original life of the defeased bonds.

During 2002, the Electric Division issued $41,625 in revenue bonds to refund $41,905 of Series 1993 revenue bonds. An additional $4,270 of the 1993 revenue bonds was not refunded, but was repaid on January 1, 2003. The refunding was undertaken to reduce total future debt service payments. The reacquisition price exceeded the net carrying value of the old debt by $462. This amount is netted against the carrying value of the new debt and is being amortized over the life of the new debt, which was shorter than the life of the refunded debt.

7. Debt (continued)

MLGW's Electric Division bond covenants require that for Series 2002 Bonds, the ratio of net revenues available for debt service to maximum amount of principal and interest for any fiscal year ("electric coverage") must not be less than 1.25. For Series 2003 A & B Bonds, the ratio of net revenues to maximum amount of principal and interest for any fiscal year must not be less than 1.00. The composite electric coverage as of December 31, 2005, was 1.98.

The Water Division bond covenant requires that the ratio of net revenues available for debt service to maximum amount of principal and interest for any fiscal year ("water coverage") must not be less than 1.20. Water coverage as of December 31, 2005, was 2.99.

(Dollars in Thousands)

7. Debt (continued)

Long-term debt activity for the years ended December 31, 2005 and 2004 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Year ended December 31, 2005:				
Electric Division				
Bonds and note payable:				
Revenue bonds	$ 1,356,140	$ -	$ (72,915)	$ 1,283,225
Premium on revenue bonds	107,133	-	(13,809)	93,324
Notes payable	8,074	-	(1,124)	6,950
Less deferred amounts:				
For issuance discounts and on refunding	(1,417)	-	749	(668)
Total bonds and note payable	$ 1,469,930	$ -	$ (87,099)	$ 1,382,831
Water Division				
Bonds payable:				
Revenue bonds	$ 27,150	$ -	$ (7,440)	$ 19,710
Premium on revenue bonds	172	-	(58)	114
Less deferred amounts:				
For issuance discounts and on refunding	(451)	-	118	(333)
Total bonds payable	$ 26,871	$ -	$ (7,380)	$ 19,491
Year ended December 31, 2004:				
Electric Division				
Bonds and note payable:				
Revenue bonds	$ 1,429,135	$ -	$ (72,995)	$ 1,356,140
Premium on revenue bonds	121,270	-	(14,137)	107,133
Note payable	24,117	-	(16,043)	8,074
Less deferred amounts:				
For issuance discounts and on refunding	(2,195)	-	778	(1,417)
Total bonds and note payable	$ 1,572,327	$ -	$ (102,397)	$ 1,469,930
Water Division				
Bonds payable:				
Revenue bonds	$ 34,230	$ -	$ (7,080)	$ 27,150
Premium on revenue bonds	255	-	(83)	172
Less deferred amounts:				
For issuance discounts and on refunding	(597)	-	146	(451)
Total bonds payable	$ 33,888	$ -	$ (7,017)	$ 26,871

(Dollars in Thousands)

8. Insurance Reserves for Medical Benefits and Injuries and Damages

MLGW is self-insured for health and medical benefits and for injuries and damages including workers compensation and general liability claims. MLGW has established insurance reserves for the estimated liabilities, including an accrual for incurred but not reported claims, resulting from medical benefits and injuries and damages claims as established by a third party administrator and MLGW's Legal Department. The medical benefits reserve and the costs and charges to the reserve are allocated to each division based on a standard administrative and general cost allocation.

The changes in the self-insurance reserves for medical benefits and injuries and damages for the years ended December 31, 2005 and 2004 are as follows:

	Medical Benefits			Injuries and Damages		
	Electric Division	Gas Division	Water Division	Electric Division	Gas Division	Water Division
Balance – December 31, 2003	$ 4,944	$ 2,342	$ 1,388	$ 1,977	$ 1,179	$ 840
Payments	(22,793)	(10,797)	(6,398)	(2,628)	(729)	(513)
Incurred claims expense	23,535	11,149	6,606	3,360	603	517
Balance – December 31, 2004	5,686	2,694	1,596	2,709	1,053	844
Payments	(24,893)	(11,791)	(6,988)	(1,759)	(773)	(559)
Incurred claims expense	24,063	11,527	6,755	1,062	764	730
Balance – December 31, 2005	$ 4,856	$ 2,430	$ 1,363	$ 2,012	$ 1,044	$ 1,015

9. Telecommunications Division

Memphis Networx, LLC (the "Company") 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. The Company is a joint venture between the Telecommunications Division of MLGW's Electric Division and Memphis Broadband, LLC, a Delaware limited liability company.

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 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.

Under the terms of the Company's Operating Agreement, capital contributions and costs incurred by the Company prior to its formation and through the date of Tennessee Regulatory Authority (TRA) approval are to be shared equally by the members. Per the Operating Agreement, allocations of net operating income or loss and distributions are based on cumulative members' contributions, accumulated members' equity (loss), and the sharing ratios.

9. Telecommunications Division (continued)

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.

The agreement also amended the operating agreement to allow one member to contribute the required capital on behalf of the other member. If a member makes such a disproportionate contribution, the agreement allows the contributing member to charge the other member interest on the disproportionate contribution or increase its ownership percentage and voting interest. On the contribution date, the sharing ratio of net operating income or loss and distributions is adjusted to reflect the increased capital contribution.

MLGW continued to provide periodic investments of capital as requested by Memphis Networx. MLGW contributed $3,532 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. Under the terms of the Company's operating agreement, MLGW's share of net operating losses for 2004 was 100%. In 2004, MLGW's investment in the Company was reduced by $1,551 to properly reflect its prior years' share of net operating losses. The carrying value of Memphis Networx, reflecting total investment and allocated losses since inception at December 31, 2004 was $9,415 or 100% of the accumulated members' equity of the Company.

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 will provide bridge loan financing to the Company in an amount up to $375 each, for a total of $750. 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 an additional 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 to Memphis Networx, such loan to bear interest at 8% per annum. Funding of $500 was made on April 25, 2005, and additional funding of $150 was made on May 18, 2005. All of the bridge loans were repaid in full on June 27, 2005.

On June 21, 2005, Memphis Broadband and MLGW entered into a Capital Contribution Allowance Agreement. Under this agreement, Memphis Broadband agreed to provide a guaranty for a loan by the Company of $4,916. The sharing ratios were adjusted from 83.73% and 16.27% for MLGW and Memphis Broadband, respectively to 56.14% and 43.86% for MLGW and Memphis Broadband, respectively. The Capital Contribution Agreement of April 1, 2002, was also terminated.

(Dollars in Thousands)

9. Telecommunications Division (continued)

Condensed results of operations of the Company for the years ended December 31, 2005 and 2004 are as follows:

	2005	2004
	(unaudited)	
Operating revenue	$ 3,925	$ 3,572
Operating expense	(7,620)	(7,458)
Net loss	$ (3,695)	$ (3,886)

The equity method of accounting is used for the Telecommunications Division's investment in the Company since the Telecommunications Division has significant influence over operating and financial policies but does not have control over policy and operations. Telecommunications Division results for the years ended December 31 are as follows:

	2005	2004
Share of the Company's loss	$ 3,695	$ 3,886
Investment reduction – To reflect ownership percentage	2,508	1,551
General and administrative expenses	67	104
Total Telecommunications Division loss	$ 6,270	$ 5,541

The Telecommunications Division's investment in the Company of $3,211 and $9,415 as of December 31, 2005 and 2004, respectively, is included in other non-current assets in the accompanying balance sheets of the Electric Division.

10. Energy Supplies

The TVA currently supplies all of MLGW's electric power requirements pursuant to a power contract. On November 19, 2003, MLGW entered into a Supplement to the Power Contract ("Supplement") with TVA under which MLGW made a prepayment of $1,500,000 to TVA for capacity and related energy. In exchange for the prepayment and a commitment by MLGW to purchase a minimum amount of electric power from TVA over the term of the Supplement (15 years), TVA will supply a specified amount of electricity over the term and provide a fixed credit to its wholesale power rates otherwise in effect. To finance the prepayment, MLGW issued the Series 2003A and Series 2003B Bonds. See Note 1 (Prepaid Power Cost) and Note 7 (Debt).

10. Energy Supplies (continued)

Under the terms of the TVA power contract, MLGW may terminate its supply arrangement with TVA upon five years' prior written notice. TVA may terminate on not less than ten years' prior written notice. However, such notice of termination cannot be given by either party before November 19, 2013, under the terms of the Supplement.

MLGW purchases gas supplies directly from producers and marketers. MLGW has no minimum purchase commitments under these agreements.

11. Rates

Electric, gas and water rates are established by MLGW and rate changes are subject to approval of the Council. The Council has approved mechanisms for pass-through of wholesale electric rate changes from TVA and natural gas price changes from suppliers without requiring additional specific approval.

TVA implemented a rate adjustment effective October 1, 2005, increasing the cost of wholesale power purchased by MLGW by approximately 7.5%. MLGW implemented changes to its retail rate schedules effective with meters read on or after September 26, 2005, to recover the increased cost of wholesale power from its retail customers. The retail effects of the rate adjustment varied by customer class, with the approximate increases being 5.6% for residential customers, 6.2% for commercial customers and 6.8% for industrial customers.

MLGW implemented a gas rate increase of approximately 6.2% effective with meters read on or after December 28, 2004. The increase was approved in the 2004 Budget process, but was delayed for one year at the direction of the Council. This was the first gas rate increase (except for pass-through of purchased gas costs) since April 1994. The rate increase is due to the effects of inflation on general operating expenses, employee health insurance costs, facility security, increases in uncollectibles, depletion of cash reserves, capital expenditures for system improvements and increases for the in lieu of tax payments and transfers to the City.

12. Commitments and Contingencies

The Gas Division has contracts and swap agreements, from which risks arise from the possible inability of counter parties to meet the terms of their contracts and from movements in gas prices. The Gas Division's exposure to credit loss in the event of nonperformance by the other party is represented by the fair value of the open futures contracts.

MLGW pays a transfer to the City and in lieu of taxes to the incorporated towns of Shelby County for the Electric and Gas Divisions based on the Tennessee Municipal Electric and Gas System Tax Equivalent Laws of 1987. MLGW pays a transfer to the City for the Water Division based upon an agreement with the City which calls for a payment of $2,500 for each of the fiscal years through 2028.

12. Commitments and Contingencies (continued)

MLGW is party to various legal proceedings incidental to its business. In the opinion of management, MLGW's liability, if any, in all pending litigation or other proceedings, taken as a whole after consideration of amounts accrued, insurance coverage, or other indemnification arrangements, will not have a material adverse effect on its financial position or results of operations.

See Note 10 for discussion of MLGW's power contract with TVA.

13. Self-Insurance

MLGW is self-insured. The Tennessee Governmental Tort Liability Act applies to all tort actions against MLGW arising in the State of Tennessee and establishes limits of liability. The current limits of liability for actions arising on or after July 1, 2002, for personal injuries are $250 per person and $600 for two or more persons per accident. Property damages are limited to $85 per accident.

14. Transfers to City

MLGW makes a transfer to the City of Memphis. Prior to 2005, the transfer to the city was classified as a payment in lieu of tax to the City of Memphis. The 2004 in lieu of tax payments have been reclassified to reflect this change. The change was made to comply with GASB requirements. Each division has its own basis of calculating these transfers.

The Electric Division transfer is based on the formula provided by the State of Tennessee Municipal Electric System Tax Equivalent Law of 1987. The formula includes a property tax equivalency calculation plus 4 % of operating revenue less power costs (three year average).

The Gas Division transfer is based on the formula provided by the Municipal Gas System Tax Equivalent Law of 1987. The formula includes a property tax equivalency calculation plus 4% of operating revenue less gas costs (three year average).

The Water Division, through an agreement with the City of Memphis, transfers a payment in the amount of $2,500 per year. The agreement is effective through the year 2028. This payment is paid out of the General Reserve Fund of the Water Division.

SCHEDULE OF ADDITIONS AND RETIREMENTS TO UTILITY PLANT
(Dollars in Thousands)
DECEMBER 31, 2005

	Electric Division	Gas Division	Water Division
Utility plant in service, December 31, 2004	$ 1,076,160	$ 502,870	$ 358,807
Additions	63,934	14,640	13,065
Retirements	(16,030)	(3,860)	(423)
Utility plant in service, December 31, 2005	$ 1,124,064	$ 513,650	$ 371,449

Note: Utility plant in service balances exclude amounts for construction work in process, non-utility property and land held for future use.

SCHEDULE OF DEPOSITS AND INVESTMENTS
(Dollars in Thousands)
DECEMBER 31, 2005

	ACCRUAL YIELD	MATURITY DATE	FAIR VALUE
COMMERCIAL PAPER			
	4.229	01/03/2006	$ 5,489
	4.266	01/03/2006	799
	4.281	01/03/2006	4,688
	4.280	01/03/2006	1,896
	4.257	01/03/2006	4,992
	4.240	01/03/2006	12,171
	4.227	01/03/2006	5,990
	4.260	01/03/2006	10,675
	4.277	01/03/2006	4,792
	4.237	01/03/2006	7,886
	4.289	01/13/2006	3,992
	4.291	01/17/2006	5,985
	4.162	01/20/2006	4,188
	4.292	01/20/2006	12,965
	4.231	01/20/2006	5,086
	4.254	01/25/2006	8,174
	4.233	01/25/2006	2,393
	4.213	01/25/2006	1,994
	4.057	01/25/2006	3,953
	4.031	01/13/2006	1,488
	4.275	01/20/2006	1,286
	4.231	01/20/2006	995
	4.277	01/25/2006	1,285
	4.281	02/02/2006	1,284
	4.286	01/13/2006	1,495
	4.125	01/13/2006	1,233
	4.274	01/17/2006	1,096
	4.291	01/17/2006	1,097
	4.291	01/17/2006	1,097
	4.259	01/20/2006	2,390
	4.222	01/25/2006	1,231
	4.162	01/25/2006	1,984
	4.259	01/27/2006	1,931
	4.279	01/27/2006	1,095
	4.226	02/02/2006	1,232
	4.262	02/02/2006	1,930
	4.280	02/10/2006	1,231
Total Commercial Paper			$ 133,488

SCHEDULE OF DEPOSITS AND INVESTMENTS
(Dollars in Thousands)
DECEMBER 31, 2005
(Continued)

		ACCRUAL YIELD	MATURITY DATE	FAIR VALUE
CERTIFICATE OF DEPOSIT				
	Sun Trust Bank	4.028	01/25/2006	$ 19,000
	Total Certificate of Deposit			$ 19,000
MUTUAL FUNDS				
	Northern Institutional Diversified Assets			$ 1,405
	Federated Treas Obligations FD 398			26,912
	Total Mutual Funds			$ 28,317
CASH				4,178
TOTAL CASH AND CASH EQUIVALENTS				$ 184,983
TREASURY NOTES				
		0.080	08/15/2006	$ 349
	Total Treasury Notes			$ 349
U. S. GOVERNMENT BONDS				
		2.375	08/31/2006	$ 740
		3.500	05/31/2007	2,370
		2.750	08/15/2007	316
		3.500	11/15/2006	1,042
		4.100	08/15/2008	1,144
		2.375	08/31/2006	1,381
		3.625	06/30/2007	494
		2.625	05/15/2008	2,258
		3.000	11/15/2007	780
		3.000	12/31/2006	1,084
		4.125	08/15/2010	693
		4.250	11/30/2007	5,883
		3.000	02/15/2009	480
		3.000	02/15/2008	243
		3.750	05/15/2008	1,972
	Total U.S. Government Bonds			$ 20,880

SCHEDULE OF DEPOSITS AND INVESTMENTS
(Dollars in Thousands)
DECEMBER 31, 2005
(Continued)

	ACCRUAL YIELD	MATURITY DATE	FAIR VALUE
U.S. GOVERNMENT AGENCIES			
	2.625	09/17/2007	$ 358
	3.000	12/17/2007	485
	4.250	10/10/2008	2,077
	3.375	02/23/2007	738
	4.125	02/15/2008	987
	3.125	08/15/2007	780
	4.000	06/13/2008	787
	3.500	05/15/2007	1,229
	2.750	10/15/2006	1,970
	2.750	08/15/2006	1,532
	4.900	11/03/2008	997
	2.500	06/15/2008	712
	2.750	11/21/2006	1,720
	3.500	11/15/2007	1,466
	2.750	08/15/2006	989
	3.250	01/15/2008	1,457
	2.375	02/15/2007	1,948
	5.800	01/14/2008	51
	3.680	06/26/2008	34
	6.600	07/07/2006	20
	3.240	02/26/2007	492
	4.250	06/30/2008	247
	5.670	02/26/2009	82
	5.865	09/02/2008	10
	5.750	05/15/2008	203
	6.050	05/27/2008	57
	2.465	05/11/2007	243
	5.545	02/17/2009	15
	6.243	06/07/2006	171
	5.940	08/28/2008	103
	4.000	02/20/2009	244
	3.375	10/15/2007	977
	5.420	09/23/2008	10
	5.425	09/24/2008	51
	5.890	06/30/2008	31
	5.900	03/26/2009	517
	5.930	03/03/2008	102
	6.060	05/21/2008	26
	3.500	07/30/2008	267
	2.050	01/02/2007	974
	4.000	12/03/2007	197
	4.500	11/18/2009	496
	3.750	08/03/2007	985
	6.700	06/19/2007	257
	2.560	03/02/2007	195

(Dollars in Thousands)

		ACCRUAL YIELD	MATURITY DATE	FAIR VALUE
U. S. GOVERNMENT AGENCIES (cont.)				
		4.750	01/02/2007	834
		4.750	12/15/2010	470
		4.125	06/16/2008	1,182
		5.800	02/22/2006	125
		3.440	12/16/2006	1,522
				$ 31,422
CORPORATE BONDS				
	Citi Group	5.000	03/06/2007	$ 601
	Fleet Boston	4.200	11/30/2007	842
	Gen Elec Cap Corp	3.125	11/09/2006	1,108
	US Bk Natl Assn	3.700	08/01/2007	739
	Citi Group	3.500	02/01/2008	974
	Gen Elec Cap Corp	4.125	03/04/2008	985
	Wal-Mart Stores Inc	8.000	09/15/2006	1,020
	Citi Group	5.750	05/10/2006	404
	Franchise Fin	7.070	01/15/2008	346
	Gen Elec Cap Corp	5.970	05/30/2008	647
	Natl Cy Bk Clev	3.375	10/15/2007	253
	PVTPL CMO 3M	5.620	07/15/2009	163
	US Bk Natl Assn	2.850	11/15/2006	492
	World Svgs Bk FSB	4.125	03/10/2008	492
	Total Corporate Bonds			$ 9,066
ASSET-BACKED SECURITIES				
	Banc of Amer Secs	4.080	04/18/2010	$ 983
	Bk 1 Auto	2.430	03/20/2010	976
	BMW Veh	2.670	03/25/2008	729
	Caterpillar Finl Ast	3.130	01/25/2009	879
	Citibank Cr Card	5.650	06/16/2008	1,004
	Daimlerchrysler Auto	3.090	01/08/2008	761
to be sold in 2006	Harley-Davidson Motorcycle	3.760	12/17/2012	980
	Honda Auto Receivables	2.790	03/16/2009	978
	HSEHD Automotive	3.300	05/18/2009	991
	Nissan Auto Lease	4.700	10/15/2008	998
	Nissan Auto Receivables	1.510	08/15/2007	153
	Toyota Auto Receivables	2.790	01/15/2010	983
	USAA Auto Owner	3.900	07/15/2009	988
	Volkswagen Auto Lease	3.940	10/20/2010	985
	Wal-Mart Stores	7.490	06/21/2007	143
	Total Asset-Backed Securities			$ 12,531

SCHEDULE OF DEPOSITS AND INVESTMENTS
(Dollars in Thousands)
DECEMBER 31, 2005
(Continued)

	ACCRUAL YIELD	MATURITY DATE	FAIR VALUE
GOVERNMENT MORTGAGE BACKED SECURITIES			
FHLMC Gold	3.500	08/01/2008	$ 546
FHLMC Pool	3.500	07/01/2008	270
FNMA Pool	4.000	06/01/2010	1,706
FHLMC Gold	5.000	08/01/2007	101
FHLMC Gold	5.000	12/01/2007	142
FHLMC Gold	5.000	01/01/2008	156
FHLMC Pool	4.500	10/01/2007	152
Total Government Mortgage Backed Securities			$ 3,073
FAIR VALUE OF FUTURES			$ 10,616
ACCRUED INTEREST			$ 884
TOTAL CASH AND INVESTMENTS			$ 273,804

SCHEDULE OF LONG TERM DEBT,
PRINCIPAL AND INTEREST REQUIREMENTS
(Dollars in Thousands)
DECEMBER 31, 2005

	Series 2002		Series 2003A		Series 2003B	
	Principal	Interest	Principal	Interest	Principal	Interest
Electric Division:						
2006	$ 5,090	$ 1,058	$ 71,170	$ 57,209	$	$ 2,460
2007	5,240	904	74,795	53,699		2,460
2008	5,410	734	78,440	50,050		2,460
2009	5,635	518	82,210	46,171		2,460
2010	5,855	295	86,495	42,110		2,460
2011			90,420	37,848		2,460
2012			95,190	33,414		2,460
2013			99,700	28,677		2,460
2014			104,675	23,817		2,460
2015			109,905	18,584		2,460
2016			115,270	13,110		2,460
2017			88,075	7,347	33,000	2,255
2018			59,650	2,966	67,000	1,511
Total	$ 27,230	$ 3,509	$1,155,995	$ 415,002	$ 100,000	$ 30,826

	Note Payable – Bank	
	Principal	Interest
Electric Division:		
2006	$ 1,213	$ 485
2007	1,308	390
2008	1,410	287
2009	1,521	177
2010	1,498	58
Total	$ 6,950	$ 1,397

SCHEDULE OF LONG TERM DEBT,
PRINCIPAL AND INTEREST REQUIREMENTS
(Dollars in Thousands)
DECEMBER 31, 2005
(Continued)

	Series 1992		Series 1998		Series 2001	
	Principal	Interest	Principal	Interest	Principal	Interest
Water Division:						
2006	$ 2,920	$ 87	$ 1,240	$ 444	$ 1,610	$ 264
2007			1,285	388	1,690	191
2008			1,350	329	1,750	117
2009			1,405	272	1,830	39
2010			1,465	205		
2011			1,540	126		
2012			1,625	43		
Total	$ 2,920	$ 87	$ 9,910	$ 1,807	$ 6,880	$ 611

Electric Division Rate Class	Base Charge	Customers
Residential	Effective meters read on or after September 26, 2005.	363,888
Customer charge:	$11.20 per month, less hydro allocation credit: $1.71	
Energy charge:	First 2,000 kWh per month at 6.563 cents per kWh; Additional kWh per month at 7.414 cents per kWh	
General Service – Schedule GSA	Effective meters read on or after September 26, 2005. If (a) the higher of (i) the customer's currently effective contract demand, if any, or (ii) its highest billing demand during the latest twelve-month period is not more than 50 kW, and (b) customer's monthly energy taking for any month during such period does not exceed 15,000 kWh:	43,740
Customer charge:	$15.52 per delivery point per month	
Energy charge:	7.566 cents per kWh If (a) the higher of (i) the customer's currently effective contract demand or (ii) its highest billing demand during the latest twelve-month period is greater than 50kW but not more than 1,000 kW, or (b) if the customer's billing demand is less than 50kW and its energy takings for any month during such period exceed 15,000 kWh.	
Customer charge:	$53.42 per delivery point per month	
Demand charge:	First 50kW of billing demand per month, no demand charge Excess over 50kW of billing demand per month, at $11.47 per kW	
Energy charge:	First 15,000 kWh per month at 8.148 cents per kWh Additional kWh per month at 3.756 cents per kWh If the higher of the customer's currently effective contract demand or its highest billing demand during the latest twelve-month period is greater than 1.000 kW.	
Customer charge:	$191.84 per delivery point per month	
Demand charge:	First 1,000 kW of billing demand per month, at $10.97 per kW Excess over 1,000 kW of billing demand per month, at $12.52 per kW, plus an additional $12.52 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand	
Energy charge:	4.053 cents per kWh per month	

Electric Division Rate Class (cont.)	Base Charge	Customers
General Service – Schedule GSB	Effective meters read on or after September 26, 2005.	15
Customer charge:	$1,500 per delivery point per month	
Demand charge:	$12.84 per kW of billing demand per month, plus an additional $12.84 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds its contract demand	
Energy charge:	First 620 hours use of metered demand per month at 3.391 cents per kWh Additional kWh per month at 2.768 cents per kWh	
General Service – Schedule GSC	Effective meters read on or after September 26, 2005.	1
Customer charge:	$1,500 per delivery point per month	
Demand charge:	$12.31 per kW of billing demand per month, plus an additional $12.31 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds its contract demand	
Energy charge:	First 620 hours use of metered demand per month at 3.391 cents per kWh Additional kWh per month at 2.768 cents per kWh	
General Service – Schedule GSD	Effective meters read on or after September 26, 2005.	0
Customer charge:	$1,500 per delivery point per month	
Demand charge:	$14.78 per kW of billing demand per month, plus an additional $14.78 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds its contract demand	
Energy charge:	2.652 cents per kWh per month	
Manufacturing – Schedule MSB	Effective meters read on or after September 26, 2005. If the customer's metered demand for the month is not more than 5,000 kW:	12
Customer charge:	$1,500 per delivery point per month	
Demand charge:	$11.04 per kW of billing demand per month, plus an additional $11.04 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds its contract demand	
Energy charge:	First 620 hours use of metered demand per month at 2.871 cents per kWh Additional kWh per month at 2.343 cents per kWh If the customer's metered demand for the month is greater than 5,000 kW:	

Electric Division Rate Class (cont.)	Base Charge	Customers
Customer charge:	$1,500.00 per delivery point per month	
Demand charge:	$10.50 per kW billing demand per month, plus an additional $10.50 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds its contract demand	
Energy charge:	First 620 hours use of metered demand per month at 2.729 cents per kWh Additional kWh per month at 2.228 cents per kWh	
Manufacturing – Schedule MSC	Effective meters read on or after September 26, 2005.	2
Customer charge:	$1,500 per delivery point per month	
Demand charge:	$9.97 per kW of billing demand per month, plus an additional $9.97 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds its contract demand	
Energy charge:	First 620 hours use of metered demand per month at 2.729 cents per kWh Additional kWh per month at 2.228 cents per kWh	
Manufacturing – Schedule MSD	Effective meters read on or after September 26, 2005.	3
Customer charge:	$1,500 per delivery point per month	
Demand charge:	$11.94 per kW of billing demand per month, plus an additional $11.94 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds its contract demand	
Energy charge:	2.145 cents per kWh per month	
Outdoor Lighting	Effective meters read on or after September 26, 2005.	16,969
	Part A – Charges for street and park lighting systems, traffic signal systems, and athletic field lighting installations.	
Energy charge:	5.113 cents per kWh per month	

Electric Division Rate Class (cont.)	Base Charge	Customers

Outdoor Lighting Facilities charge:

The annual facility charge shall be 9.84% of the installed cost to the Division's electric system of the facility devoted to street and park lighting service specified in this Part A. Such installed cost shall be recomputed on July 1 of each year, or more often if substantial changes in the facilities are made. Each month, one-twelfth of the then total annual facility charge shall be billed to the customer. If any part of the facilities has not been provided at the electric system's expense or if the installed cost of any portion thereof is reflected on the books of another municipality or agency or department, the annual facility charge shall be adjusted to reflect properly the remaining cost to be borne by the electric system.

Traffic signal systems and athletic field lighting installations shall be provided, owned, and maintained by and at the expense for the customer, except as Division may agree otherwise in accordance with the provisions of the paragraph next following in this section. The facilities necessary to provide service to such systems and installations shall be provided by and at the expense of Division's electric system, and the annual facility charge provided for first above in this section shall apply to the installed cost of such facilities.

When so authorized by policy duly adopted by Division's governing board, traffic signal systems and athletic field lighting installations may be provided, owned and maintained by Division's electric system for the customer's benefit. In such cases Division may require reimbursement from the customer for a portion of the initial installed cost of any such system or installation and shall require payment by the customer of a facility charge sufficient to cover all of Division's costs (except reimbursed costs), including appropriate overheads, of providing, owning, and maintaining such system or installation; provided that, for athletic field lighting installations, such facility charge shall in no case be less than 12% per year of such costs. Said facility charge will be in addition to the annual facility charge on the facilities necessary to provide service to such system or installation as provided for in the preceding paragraph.

Part B – Charges for outdoor lighting for individual customers – charges per fixture per month

(a) Type of fixture	Watts	Lamp Size (Lumens)	Rated (kWh)	Charge
Mercury Vapor or Incandescent	175	7,650	70	$2.95
	250	10,400	98	3.49
	400	19,100	155	4.42
	700	33,600	266	5.96
	1,000	47,500	378	7.59
Metal Halide	175	8,300	70	2.95
	250	14,000	98	3.49
	400	22,600	155	4.42
	1,000	88,000	378	7.59

Electric Division Rate Class (cont.)	Base Charge				Customers
		Lamp Size	Rated		
(a) Type of fixture	Watts	(Lumens)	(kWh)	Charge	
High Pressure Sodium	50	3,285	22	4.19	
	100	8,550	42	4.48	
	150	14,400	63	4.61	
	200	18,900	82	5.01	
	250	23,000	105	5.30	
	400	45,000	165	6.29	
	1,000	126,000	385	10.05	

Gas Division Rate Class	Base Charge	Customers
Residential G-1 & G-3	Effective December 28, 2004 Schedule G-1 is available for domestic use to residential customers in individual private residences or other individual dwelling units situated within the corporate limits of the City of Memphis, Tennessee. Schedule G-3 is available for domestic use to residential customers in individual private residences or other individual dwelling units situated outside the corporate limits of the City of Memphis, Tennessee.	295,492
Service charge:	$ 7.00 per month plus	
Commodity charge:	All gas consumed: $0.7192 per Ccf per month, plus The above rates are subject to adjustment under the provisions of the Purchased Gas Adjustment Rider.	
Minimum bill:	$7.00 per meter per month	
Small General Service G-7	Effective December 28, 2004 This rate schedule is available for gas service to all gas customers except residential	22,246
Service charge:	$18.00 per month plus,	
Commodity charge:	All gas consumed: $0.7198 per Ccf per month, plus The above rates are subject to adjustment under the provisions of the Purchased Gas Adjustment Rider.	
Minimum bill:	The minimum monthly bill shall be $.6539 for each Ccf of the higher of: (1) The maximum daily demand during the preceding eleven months, or (2) The daily contract demand, but in no case less than $18.00.	

Gas Division Rate Class (cont.)	Base Charge	Customers
Large General Service Firm on-peak G-8 and G-9	Effective December 28, 2004 This rate schedule is available for gas service to all customers contracting for not less than 100 Ccf of maximum daily demand.	509
Demand charge:	$0.609 Ccf per month of contract demand or maximum daily demand during the twelve (12) months ending with the billing month, whichever is higher, plus First 200,000 Ccf per month @ $0.5698 Ccf Excess over 200,000 Ccf per month @ $0.5015 Ccf, plus The above rates are subject to adjustment under the provisions of the Purchased Gas Adjustment Rider.	
Minimum bill:	The minimum bill shall be $.9035 for Ccf of the higher of: (1) the maximum Daily Demand during the twelve (12) months ending with the billing month, or (2) the Daily Contract Demand. Sales and transportation usage is combined when calculating the minimum bill.	
Large General Service Interruptible Off-peak G-10 and G-12	Effective December 28, 2004 This rate schedule is available for gas service to all customers contracting for not less than 1,500 Ccf of maximum daily demand and providing all or other alternate fuel facilities approved by the Division as being adequate in design and capacity.	34
Service charge:	$301.42 per month, plus First 200,000 Ccf per month @ $0.5513 Ccf Excess over 200,000 Ccf per month @ $0.5015 per Ccf, plus The above rates are subject to adjustment under the provisions of the Purchased Gas Adjustment Rider.	
Minimum bill:	The minimum monthly bill shall be $.3496 for each Ccf of the higher of (1) the maximum daily demand during the twelve months ending with the billing month, or (2) the daily contract demand, but in no event less than $301.42.	
General Service Seasonal Off-peak G-17	Effective December 28, 2004 Schedule G-17 is available for gas service from April 1 through October 31 of any year to all customers contracting for not less than 250 Ccf of maximum daily demand and providing oil or other alternative fuel facilities approved by the Division as being adequate in design and capacity.	0

Gas Division Rate Class (cont.)	Base Charge	Customers
Monthly rate:	(Ccf equals 100 cubic feet)	
All gas consumed:	$0.6158 per Ccf, plus The above rates are subject to adjustment under the provisions of the Purchased Gas Adjustment Rider.	
Minimum bill:	The minimum monthly bill shall be $0.3661 for each Ccf of the higher of: (1) the maximum daily demand during the preceding eleven (11) months, or (2) the daily contract demand, but in no case less than $217.47	

Water Division Rate Class	Base Charge	Customers
Residential – Inside City Rate	Effective meters read on or after December 30, 2003 For water furnished to premises entirely within the corporate limits of the City of Memphis	188,088
Commodity charge:	All water consumed: $1.1406 per Ccf per month	
Minimum bill:	The minimum monthly bill shall be determined by the size of the meter installed, as follows: 5/8" meter $ 4.81 3/4" meter 6.94 1" meter 12.33 1-1/2" meter 27.74 2" meter 49.32	
Residential – Outside City Rate	Effective meters read on or after December 30, 2003 For water furnished to premises outside the corporate limits of the City of Memphis	18,943
Commodity charge:	All water consumed: $1.7750 per Ccf per month	
Minimum bill:	The minimum monthly bill shall be determined by the size of the meter installed, as follows: 5/8" meter $ 6.70 3/4" meter 9.64 1" meter 17.16 1-1/2" meter 38.60 2" meter 68.61	

Water Division Rate Class (cont.)	Base Charge		Customers
General Service – Inside City Rate	Effective meters read on or after December 30, 2003 For water service to all customers within the corporate limits of the City of Memphis, except residential customers		18,848
Commodity charge:	Water consumed per month:		
	First 30 Ccf	$1.4558 per Ccf	
	Next 70 Ccf	$1.2353 per Ccf	
	Next 100 Ccf	$0.9412 per Ccf	
	Next 400 Ccf	$0.7866 per Ccf	
	Next 5,400 Ccf	$0.6044 per Ccf	
	Excess over 6,000 Ccf	$0.6323 per Ccf	
Minimum bill:	The minimum monthly bill shall be determined by the size of the meter installed, as follows:		
	5/8" meter	$9.23	
	3/4" meter	10.75	
	1" meter	18.44	
	1-1/2" meter	36.90	
	2" meter	76.91	
	3" meter	153.77	
	4" meter	229.95	
	6" meter	290.89	
	8" meter	351.85	
	10" meter	728.85	
	12" meter	1,016.99	
	14" meter	1,398.37	
	Battery of 2-2" meters	153.77	
	Battery of 3-2" meters	229.95	
General Service – Outside City Rate	Effective meters read on or after December 30, 2003 For water service to all customers outside the corporate limits of the City of Memphis, except residential customers		806
Commodity charge:	Water consumed per month:		
	First 30 Ccf	$2.1784 per Ccf	
	Next 70 Ccf	$1.8341 per Ccf	
	Next 100 Ccf	$1.3998 per Ccf	
	Next 400 Ccf	$1.1753 per Ccf	
	Next 5,400 Ccf	$0.9179 per Ccf	
	Excess over 6,000 Ccf	$0.9583 per Ccf	

Water Division Rate Class (cont.)	Base Charge	Customers
Minimum bill:	The minimum monthly bill shall be determined by the size of the meter installed, as follows: 5/8" meter $14.10 3/4" meter 16.46 1" meter 28.21 1-1/2" meter 56.41 2" meter 117.54 3" meter 235.12 4" meter 351.38 6" meter 444.52 8" meter 537.65 10" meter 1,113.75 12" meter 1,554.06 14" meter 2,135.38 Battery of 2-2" meters 235.12 Battery of 3-2" meters 351.38	
Residential – Shelby County Water Distribution System	Effective meters read on or after December 30, 2003 For water service within the area served by the Shelby County Water Distribution System at the time of its acquisition on June 30, 1999, for domestic uses to residential customers in individual private residences or other individual dwelling places.	22,988
Monthly rate:	All water consumed $1.7750 per Ccf per month	
Minimum bill:	The minimum monthly bill shall be determined by the size of the meter installed, as follows: 5/8" meter $6.70 3/4" meter 9.64 1" meter 17.16 1-1/2" meter 38.60 2" meter 68.61 Residential customers shall be served through a single meter not larger than 2" in size.	
Commercial - Industrial – Shelby County Water Distribution System	Effective meters read on or after December 30, 2003 For water service within the area served by the Shelby County Water Distribution System at the time of its acquisition on June 30, 1999, for all customers except residential customers using service exclusive for domestic use.	607

Water Division Rate Class (cont.)	Base Charge		Customers
Monthly rate:	Water consumed per month:		
	First 30 Ccf	$2.1784 per Ccf	
	Next 70 Ccf	$1.8341 per Ccf	
	Next 100 Ccf	$1.3998 per Ccf	
	Next 400 Ccf	$1.1753 per Ccf	
	Next 5,400 Ccf	$0.9179 per Ccf	
	Excess over 6000 Ccf	$0.9583 per Ccf	
Minimum bill:	The minimum monthly bill shall be determined by the size of the meter installed, as follows:		
	5/8" meter	$14.10	
	3/4" meter	16.46	
	1" meter	28.21	
	1-1/2" meter	56.41	
	2" meter	117.54	
	3" meter	235.12	
	4" meter	351.38	
	6" meter	444.52	
	8" meter	537.65	
	10" meter	1,113.75	
	12" meter	1,554.06	
	14" meter	2,135.38	

SCHEDULE OF INSURANCE
(Thousands of Dollars)
FOR DECEMBER 31, 2005

Type of Coverage	Amount of Coverage
Property	$500,000
Boiler and Machinery	50,000
LNG Plants	100,000
Crime	1,000
Travel Accident	1,000

WATKINS UIBERALL

Watkins Uiberall, PLLC
Certified Public Accountants & Financial Advisors

BANKS, FINLEY, WHITE & CO.
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Commissioners and Management
Memphis Light, Gas and Water Division
Memphis, Tennessee

We have audited the financial statements of the Electric, Gas, and Water divisions (the Divisions) of Memphis Light, Gas, and Water Division, an enterprise fund of the City of Memphis, Tennessee, (the "Division") as of and for the year ended December 31, 2005, and have issued our report thereon dated April 7, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Divisions' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Divisions' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion

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on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Audit Committee, Board of Commissioners, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Watkins Uiberall, PLLC
Banks, Finley, White & Co.

Memphis, Tennessee
April 7, 2006