

MPHASE TECHNOLOGIES INC
Form 10-Q
November 14, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
FOR THE QUARTER ENDED September 30, 2008

COMMISSION FILE NO. **000-24969**

mPhase Technologies, Inc.

(Exact name of registrant as specified in its charter)

NEW JERSEY

(State or other jurisdiction of
incorporation or organization)

22-2287503

(I.R.S. Employer
Identification Number)

587 CONNECTICUT AVE., NORWALK, CT

(Address of principal executive offices)

06854-1711

(Zip Code)

ISSUER'S TELEPHONE NUMBER, (203) 838-2741

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934, DURING THE PRECEDING 12 MONTHS (OR FOR SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORT), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS.

YES

Q NO "

THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE REGISTRANT'S CLASSES OF COMMON STOCK AS OF NOVEMBER 14, 2008 IS 544,239,955 SHARES, ALL OF ONE CLASS OF \$.01 STATED VALUE COMMON STOCK.

mPHASE TECHNOLOGIES, INC.

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mPHASE TECHNOLOGIES, INC.
(A Development Stage Company)
Consolidated Balance Sheets

	June 30, 2008	September 30, 2008 (Unaudited)
ASSETS		
CURRENT ASSETS		
Cash	\$15,533	\$41,589
Accounts receivable	4,000	10,266
Prepaid and other current assets	121,882	39,487
Total Current Assets	141,415	91,342
Property and equipment, net	149,418	109,111
Note receivable	1,950,000	3,250,000
Investment in Sovereign	110,000	110,000
TOTAL ASSETS	\$2,350,833	\$3,560,453
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Accounts payable	\$2,076,965	\$2,094,583
Accrued expenses	388,444	428,949
Due to related parties	1,030,167	1,030,503
Notes payable, related parties	204,038	224,538
Short term notes	240,820	240,820
Convertible debt	54,000	54,000
TOTAL CURRENT LIABILITIES	\$3,994,434	\$4,073,393
Convertible debt derivative liability - (Note 4)	\$750,151	1,026,724
Convertible debentures net of discount of \$2,953,899 and \$3,351,053 on June 30, 2008 and Sept 30, 2008 respectively (Note 4)	\$411,101	1,398,948
TOTAL LIABILITIES	\$5,155,686	\$6,499,065
COMMITMENTS AND CONTINGENCIES (Note 6)		
STOCK HOLDERS' DEFICIT		
Common stock, par value \$.01, 2,000,000,000 shares authorized 440,395,000 and 526,233,500 shares issued and outstanding at June 30, and Sept.30, respectively	\$4,403,950	5,262,335
Additional paid in capital	165,067,510	170,826,364

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Deficit accumulated during development stage	(172,268,340)	(179,019,338)
Less-Treasury stock, 13,750 shares at cost	(7,973)	(7,973)
TOTAL STOCK HOLDERS' DEFICIT	(\$2,804,853)	(\$2,938,612)
TOTAL LIABILITIES AND STOCK HOLDERS' DEFICIT	\$2,350,833	\$3,560,453

The accompanying notes are an integral part of these consolidated financial statements.

mPHASE TECHNOLOGIES, INC.
(A Development Stage Company)
Consolidated Statements of Operations

	For the Three Months ended Ended Sept 30,		Date of Inception to Sept 30, 2008
	2007	2008	2008
REVENUES	\$34,959	\$6,266	\$22,568,305
COSTS AND EXPENSES			
Cost of Sales	0	0	16,424,692
Research and Development (including non-cash stock related charges of \$0, \$93,600 and \$2,503,719 for years three months ended Sept 30, 2007, 2008 and inception to date respectively)	1,054,931	387,676	59,348,184
General and Administrative (including non-cash stock related charges of \$208,097, \$5,511,950 and \$67,844,914 for the three months ended Sept 30, 2007, 2008 and inception to date respectively)	1,496,784	6,239,260	115,711,023
Depreciation and Amortization	34,059	13,483	3,283,671
TOTAL COSTS AND EXPENSES	2,585,774	6,640,419	194,767,570
LOSS FROM OPERATIONS	(2,550,815)	(6,634,153)	(172,199,265)
OTHER INCOME (EXPENSE) net			
Interest (Expense), net	(12,811)	(39,053)	(422,382)
Reparation, Impairment and Other (Expense) net	(222,640)	(198,372)	(8,357,019)
Change in Derivative Value and Debt Discount	0	120,580	1,959,328
TOTAL OTHER INCOME (EXPENSE)	(235,451)	(116,845)	(6,820,073)
NET LOSS	(\$2,786,266)	(\$6,750,998)	(\$179,019,338)
LOSS PER COMMON SHARE, basic and diluted			
	(\$0.01)	(\$0.01)	
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING, basic and diluted			
	389,791,154	452,895,360	

The accompanying notes are an integral part of these consolidated financial statements.

mPHASE TECHNOLOGIES, INC.
(A Development Stage Company)
Consolidated Statement of Changes in Shareholders' Deficit

	Shares	\$.01 Stated Value	Treasury Stock	Additional Paid in Capital	Accumulated Deficit	Total Shareholders (Deficit) Equity
Balance June 30, 2008	440,395,000	\$4,403,950	(\$7,973)	\$165,067,510	(\$172,268,340)	(\$2,804,853)
Issuance of common stock in private placements net of offering cost (\$20,000)	4,000,000	\$40,000		\$140,000		\$180,000
Issuance of additional shares effect repricing	3,862,000	\$38,620		\$178,069		\$216,689
Stock options/ warrants awarded to employees and investors				\$2,825,900		\$2,825,900
Stock based compensation	61,750,000	\$617,500		\$2,162,150		\$2,779,650
Conversion of debt securities	16,226,500	\$162,265		\$452,735		\$615,000
Net Loss					(\$6,750,998)	(\$6,750,998)
Balance September 30, 2008	\$526,233,500	\$5,262,335	(\$7,973)	\$170,826,364	(\$179,019,338)	(\$2,938,612)

The accompanying notes are an integral part of these consolidated financial statements.

mPHASE TECHNOLOGIES, INC.

(A Development Stage Company)

Consolidated Statements of Cash Flows

	For Three Months Ended		October 2, 1996
	Sept 30,	Sept 30,	(Date of Inception)
	2007	2008	To Sept 30, 2008
Cash Flow From Operating Activities:			
Net Loss	(\$2,786,266)	(\$6,750,998)	(\$179,019,338)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	57,942	40,307	\$7,322,664
(Gain) loss on debt extinguishments			(\$772,216)
Non-cash charges relating to issuance of common stock, common stock options and warrants	1,054	5,605,550	\$68,226,018
Reparation charges	226,118	216,689	\$8,013,251
Derivative Value and Debt Discount charges		(120,580)	(\$1,309,177)
Write off of Granita Inventory		0	\$505,910
Other non cash charges including amortization of deferred compensation	207,042	\$0	\$1,015,065
Changes in assets and liabilities:			
Accounts receivable	(32)	(6,266)	\$417,610
Inventories	495,283		(\$510,471)
Prepaid expenses and other current assets	257,646	82,395	\$41,574
Other			\$906,535
Accounts payable, Accrued expenses, Deferred revenue Due to/from related parties	(39,722)	58,123	\$8,092,683
Microphase / Janifast / /Lintel	(157,865)		\$5,378,063
Officers and Other	(14,225)	20,836	\$1,456,089
Net cash used in operating activities	(\$1,753,025)	(\$853,944)	(\$80,235,740)
Cash Flow from Investing Activities:			
Payments related to patents and licensing rights	-		(\$450,780)
Purchase of fixed assets	\$0		(\$3,279,387)
Investment in Sovereign			(\$110,000)
Net cash (used) in investing activities	\$0	\$0	(\$3,840,167)
Cash Flow from Financing Activities:			
Proceeds from issuance of common stock, exercises warrants and finders fees, net	\$550,000	\$180,000	\$82,166,852
Payments of short term notes	450,531		(\$1,281,552)
Advances from Microphase			\$347,840
Issuance of Convertible Debentures			\$154,000

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Net Proceeds (Repayment) from notes payable related parties	462,495		\$174,329
Proceeds under securities purchase agreements (note 4)		700,000	\$2,050,000
Sale of minority interest in Granita subsidiary	514,000		\$514,000
Repurchase of treasury stock at cost			(\$7,973)
Net cash provided by financing activities	\$1,977,026	\$880,000	\$84,117,496
Net increase in cash	\$224,001	\$26,056	\$41,589
CASH AND CASH EQUIVALENTS, beginning of period	\$23,253	\$15,533	
CASH AND CASH EQUIVALENTS, end of period	\$247,254	\$41,589	\$41,589

The accompanying notes are an integral part of these consolidated financial statements.

mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS - mPhase Technologies, Inc. (the "Company") was organized on October 2, 1996 and is in the development stage, as defined by Statement of Financial Accounting Standards ("SFAS") No. 7, "Accounting and Reporting by Development Stage Enterprises." The Company's present activities are focused on microfluidics, microelectromechanical systems (MEMS) and nanotechnology. Since mPhase is in the development stage, the accompanying consolidated financial statements should not be regarded as typical for normal operating periods.

BASIS OF PRESENTATION - The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the regulations of the Securities Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three months ending September 30, 2008 are not necessarily indicative of the results that may be expected for a full fiscal year. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended June 30, 2008.

Through September 30, 2008, the Company had incurred cumulative (a) development stage losses totaling approximately \$179,019,338 (b) stockholders' deficit of \$2,938,612, and (c) negative cash flow from operations equal to \$80,235,740. At September 30, 2008, the Company had \$41,589 of cash and \$10,266 of trade receivables to fund short-term working capital requirements. In addition, the Company relies on the continuation of funding under certain convertible securities agreements (See Note 4) The Company's ability to continue as a going concern and its future success is dependent upon its ability to raise capital in the near term to: (1) satisfy its current obligations, (2) continue its research and development efforts, and (3) allow the successful wide scale development, deployment and marketing of its products.

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

LOSS PER COMMON SHARE, BASIC AND DILUTED - The Company accounts for net loss per common share in accordance with the provisions of SFAS No. 128, "EARNINGS PER SHARE" ("EPS"). SFAS No. 128 requires the disclosure of the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. Common equivalent shares have been excluded from the computation of diluted EPS for all periods presented since their affect is anti dilutive.

2. SUPPLEMENTAL CASH FLOW INFORMATION

For the months ended September 30,

	2007	2008
Interest Accrued Unpaid	\$10,261	\$39,053
Non Cash Investing and Financing Activities:		

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Assumption of Sovereign note payable	\$110,000	
Stock issued in settlement of accrued expenses	\$100,000	
Conversion of convertible debt		\$615,000

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3. RELATED PARTY TRANSACTIONS

MICROPHASE CORPORATION

mPhase's President, Chief Operating Officer and Chairman of the Board of the Company are also officers of Microphase and mPhase's President and Chairman of the Board are shareholders of Microphase. On May 1, 1997, the Company entered into an agreement with Microphase, whereby it will use office space as well as the administrative services of Microphase, including the use of accounting personnel. This agreement was for \$5,000 per month and was on a month-to-month basis. In July 1998, the office space agreement was revised to \$10,000, in January 2000 to \$11,050 per month, in July 2001 to \$11,340 per month, in July 2002 to \$12,200 per month, in January 2003 to \$10,000 per month, and in July 2003 to \$18,000 per month. Additionally, in July 1998, mPhase entered into an agreement with Microphase, whereby mPhase reimburses Microphase \$40,000 per month for technical research and development. In January 2003 the technical research and development agreement was revised to \$20,000 per month, and in July 2003 it was further revised to \$5,000 per month for technical and research development, \$5,000 per month for administrative services and \$5,000 per month under the office space agreement. Beginning July 1, 2006, billings for all of the above services has been \$5,000 per month. In addition, Microphase also charges fees for specific projects on a project-by-project basis. During the three months ended September 30, 2007 and 2008 and from inception (October 2, 1996), \$59,054, \$12,644 and \$9,156,238 respectively, have been charged to expense.

As a result of the foregoing transactions as of September 30, 2008, the Company had a \$40,650 payable to Microphase.

JANIFAST LTD.

The Company purchases products and incurs certain research and development expenses with Janifast Ltd., which is owned by U.S. Janifast Holdings, Ltd., a company in which three directors of mPhase are significant shareholders and one is an officer, in connection with the manufacturing of POTS Splitter shelves and component products including cards and filters sold by the Company.

During the three months ended September 30, 2007 and 2008 and the period from inception (October 2, 1996), \$0, \$0 and \$16,031,811 respectively, have been charged by Janifast to inventory or is included in operating expenses in the accompanying statements of operations.

OTHER RELATED PARTIES

Mr. Abraham Biderman was employed until September 30, 2003 by our former investment-banking firm Lipper & Company. On Sept. 30, 2008, Mr. Biderman's affiliated firm of Palladium Capital Advisors was owed unpaid finders fees in the amount of \$150,000. During the three months ended September 30, 2008 finders fees in the amount of \$20,000 were recorded and paid.

Transactions with Officers

At various points during the current quarter and at various points during the past fiscal year the Messrs, Durando, Dotoli and Smiley provided bridge loans to the Company, evidenced by individual promissory notes and deferred compensation so as to provide working capital to the Company. All of the notes are payable on demand. In addition, during the current quarter, the Company issued to employees and consultants a total of 61,750,000 shares of common stock and 104,675,000, 5 year options to purchase Company stock at 5 cents per share.

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Total compensation (including the value of stock awards) to related parties and payables to officers are summarized below

Summary of compensation to related parties for the three months ended September 30, 2008

	Durando	Dotoli	Smiley	Biderman	Microphase	Total
Consulting / Salary	\$98,400	\$70,500	\$50,000			\$218,900
Interest			\$4,291			\$4,291
Rent					\$9,000	\$9,000
R&D					\$3,644	\$3,644
Finders Fees				\$20,000		\$20,000
Stock based compensation (shares issued)	\$1,215,000	\$720,000	\$450,000	\$180,000		\$2,565,000
Stock based compensation (options issued)	\$1,350,000	\$810,000	\$486,000	\$54,000		\$2,700,000
Total compensation	\$2,663,400	\$1,600,500	\$990,291	\$254,000	\$12,644	\$5,520,835
Common stock issued*	27,000,000	16,000,000	10,000,000	4,000,000		57,000,000
Options issued (5years @ .05)	50,000,000	30,000,000	18,000,000	2,000,000		100,000,000

Summary of compensation to related parties for the three months ended September 30, 2007

	Durando	Dotoli	Smiley	Biderman	Microphase	Total
Consulting / Salary	\$98,400	\$70,500	\$50,000			\$218,900
Interest	\$2,550	\$350	\$6,950			\$9,850
Rent					\$9,000	\$9,000
R&D					\$50,054	\$50,054
Finders Fees						\$0
Stock based compensation (shares issued)						\$0
Stock based compensation (options issued)						\$0
Total compensation	\$100,950	\$70,850	\$56,950	\$0	\$59,054	\$68,904

Summary of payables to related parties as of September 30, 2008

	Durando	Dotoli	Smiley	Microphase	Janifast	Total
Notes payable		\$8,000	\$216,538			\$224,538
Deferred Compensation	\$278,000	\$323,500				\$601,500
Due to Officers / Affiliates	\$295,890	\$88,756		\$40,650	(\$19,336)	\$405,960
Interest Payable			\$23,043			\$23,043
Total Payable to Officers	\$573,890	\$420,256	\$239,581	\$40,650	(\$19,336)	\$1,255,041

*Shares issued to officers are pursuant to agreements dated August 8, 2008 between the Company and the Messrs Durando, Dotoli and Smiley. The agreements state that the stock granted may not be sold until the earlier of two (2) years or when the stock price for 60 consecutive days closes at a price of \$.25 per share or greater and the average trading volume during such 60 day period is not less than 1,000,000 shares per day.

4. EQUITY TRANSACTIONS AND CONVERTIBLE DEBT

Private Placements

During the quarter ended September 30, 2008, the Company issued 4,000,000 shares of its common stock at \$.05 per share in private placements generating net proceeds of \$180,000. Related to this transaction was the issuance of 3,862,000 shares as reparations shares to effect repricing costing an estimated \$216,689.

Stock Based Compensation

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During the three months ended September 30, 2008, the Company issued 5 year options to purchase 104,675,000 shares of common stock at \$.05 per share. The fair value of such options was estimated to be \$2,825,900 at the date of the grant using the Black Scholes pricing model based on the following weighted average assumptions: an annual expected return of zero percent; annual volatility of 78%; an interest free rate of 1.5% and an expected life of 5 years. In addition, 61,750,000 shares of common stock, with a market value on the date of issuance of \$2,779,650, were issued to employees and consultants. (See note 3)

Conversion of debt securities

During the three months ended September 30, 2008, \$615,000 of convertible debt was converted into 16,226,500 shares of Common stock

Long Term Convertible Debentures / Note Receivable / Debt Discount

The Company entered into four separate convertible debt arrangements with independent investors. These transactions are intended to provide liquidity and capital to the Company and are summarized below.

Arrangement #1

In December, 2007, the Company received proceeds of \$500,000 under a Securities Purchase Agreement. This transaction involves three related agreements: 1) A Securities Purchase Agreement which may under certain circumstances permit the Company to draw up to \$6,000,000 of funds; 2) A Convertible Debenture in the amount of \$1.5 million, with an interest rate of 7 ¼% and a maturity date of December 11, 2010 and 3) A Secured Note Receivable in the amount of \$1.0 million, with an interest rate of 8 ¼ % and a maturity date of February 1, 2011 due from the same parties who are the holders of the Convertible Debentures . Conversion of outstanding debentures into common shares is at the option of the holder. The number of shares into which this debenture can be converted is equal to the dollar amount of the debenture divided by the lesser of \$.35 per share or 80% of the 3 lowest Volume Weighted Average Prices during a 20 day trading period. At the time of the transaction (December 11, 2007) the derivative value of this security was calculated to be \$1,678,471. On June 30, 2008, given the decrease in the stock price, this value had decreased to \$322,636 and on September 30,2008 such value was \$141,509 creating a non-cash credit to earnings for the quarter ended September 30, 2008 of \$181,127. In addition, the transaction resulted in a note discount of \$1.5 million which is being amortized as expense over the life of the loan. During the three month period ended Sept 30, 2008, amortization of debt discount amounted to \$576,983 reducing the balance to \$545,663. During the first quarter of FYE 2009, \$615,000 of such debt was converted into 16,226,500 shares of common stock and the Company received a \$500,000 payment under the provisions of the related Note Receivable. Subsequently, through October 31, 2008, an additional \$289,000 was converted into 14,152,580 shares and the Company received additional payments of \$250,000 of its Note Receivable. The Note Receivable is secured by all the assets of Golden Gate. It should also be noted that the holder has the right to offset unpaid principal amount against the note receivable as well as receive certain compensatory fees in the event of a default.

Arrangement #2

In February 2008, the Company entered into a Convertible Debenture transaction which involved the receipt of \$500,000 cash, a note payable of \$550,000 and the issuance of 3,250,000 shares of stock valued at \$260,000. The relative fair value of the shares was \$105,000. The terms of the debenture provide for a 7.5% interest rate, a due date of February 2012 and allow similar conversion privileges equal to 75% of the average of the three lowest prices over a 20 day period. The derivative value of such security was estimated to be \$581,428 on the date of issuance. On June 30, 2008, this value had decreased to \$142,593 and on September 30,2008 such value was \$129,195 creating a non-cash credit to earnings for the quarter ended of \$13,398. The cost of the shares issued and related debt discount is being amortized to expense over the life of the debenture. In the event of default under the note payable the holder is entitled to certain compensatory fees. During the three month period ended Sept 30, 2008, amortization of debt discount amounted to \$36,738 reducing the balance to \$465,345.

Arrangement #3

In April, 2008, the Company received proceeds of \$300,000 under a Securities Purchase Agreement. This transaction involves three related agreements: 1) A Securities Purchase Agreement which may under certain circumstances permit the Company to draw up to \$1,000,000 of funds; 2) Two Convertible Debentures totaling \$1,450,000, with a one time

interest factor of 12% and a maturity date of March 25, 2011 and 3) A Secured Note Receivable in the amount of \$1.0 million, with a one time interest factor of 13.2 % and maturity dates of March 25, 2012 due from the same parties who are the holders of the Convertible Debentures . Conversion of outstanding debentures into common shares is at the option of the holder. The number of shares into which this debenture can be converted is equal to the dollar amount of the debenture divided by 75%- 80% of the 3 lowest Volume Weighted Average Prices during a 20 day trading period. At the time of the transaction the derivative value of this security was calculated to be \$2,493,212. On June 30, 2008, given the decrease in the stock price, this value had decreased to \$284,922. On September 30, 2008, such value had increased to \$378,662 creating a non-cash charge to earnings over the year of \$93,740. In addition, the transaction resulted in a note discount which is being amortized as expense over the life of the loan. Draws under the Note Receivable are not anticipated until November 2008 and are collateralized by \$1 million of Blue Chip Stocks. In total 2 million shares were issued in connection with the convertible debentures with a relative fair value of \$160,000 included in debt discount. During the three month period ended Sept 30, 2008, amortization of debt discount amounted to \$132,917 reducing the balance to \$1,196,250.

Arrangement #4 (Related to parties in arrangement #1)

On Sept 11, 2008, the Company received proceeds of \$200,000 under a Securities Purchase Agreement. This transaction involves three related agreements: 1) A Securities Purchase Agreement which may under certain circumstances permit the Company to draw up to \$2,000,000 of funds; 2) A Convertible Debenture totaling \$2,000,000, with a interest rate of 7 1/4% and a maturity date of September 30, 2011 and 3) A Secured Note Receivable in the amount of \$1,800,000, with a interest rate of 8 1/4% and maturity dates of September 30,2011 due from the same parties who are the holders of the Convertible Debentures. In addition, the holder of the debenture is related to the holder in Arrangement #1. Conversion of outstanding debentures into common shares is similar to the terms of Arrangement #1. At the time of the transaction (September 11, 2008) the derivative value of this security was calculated to be \$1,176,471. On September 30, 2008, given the changes in the stock price, this value had decreased to \$377,358 creating a non-cash credit to earnings for the quarter ended September 30, 2008 of \$799,113 . During the three month period ended Sept 30, 2008, amortization of debt discount amounted to \$32,680 reducing the balance to \$1,143,791.

5. GRANITA MEDIA

Effective July 1, 2007, the Company formed Granita Media, Inc. to separate its IPTV business and facilitate the raising of capital. Pursuant to an arrangement with 4 employees of mPhase, such employees were terminated from mPhase as of July 1, 2007 and became employees of Granita Media Inc and invested solely in the common stock of Granita Media Inc. Under the arrangement, each of the 4 employees was required to invest \$125,000 in exchange for an aggregate 2% equity interest in Granita Media, Inc with mPhase continuing to own 98% of the Company. The 4 employees contributed a total of \$339,000 of the total \$500,000 equity investment required from them and raised from third party investors another \$175,000 for a total of \$514,000. Granita Media has 19,000,000 shares of common stock outstanding of which 18,000,000 was owned by mPhase Technology and 1,000,000 is being held for issuance to the 4 employees and the third party investors pending an agreement among such persons of the allocation of such shares.

Under the terms of the arrangement between mPhase and the 4 employees, such employees were authorized to sell up to 7.99% of additional equity in the Company for a total of not less than \$2,000,000 of additional capital by December 31, 2007. As noted above, the employees raised a total of \$175,000 of outside capital only and pursuant to the arrangement, such employees either resigned or were terminated by mPhase together with several lower level employees of Granita. A dispute has arisen between Granita Media and one of the former employees with respect to a sum of approximately \$176,000 included in short term loans. It is the Company's position that such sums were voluntarily advanced to fund operating expenses after July 1, 2007. Since the 4 employee / officers of Granita Media were required to cover operating expenses of Granita Media after July 1, 2007 through equity investments either directly or from third parties, the Company has taken the position that such amount nor any related interest and fees are not owed to the employee. In addition, the Company has substantial rights of offset for unpaid rent with respect to the portion of its Little Falls office occupied by Granita Media after July 1, 2007. During the three month period ended September 30, 2008, Granita Media Inc did not conduct any operations and management is considering all alternatives.

6. COMMITMENTS AND CONTINGENCIES

The Company has a lease obligation for the rental of office space in Little Falls New Jersey until May 31, 2009. The annual obligation under such lease requires rent of \$151,862 for the year beginning June 1, 2008 and ending May 31, 2009.

mPhase has entered into various agreements with Georgia Tech Research ("GTRC") and its affiliate, Georgia Tech Applied Research Corporation, ("GTARC"), pursuant to which the Company received technical assistance in developing the commercialization of its Digital Video and Data Delivery System. Inception to date cost for GTRC technical assistance with respect to its research and development activities has totaled \$13,539,952. All of such costs were incurred prior to 2005.

Legal Proceedings

On November 9, 2007, Magpie Telecom Insiders, Inc ("Magpie") filed a lawsuit in the Federal District Court in the State of Colorado alleging a breach of contract by mPhase in connection with a Statement of Work dated July 10, 2006 in connection with software supplied by Magpie for mPhase's TV+ solution. The claim alleges the failure of mPhase to make payments amounting to \$679,969 under the contract. mPhase believes it has certain affirmative defenses to the claim including deficiencies in the software delivered by Magpie and failure to deliver support services by Magpie. mPhase has counterclaimed against Magpie asserting that the software delivered was not of "carrier class" standards required in the telecommunications industry and that Magpie so