

METRETEK TECHNOLOGIES INC

Form DEF 14A

May 17, 2006

**U.S. Securities and Exchange Commission
Washington, D.C. 20549
SCHEDULE 14A INFORMATION
Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934**

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to Rule 14a-12

METRETEK TECHNOLOGIES, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

Metrotek Technologies, Inc.
303 East 17th Avenue
Suite 660
Denver, Colorado 80203

NOTICE OF 2006 ANNUAL MEETING OF STOCKHOLDERS
To Be Held June 12, 2006

To the Stockholders of
Metrotek Technologies, Inc.:

NOTICE IS HEREBY GIVEN that the 2006 Annual Meeting of Stockholders (the Annual Meeting) of Metrotek Technologies, Inc., a Delaware corporation (the Company), will be held at The Warwick Hotel, 1776 Grant Street, Denver, Colorado, on Monday, June 12, 2006 at 9:00 a.m., local time, for the following purposes:

1. To elect one director to serve for a term of three years and until his successor is duly elected and qualified;
2. To approve amendments of the Company s 1998 Stock Incentive Plan to (i) increase the number of shares of Common Stock authorized for issuance thereunder by 1,000,000 shares to an aggregate of 3,750,000 shares, (ii) eliminate the provision requiring formula grants of stock options to non-employee directors, (iii) prohibit the repricing of stock options without stockholder approval, and (iv) address and comply with Section 409A of the Internal Revenue Code of 1986, as amended;
3. To ratify the appointment of Hein & Associates LLP as the Company s independent registered public accounting firm for the fiscal year ending December 31, 2006; and
4. To transact such other business as may properly come before the Annual Meeting or any adjournments or postponements thereof.

The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice.

Only holders of record of the Company s Common Stock as of the close of business on May 12, 2006 are entitled to notice of and to vote at the Annual Meeting and at any adjournments or postponements thereof.

By Order of the Board of Directors,

Gary J. Zuiderveen
Secretary

Denver, Colorado
May 17, 2006

YOUR VOTE IS IMPORTANT

All stockholders are cordially invited to attend the Annual Meeting in person. However, whether or not you plan to attend, it is important that your shares be represented and voted at the Annual Meeting. You are requested to sign and date the enclosed proxy card and return it promptly in the enclosed, self-addressed stamped envelope, which requires no postage if mailed in the United States. If you attend the Annual Meeting and so desire, you may revoke your proxy and vote your shares in person.

Metretek Technologies, Inc.
303 East 17th Avenue
Suite 660
Denver, Colorado 80203

PROXY STATEMENT
For The
2006 Annual Meeting of Stockholders
To Be Held June 12, 2006

GENERAL SOLICITATION AND VOTING INFORMATION

Proxy Solicitation

This Proxy Statement is being furnished to the holders of Common Stock, par value \$.01 per share (Common Stock), of Metretek Technologies, Inc., a Delaware corporation (the Company), in connection with the solicitation of proxies by the Board of Directors of the Company (the Board or the Board of Directors) for use at the 2006 Annual Meeting of Stockholders of the Company to be held at The Warwick Hotel, 1776 Grant Street, Denver, Colorado, on Monday, June 12, 2006 at 9:00 a.m., local time, and at any adjournments or postponements thereof (the Annual Meeting), for the purposes set forth in the accompanying Notice of Annual Meeting of Stockholders. This Proxy Statement, the accompanying proxy card and the Notice of 2006 Annual Meeting of Stockholders are being first mailed to stockholders on or about May 17, 2006.

The solicitation of proxies will initially be made by mail and may thereafter be made in person or by mail, telephone, facsimile, electronic communication or other means of communication by the directors, officers and regular employees of the Company for no additional or special compensation. In addition, brokerage houses, banks, nominees, trustees, custodians and other fiduciaries will be requested by the Company to forward proxy solicitation materials for shares of Common Stock held of record by them to the beneficial owners of such shares, and such fiduciaries will, upon request, be reimbursed by the Company for their reasonable out-of-pocket expenses incurred in connection therewith. In addition, the Company has engaged Georgeson Shareholders Communications, Inc., a professional soliciting organization, to assist the Company in the solicitation of proxies for an estimated fee of \$8,000, plus reimbursement for certain out-of-pocket expenses. The cost of the solicitation of proxies for use at the Annual Meeting will be borne by the Company.

Voting Rights and Procedures

Only holders of record of the Company's Common Stock as of the close of business on May 12, 2006 (the Record Date) are entitled to notice of and to vote at the Annual Meeting. As of the close of business on the Record Date, 15,692,237 shares of Common Stock of the Company were issued and outstanding. Each share of Common Stock outstanding on the Record Date entitles the holder thereof to one vote on each matter to be voted upon at the Annual Meeting. The presence, in person or by proxy, at the Annual Meeting of the holders of a majority of the shares of Common Stock outstanding as of the Record Date is necessary to constitute a quorum for the transaction of business at the Annual Meeting.

One director will be elected by a plurality of the votes cast by the holders of shares of Common Stock present, in person or by proxy, and entitled to vote at the Annual Meeting. The affirmative vote of the holders of a majority of the shares of Common Stock present, in person or by proxy, and entitled to vote at the Annual Meeting is required to approve an amendment to the Company's 1998 Stock Incentive Plan, as amended and restated to date (the 1998 Stock Plan), to (i) increase the number of shares of Common Stock authorized for issuance thereunder by 1,000,000 shares to an aggregate of 3,750,000 shares, (ii) eliminate the provision requiring formula grants of stock options to non-employee directors, (iii) prohibit the repricing of stock options without stockholder approval, and (iv) address and comply with Section 409A of the Internal Revenue Code of 1986, as amended (the Stock Plan Proposal). The affirmative vote of the holders of a majority of the shares of Common Stock present, in person or by proxy, and entitled to vote at the Annual Meeting is required to ratify the appointment of Hein & Associates LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2006 (the Auditors

Proposal).

Abstentions and broker non-votes (which occur when shares held of record by a broker or nominee for a beneficial owner are not voted on a particular matter because the broker or nominee has not received voting instructions from the beneficial owner of such shares and does not have discretionary authority to vote those shares with respect to that matter) will

be treated as present for purposes of determining the presence of a quorum for the transaction of business at the Annual Meeting. Abstentions on a matter will be treated as present on such matter and, accordingly, (i) will have no effect on the outcome of the election of directors, and (ii) will have the same effect as votes ~~AGAINST~~ the Stock Plan Proposal and ~~AGAINST~~ the Auditors Proposal. Broker non-votes on a matter will not be treated as present on such matter and, accordingly, will have no effect on the outcome of the election of directors, the Stock Plan Proposal or the Auditors Proposal.

If a proxy card is properly signed and returned to the Company at or prior to the Annual Meeting, unless subsequently properly revoked, the shares represented by that proxy card will be voted at the Annual Meeting in accordance with the instructions specified thereon. **If a proxy card is properly signed and returned to the Company at or prior to the Annual Meeting without voting instructions, it will be voted (i) FOR the election to the Board of Directors of the nominee named herein, (ii) FOR the Stock Plan Proposal, and (iii) FOR the Auditors Proposal.** If any other matters are properly presented at the Annual Meeting or any adjournments or postponements thereof, the persons appointed as proxies in the proxy card will have the discretionary authority to vote or act thereon in accordance with their best judgment.

A stockholder may revoke a proxy and change the stockholder's vote at any time before the proxy is exercised and voted at the Annual Meeting by delivering to the Secretary of the Company a written notice of revocation, by delivering a properly signed proxy bearing a later date, or by attending the Annual Meeting and voting in person. Attendance at the Annual Meeting will not in and of itself constitute the revocation of a proxy.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information known by the Company regarding the beneficial ownership of the Company's Common Stock as of May 12, 2006 (except as otherwise noted) by:

each person known by the Company to beneficially own more than 5% of the outstanding shares of the Company's Common Stock;

each director and nominee for director of the Company;

each of the Named Executive Officers (as defined in Executive Compensation below); and

all directors and executive officers of the Company as a group.

| Name of Beneficial Owner | Shares Beneficially Owned (1) | |
|---|----------------------------------|-------------|
| | Number | Percent (2) |
| Gruber & McBaine Capital Management, LLC (3) 50 Osgood Place, Penthouse San Francisco, CA 94133 | 1,570,743 | 9.9 |
| DDJ Capital Management, LLC (4) 141 Linden Street, Suite 4 Wellesley, Massachusetts 02482 | 1,202,271 | 7.7 |
| W. Phillip Marcum (5) | 641,635 | 4.0 |
| Sidney Hinton (6) | 505,101 | 3.2 |
| A. Bradley Gabbard (7) | 388,667 | 2.4 |
| Anthony D. Pell (8) | 147,064 | 0.9 |
| Basil M. Briggs (9) | 113,249 | 0.7 |
| Kevin P. Collins (10) | 94,276 | 0.6 |
| John Bernard (11) | 86,234 | 0.5 |
| Daniel J. Packard (12) | 40,667 | 0.3 |
| All directors and executive officers as a group (9 persons)(13) | 2,082,358 | 12.4 |

(1) For purposes of this table, the Number and the Percent of shares of Common Stock beneficially owned is determined in accordance with Rule 13d-3 promulgated by the Securities and Exchange Commission (SEC) under the Securities Exchange Act of

1934, as amended (the Exchange Act), and such information is not necessarily indicative of beneficial ownership for any other purpose. Under Rule 13d-3, beneficial ownership includes any shares as to which the beneficial owner has sole or shared voting power or investment power and any shares that the beneficial owner has the right to acquire within 60 days of May 12, 2006 through the exercise of any stock option, warrant or other right to acquire shares of Common Stock. In addition, such shares are deemed to be outstanding in calculating the percent beneficially owned by such beneficial owner, but are not deemed to be outstanding in determining the percent beneficially

owned by any other beneficial owner. Unless otherwise indicated in these notes, each beneficial owner has sole voting and investment power with respect to the shares shown as beneficially owned, subject to community property laws where applicable.

- (2) The percent of class is based upon 15,692,237 shares of Common Stock outstanding as of May 12, 2006.

- (3) Information based, in part, upon Schedule 13G filed with the SEC on February 3, 2006 by Gruber & McBaine Capital Management, LLC (GMCM), Jon D. Gruber (Gruber), J. Patterson McBaine (McBaine), Eric B. Swergold (Swergold), J. Lynn Rose (Rose) and Lagunitas Partners LP

(Lagunitas),
indicating
beneficial
ownership as of
December 31,
2005. GMCM is
the manager of
GMI and the
general partner
of Lagunitas, an
investment
limited
partnership.
Messrs. Gruber
and McBaine
are the
managers,
controlling
persons and
portfolio
managers of
GMCM and
have voting
control and
investment
discretion over
the securities
held by
Lagunitas and
GMI. GMCM,
Messrs. Gruber,
McBaine and
Swergold and
Ms. Rose
constitute a
group within the
meaning of
Rule 13d-5(b).
Includes
293,200 shares
held in accounts
managed by
GMCM over
which GMCM
shares voting
power and
investment
control. Also
includes 78,500
shares that may
be acquired

upon the

exercise of
currently
exercisable
warrants.

Lagunitas is not
a member of
any group and
disclaims
beneficial
ownership of
the securities
with respect to
its ownership is
reposited.

- (4) Information
based, in part,
on Amendment
No. 9 to
Schedule 13D
filed with the
SEC on
January 17,
2006, by DDJ
Capital
Management,
LLC (DDJ), B
III-A Capital
Partners, L.P. (B
III-A Capital
Partners) and
GP III-A, LLC
(GP III-A),
indicating
beneficial
ownership as of
January 5, 2006.
Information also
based, in part,
on Amendment
No. 4 to
Schedule 13G
filed with the
SEC on
February 13,
2006 by General
Motors Trust
Company, as
trustee for

GMAM
Investment
Funds Trust
II-Promark
Alternative
High Yield
Bond Fund
(GMAM) and
General Motors
Investment
Management
Corporation
(GMIMCO),
indicating
beneficial
ownership as of
January 5, 2006.
Includes
168,498 shares
held by B III-A
Capital Partners,
519,284 shares
held by DDJ
High Yield
Fund, 336,987
shares held by
GMAM and
262,300 shares
held by The
October Fund,
Limited
Partnership (the
October Fund).
DDJ is the
investment
advisor to, and
October G.P.,
LLC is the
general partner
of, the October
Fund. DDJ is
also an
investment
manager for
GMAM. GP
III-A is the
general partner
of, and DDJ is
the investment
manager for, B
III-A Capital

Partners. DDJ is also the investment sub-advisor to the DDJ High Yield Fund.

- (5) Includes 383,334 shares that may be acquired by Mr. Marcum upon the exercise of currently exercisable stock options. Also includes 16,666 restricted shares that are subject to risk of forfeiture prior to vesting.
- (6) Includes 195,000 shares that may be acquired by Mr. Hinton upon the exercise of currently exercisable stock options. Also includes 5,000 restricted shares that are subject to risk of forfeiture prior to vesting.
- (7) Includes 2,187 shares owned by immediate family members of Mr. Gabbard and 278,715 shares that may be acquired by Mr. Gabbard

upon the exercise of currently exercisable stock options. Also includes 8,333 restricted shares that are subject to risk of forfeiture prior to vesting.

(8) Includes 2,937 shares held by Mr. Pell's wife. Also includes 80,915 shares that may be acquired by Mr. Pell upon the exercise of currently exercisable stock options.

(9) Includes 70,952 shares that are owned jointly with Mr. Briggs wife and 11,000 shares held in a family trust of which Mr. Briggs is a trustee. Also includes 3,186 shares that may be acquired by Mr. Briggs upon the exercise of currently exercisable stock options.

(10) Includes 92,026 shares that may be acquired by Mr. Collins upon the exercise of currently

exercisable
stock options.

(11) Includes 85,876
shares that may
be acquired by
Mr. Bernard
upon the
exercise of
currently
exercisable
stock options.

(12) Includes 40,667
shares that may
be acquired by
Mr. Packard
upon the
exercise of
currently
exercisable
stock options.

(13) Includes
1,205,386
shares that may
be acquired
upon the
exercise of
currently
exercisable
stock options.
Also includes
29,999
restricted shares
that are subject
to risk of
forfeiture prior
to vesting. See
note notes
(5) through (12).

PROPOSAL NO. 1
ELECTION OF DIRECTORS

The Board of Directors of the Company currently consists of five members divided into three classes, designated Class I, Class II and Class III, with members of each class serving staggered three year terms. Each director serves in office until the expiration of his term and until his successor is duly elected and qualified, or until his earlier death, resignation or removal. In the future, any new members added to the Board of Directors will be distributed among the three classes so that, as nearly as possible, each class will consist of an equal number of directors.

The term of the sole Class III director expires at the Annual Meeting. One Class III director is to be elected at the Annual Meeting, to serve for a term of three years and until his successor is duly elected and qualified. Upon the recommendation of the Nominating and Corporate Governance Committee, the Board of Directors has nominated **Anthony D. Pell** to be re-elected as a Class III director. All other directors will continue in office until the expiration of their respective terms, as indicated below, and until their respective successors are duly elected and qualified.

The nominee listed below has indicated he is willing and able to serve if elected. If the nominee should become unexpectedly unable to serve as a director, then the persons appointed as proxies in the accompanying proxy card intend to vote, unless the number of directors is reduced by the Board of Directors, for such other nominee as the Board of Directors may designate, upon the recommendation of the Nominating and Corporate Governance Committee.

Nominee

Class III Term Expires in 2009

Anthony D. Pell, 67, has served as a director of the Company since June 1994. Mr. Pell is the President, Chief Executive Officer and a co-owner of Pelican Investment Management, an investor advisory firm that he co-founded in November 2001. Mr. Pell is a director of Rochdale Investment Management, Inc. He was the President and a co-owner of Pell, Rudman & Co., an investment advisory firm, from 1981 until 1993, when it was acquired by United Asset Management Company, and he continued to serve as an employee until June 1995. Mr. Pell was a director of Metretek, Incorporated until it was acquired by the Company in March 1994. Mr. Pell was associated with the law firm of Coudert Brothers from 1966 to 1968 and with the law firm of Cadwalder, Wickersham and Taft from 1968 to 1972, specializing in estate and tax planning. In 1972, Mr. Pell joined Boston Company Financial Strategies, Inc. as a Vice President and was appointed a Senior Vice President in 1975.

Continuing Directors

Class I Term Expires in 2007

W. Phillip Marcum, 62, a founder of the Company, has served as the Chairman of the Board, President, Chief Executive Officer and a director of the Company since its incorporation in April 1991. He also serves as the Chairman of each of the Company's principal operating subsidiaries. Mr. Marcum also serves on the board of directors of Key Energy Services, Inc., an oilfield service provider.

Basil M. Briggs, 70, has served as a director of the Company since June 1991. He has been an attorney in the Detroit, Michigan area since 1961, practicing law with Cox, Hodgman & Giarmarco, P.C., since January 1997. Mr. Briggs was of counsel with Miro, Weiner & Kramer, P.C., from 1987 through 1996. He was the President of Briggs & Williams, P.C., Attorneys at Law, from its formation in 1977 through 1986. Mr. Briggs was the Secretary of Patrick Petroleum Company (Patrick Petroleum), an oil and gas company, from 1984, and a director of Patrick Petroleum from 1970, until Patrick Petroleum was acquired by Goodrich Petroleum Company (Goodrich Petroleum), an oil and gas company, in August 1995. From August 1995 until June 2000, he served as a director of Goodrich Petroleum.

Class II Term Expires in 2008

A. Bradley Gabbard, 51, a founder of the Company, has served as an executive officer and director of the Company since its incorporation in April 1991. He has served as the Executive Vice President of the Company since July 1993 and the Chief Financial Officer and Treasurer of the Company since August 1996 and from April 1991 until July 1993. He also serves as the Chief Financial Officer of each of the Company's principal operating subsidiaries. Mr. Gabbard also served as the

Secretary of the Company from May 2000 until April 2001, and as the Vice President and the Secretary of the Company from April 1991 through July 1993.

Kevin P. Collins, 55, has served as a director of the Company since March 2000. Mr. Collins has been a Managing Member of The Old Hill Company LLC, which provides corporate financial and advisory services, since 1997. From 1992 to 1997, he served as a principal of JHP Enterprises, Ltd., and from 1985 to 1992 he served as Senior Vice President of DG Investment Bank, Ltd., both of which were engaged in providing corporate finance and advisory services. Mr. Collins also serves as a director of Key Energy Services, Inc.; The Penn Traffic Company, a food retailer; Malden Mills Industries, Inc., a synthetic fleece manufacturer; Mail Contractors of America Inc., a trucking company; and Deluxe Pattern, Inc., a designer of automotive components. Mr. Collins is a Chartered Financial Analyst.

Vote Required

The Class III director will be elected by a plurality of the votes cast by the holders of shares of Common Stock present, in person or by proxy, and entitled to vote at the Annual Meeting. If properly signed and returned to the Company at or prior to the Annual Meeting, the accompanying proxy card will be voted **FOR** the election of the nominee listed above, unless contrary instructions are specified.

Recommendation

The Board of Directors recommends that stockholders vote FOR the election to the Board of Directors of the person listed above as the Nominee . Proxy cards signed and timely returned to the Company will be so voted, unless contrary instructions are specified thereon.

EXECUTIVE OFFICERS AND KEY EMPLOYEES

The executive officers and certain other key employees of the Company and its subsidiaries are as follows:

W. Phillip Marcum, 62, a founder of the Company, has served as the Chairman of the Board, President, Chief Executive Officer and a director of the Company since April 1991. He also serves as the Chairman of each of the Company's principal operating subsidiaries.

A. Bradley Gabbard, 51, a founder of the Company, has served as an executive officer and director of the Company since its incorporation in April 1991. He has served as the Executive Vice President of the Company since July 1993 and as the Chief Financial Officer and Treasurer of the Company since August 1996 and from April 1991 until July 1993. He also serves as the Chief Financial Officer of each of the Company's principal operating subsidiaries. Mr. Gabbard also served as the Secretary of the Company from May 2000 until April 2001, and as the Vice President and the Secretary of the Company from April 1991 through July 1993.

Gary J. Zuiderveen, 47, has served as the Vice President of the Company since April 2005 and as the Controller, Principal Accounting Officer and Secretary of the Company since April 2001. He had previously served as the Controller of the Company from May 1994 until May 2000 and as the Secretary and Principal Accounting Officer of the Company from August 1996 until May 2000. He also serves in one or more of the capacities of Controller, Principal Accounting Officer or Secretary of the principal operating subsidiaries of the Company. From June 1992 until May 1994, Mr. Zuiderveen was the General Accounting Manager at the University Corporation for Atmospheric Research in Boulder, Colorado. From 1983 until June 1992, Mr. Zuiderveen was employed in the Denver, Colorado office of Deloitte & Touche LLP, providing accounting and auditing services to clients primarily in the manufacturing and financial services industries and serving in the firm's national office accounting research department.

Sidney Hinton, 43, has served as the President and Chief Executive Officer and a director of PowerSecure, Inc. (PowerSecure), a wholly-owned subsidiary of the Company, since its incorporation in September 2000. He also served as the President and Chief Executive Officer of PowerSpring, Inc., a wholly-owned subsidiary of the Company, from May 2000 until January 2001. From February 2000 until May 2000, Mr. Hinton was an Executive-in-Residence with Carousel Capital, a private equity firm. From February 1999 until December 1999, he was the Vice President of Market Planning and Research for Carolina Power & Light (now known as Progress Energy). From August 1997 until December 1998, Mr. Hinton was the President and Chief Executive Officer of IllumElex Lighting Company, a national lighting company. From 1982 until 1997, Mr. Hinton was employed in several positions with Southern Company and Georgia Power Company.

John Bernard, 51, has served as the President and Chief Executive Officer and a director of Southern Flow Companies, Inc. (Southern Flow), a wholly-owned subsidiary of the Company, since December 1, 2004. Mr. Bernard has served in various managerial capacities since joining Southern Flow in 1988, including serving as the Vice President and General Manager of Southern Flow from June 1998 through November 2004.

CORPORATE GOVERNANCE

The Company's Board of Directors believes that good corporate governance principles and practices provide an important framework to ensure that the Company is managed for the long-term benefit of its stockholders. The Board of Directors has adopted a set of Corporate Governance Guidelines, which are intended to formalize the corporate governance practices to which the Company adheres through its Board of Directors and committees of the Board. The Board of Directors continually reviews its corporate governance practices in light of changes and developments in laws and regulations, including the Sarbanes-Oxley Act of 2002, the rules and regulations of the SEC and the listing standards of the American Stock Exchange, as well as best practices recommended by recognized authorities. The Company's Corporate Governance Guidelines are available at the Company's website at www.metrotek.com under Investor Info Corporate Governance.

Director Independence

Under its Corporate Governance Guidelines, the Company has established a policy that a majority of the members of the Board of Directors must be independent. In order to assist it in making determinations of director independence, the Board of Directors has adopted a formal set of categorical standards (the Standards of Director Independence), based upon the meaning of independent directors under applicable law, SEC rules and regulations (including Rule 10A-3 under the Exchange Act) and the current listing standards of the American Stock Exchange.

Under the Standards of Director Independence, a director of the Company will only be considered independent if the Board of Directors affirmatively determines that the director has no direct or indirect material relationship with the Company, other than in his capacity as a director. In making such determinations, the Board of Directors considers all relevant facts and circumstances. The Standards of Director Independence provide that a director will not be considered independent if he has any of these relationships:

Employment. The director is or has been an employee, or has an immediate family member who is or has been an executive officer, of the Company at any time during the past three years.

Compensation. The director or an immediate family member of the director has received more than \$60,000 in direct compensation from the Company during any 12-month period within the past three years, other than Board and committee fees.

Affiliation with the Company's Independent Registered Public Accounting Firm.

The director or an immediate family member of the director is a current partner of the Company's current independent registered public accounting firm.

The director is a current employee of the Company's current independent registered public accounting firm.

An immediate family member of the director is a current employee of the Company's current independent registered public accounting firm and participates in that firm's audit, assurance or tax compliance practice (excluding tax planning).

The director or an immediate family member of the director was within the past three years, but is no longer, a partner or employee of the Company's current independent registered public accounting firm and personally worked on the Company's audit within that time.

Interlocking Relationships. The director or an immediate family member of the director is, or has been within the past three years, employed as an executive officer of another company for which any of the Company's present executive officers at the same time serves or served on that company's compensation committee.

Business Transactions. The director or an immediate family member of the director is a partner in, or a controlling shareholder or an executive officer of, an organization that has made payments to, or received payments from, the Company for property or services in an amount which, in any of the past three fiscal years, exceeds the greater of \$200,000 or 5% of such other organization's consolidated gross revenues for that year (other than those arising solely from investments in the Company's securities or payments under non-discretionary charitable contribution matching programs).

Indebtedness. The director is an executive officer, partner, member or significant equity holder of another company that is indebted to the Company, or to which the Company is indebted, and the total amount of indebtedness exceeds 2% of the total consolidated assets of such other company.

Charitable Contributions. Within the past three years, the director was an executive officer, trustee or director of a foundation, university or other non-profit or charitable organization receiving grants, endowments or other contributions from the Company that exceeded the greater of \$1.0 million or 2% of such charitable organization's consolidated gross revenues in any single fiscal year.

In addition, in order to be independent under the Standards of Director Independence, a member of the Audit Committee cannot be an affiliated person of the Company or any of its subsidiaries and cannot accept or receive directly or indirectly any consulting, advisory or other compensatory fees from the Company or any of its subsidiaries, other than (i) in his capacity as a member of the Board of Directors or a committee of the Board, and (ii) fixed amounts of compensation under a retirement plan (including deferred compensation) for prior services with the Company (provided that such compensation is not contingent in any way on continued service with the Company).

Based upon these Standards of Director Independence, the Board of Directors has determined that of its five current members, each of its three non-management members (Basil M. Briggs, Anthony D. Pell and Kevin P. Collins) is independent. Accordingly, a majority of the members of the Board of Directors is independent under the Standards of Director Independence.

Meetings of the Board of Directors

The Board of Directors meets regularly throughout the year and holds special meetings and acts by unanimous written consent whenever circumstances require. The Board of Directors held a total of seven meetings during 2005. During 2005, each director attended more than 90% of the total number of meetings of the Board of Directors and of the committees of the Board of Directors on which he served, and the average attendance of all directors at all Board and committee meetings exceeded 96%.

Committees of the Board of Directors

The Board of Directors has established a standing Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee. The membership of each committee and its functions, duties and responsibilities are discussed below. Each committee operates under a written charter adopted by, and from time to time amended by, the Board of Directors. These committee charters are available on the Company's website at www.metrotek.com under Investor Info Corporate Governance.

Audit Committee

The Board of Directors has established an Audit Committee in accordance with Section 3(a)(58)(A) of the Exchange Act. The members of the Audit Committee are Anthony D. Pell (Chairman), Basil M. Briggs and Kevin P. Collins. The Board of Directors has determined that each member of the Audit Committee is independent under the Board's Standards of Director Independence, under the current listing standards of the American Stock Exchange applicable to members of an audit committee and under Rule 10A-3 under the Exchange Act. The Board of Directors has also determined that each member of the Audit Committee is able to read and understand fundamental financial statements and qualifies as an audit committee financial expert, as that term is defined in Item 401(h) of Regulation S-K under the Exchange Act. The Audit Committee met eight times during 2005.

The purpose of the Audit Committee is to assist the Board of Directors in fulfilling its oversight and monitoring responsibilities relating to:

the integrity of the Company's financial statements;

the Company's auditing, accounting and financial reporting processes generally;

the Company's system of internal control over financial reporting and disclosure controls and procedures;

the independent registered public accounting firm, including its engagement, compensation, qualifications, independence and performance; and

the Company's compliance with legal and regulatory requirements.

The Audit Committee's duties and responsibilities include:

reviewing and discussing with management and the Company's independent registered public accounting firm the annual audited and quarterly unaudited consolidated financial statements of the Company;

determining whether to recommend to the Board of Directors that the Company's annual consolidated financial statements be included in the Company's Annual Report on Form 10-K;

appointing and, when appropriate, terminating the independent registered public accounting firm;

reviewing and pre-approving the nature, scope and fee arrangements of the annual audit and non-audit services of the Company's independent registered public accounting firm;

reviewing the independence of the Company's independent registered public accounting firm;

reviewing the scope and the results of the annual audit of the Company's consolidated financial statements by the Company's independent registered public accounting firm;

reviewing and discussing with management, the Company's internal accountants and the Company's independent registered public accounting firm, the Company's accounting and financial reporting practices and procedures and the adequacy and effectiveness of the Company's system of internal controls;

preparing the report required by the rules of the SEC to be included in the Company's proxy statement for its annual meeting of stockholders;

reviewing any transaction that involves a potential conflict of interest;

adopting procedures for the receipt, retention and treatment of employee concerns and complaints regarding accounting, internal controls or auditing matters; and

providing other assistance to the Board of Directors, as requested, with respect to the financial, accounting and reporting practices of the Company.

The Audit Committee performs its functions and responsibilities under a formal written charter adopted by the Board of Directors. A copy of the Audit Committee Charter, as amended and restated by the Board of Directors on March 20, 2006, is attached to this Proxy Statement as Appendix A and is available on the Company's website at www.metrotek.com under Investor Info Corporate Governance. The Report of the Audit Committee begins on page 36 of this Proxy Statement.

Compensation Committee

The Board of Directors has established a Compensation Committee. The members of the Compensation Committee are Basil M. Briggs (Chairman), Anthony D. Pell and Kevin P. Collins. The Board of Directors has determined that each member of the Compensation Committee is independent under the Board's Standards of Director Independence

and under the current listing standards of the American Stock Exchange. The Compensation Committee met four times during 2005.

The primary purposes of the Compensation Committee are to review and approve the compensation of the Company's executive officers and to oversee the Company's compensation plans and policies generally. The Compensation Committee's duties and responsibilities include:

- reviewing and approving the compensation of executive officers, including the Company's chief executive officer;

- approving employment agreements for executive officers;

- reviewing and approving the compensation of directors;

- assisting the Board of Directors in administering and recommending changes to the Company's stock and incentive compensation plans and programs; and

- preparing an annual report on executive compensation for inclusion in the Company's annual proxy statement.

The Compensation Committee performs its functions and responsibilities under a formal written charter adopted by the Board of Directors. A copy of the Compensation Committee Charter, as amended and restated by the Board of Directors on March 20, 2006, is available on the Company's website at www.metrotek.com under Investor Info Corporate Governance. The Report of the Compensation Committee on Executive Compensation begins on page 21 of this Proxy Statement.

Nominating and Corporate Governance Committee

The Board of Directors has established a Nominating and Corporate Governance Committee. The members of the Nominating and Corporate Governance Committee are Kevin P. Collins (Chairman), Basil M. Briggs and Anthony D. Pell. The Board of Directors has determined that each member of the Nominating and Corporate Governance Committee is independent under the Board's Standards of Director Independence and under the current listing standards of the American Stock Exchange. The Nominating and Corporate Governance Committee met four times during 2005.

The principal duties of the Nominating and Corporate Governance Committee are:

- identifying individuals qualified to become members of the Board of Directors;

- recommending qualified individuals for nomination to the Board of Directors;

- assessing and advising the Board of Directors with respect to its size, composition, procedures and committees; and

- reviewing and evaluating the Company's Corporate Governance Guidelines and principles and recommending to the Board of Directors any changes that it deems necessary.

Other specific duties and responsibilities of the Nominating and Corporate Governance Committee include:

- developing and applying qualifications for Board membership;

- monitoring and recommending to the Board committee functions;

- recommending Board committee assignments; and

- reviewing governance-related stockholder proposals and recommending Board responses.

The Nominating and Corporate Governance Committee recommended the directors currently standing for re-election at the Annual Meeting, which recommendation was unanimously approved by the Board of Directors.

The Nominating and Corporate Governance Committee performs its functions and responsibilities under a formal written charter adopted by the Board of Directors. A copy of the Nominating and Corporate Governance Committee

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Charter, as amended and restated by the Board of Directors on April 25, 2005, is available on the Company's website at www.metrotek.com under Investor Info Corporate Governance.

Executive Sessions

Executive sessions of non-management directors, without any management directors or other members of management being present, are held at least twice a year, and more often if such directors deem appropriate. The sessions are scheduled and chaired by the Chairman of the Nominating and Corporate Governance Committee. Any non-management director can request that additional executive sessions be scheduled.

Director Attendance at Annual Meetings of Stockholders

The Board of Directors expects all directors to attend each annual meeting of stockholders of the Company, except where the failure to attend is due to unavoidable or unforeseeable circumstances. All members of the Board of Directors attended the 2005 Annual Meeting of Stockholders.

Nominations of Directors

Identifying and Evaluating Nominees for Director

The Nominating and Corporate Governance Committee utilizes a variety of methods for identifying and evaluating nominees for director. In selecting candidates for nomination at an annual meeting of the Company's stockholders, the Nominating and Corporate Governance Committee begins by determining whether the incumbent directors whose terms expire at that meeting desire and are qualified to continue their service on the Board. The Nominating and Corporate Governance Committee believes that the continuing service of qualified incumbents promotes stability and continuity in the Board room, giving the Company the benefit of the familiarity and insight into the Company's affairs that its directors have accumulated during their tenure, while contributing to the Board's ability to work as a collective body. Accordingly, it is the policy of the Nominating and Corporate Governance Committee, absent special circumstances, to nominate qualified incumbent directors who continue to satisfy the criteria for membership on the Board, and who the Nominating and Corporate Governance Committee believes will continue to make important contributions to the Board and who consent to stand for reelection, to continue their service on the Board.

If there are Board positions for which the Nominating and Corporate Governance Committee will not be re-nominating a qualified incumbent, the Nominating and Corporate Governance Committee will consider recommendations for director nominees from a wide variety of sources, including Board members, management, business contacts, professional search firms, stockholders and other appropriate sources. In evaluating such recommendations, the Nominating and Corporate Governance Committee seeks to achieve a balance of knowledge, experience and capability on the Board of Directors and to address the criteria for membership set forth below under

Qualifications of Nominees for Director. Candidates recommended by the Nominating and Corporate Governance Committee are subject to approval by the Board of Directors. The sole nominee for election to the Board of Directors at the Annual Meeting is currently serving as a director of the Company.

Qualifications of Nominees for Director

The Nominating and Corporate Governance Committee is responsible for reviewing with the Board of Directors the requisite skills and characteristics of new Board candidates in the context of the current composition of the Board, the operating requirements of the Company and the long-term interests of the Company's stockholders. The Nominating and Corporate Governance Committee has established criteria and qualifications that candidates for membership on the Board of Directors must possess. Except in limited and exceptional circumstances, each candidate to serve on the Board of Directors of the Company should have the following qualifications:

A reputation for high personal and professional integrity, strong moral character and adherence to high ethical standards and the values of the Company.

The absence of any conflict of interest (whether due to a business or personal relationship) or legal impediment to, or restriction on, the nominee serving as a director, and no other interests that would materially impair his ability to (i) exercise independent judgment, or (ii) otherwise discharge the fiduciary duties owed as a director to the Company and its stockholders.

Holds or has held a recognized position of leadership in his community or his field of endeavor, and has demonstrated high levels of achievement in his community or his field.

Business acumen and experience, inquisitiveness, strong analytical skills and the ability to exercise sound business judgment and common sense in matters that relate to the current and long-term objectives of the Company.

A general level of expertise and experience in the Company's business areas.

The ability to read and understand basic financial statements and other financial information pertaining to the Company.

A commitment to understanding the Company and its business, industry and strategic objectives.

The availability and a commitment to devote adequate time to the Board and its committees and the ability to generally fulfill all responsibilities as a director of the Company, including to regularly attend and participate in meetings of the Board, Board committees and stockholders, in light of the number of other company boards on which the candidate serves and his other personal and professional commitments.

The willingness and ability to represent fairly and to act in the interests of all stockholders of the Company rather than the interests of any particular stockholder, special interest group or other constituency.

For prospective non-employee directors, independence under SEC and applicable stock exchange rules and regulations.

The willingness to accept the nomination to serve as a director of the Company.

The Nominating and Corporate Governance Committee will also consider the following additional factors in connection with its evaluation of each prospective nominee:

Whether the prospective nominee will foster a diversity of skills, experiences and backgrounds on the Board.

Whether the prospective nominee possesses the requisite education, training and experience to qualify as financially literate or as an audit committee financial expert under applicable SEC and stock exchange rules.

For incumbent directors standing for re-election, the incumbent director's performance during his term, including the number of meetings attended, the level of participation, and overall contribution to the Company.

The composition of the Board and whether the prospective nominee will add to or complement the Board's existing strengths.

Notwithstanding the foregoing requirements, from time to time the Nominating and Corporate Governance Committee may identify certain other skills or attributes as being particularly desirable to help meet specific Board needs that have arisen.

Nominations by Stockholders

The policy of the Nominating and Corporate Governance Committee is to consider properly submitted written nominations from stockholders for nominees for director. In general, persons properly recommended by stockholders as nominees for director are evaluated on the same basis as candidates recommended by other sources. Any such nominations made by stockholders must be submitted in compliance with the requirements for stockholder nominations set forth in the By-Laws of the Company, which requirements are summarized below under "Stockholder Proposals," and should include the following:

The name and address of the stockholder making the nomination and the number of shares of the Company's Common Stock which are owned beneficially and of record by such stockholder;

The nominee's name, age, address, number of shares of Common Stock owned beneficially and of record, principal occupation, employment, background, experience, education and qualifications for Board membership;

A description of all arrangements or understandings between the stockholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are to be made by the stockholder; and

All other information relating to such nominee that is required to be disclosed pursuant to Regulation 14A under the Exchange Act (including such person's written consent to be named in the proxy statement as a nominee and to serving as a director if elected).

Nominations by stockholders for director candidates must be addressed to:

Metrotek Technologies, Inc.
303 East 17th Avenue, Suite 660
Denver, Colorado 80203
Attn: Corporate Secretary

Communications with the Board of Directors

Any stockholder who wishes to communicate directly with the Board of Directors, any committee of the Board or any specific director may do so by directing a written request addressed to such director or directors in care of the Company's Corporate Secretary at the Company's principal executive offices. Communications directed to members of the Board will be forwarded to the intended Board members, unless such communication is deemed unduly hostile, threatening, illegal or otherwise unnecessary or inappropriate to forward, in which case the Corporate Secretary has the authority to discard the communication or to take appropriate action regarding such communication.

Codes of Ethics

The Company has adopted two codes of ethics, each designed to encourage its directors, officers and employees to act with the highest level of integrity. These codes are available on the Company's website at www.metrotek.com under Investor Info Corporate Governance.

The Company has adopted the Metrotek Technologies, Inc. Code of Ethics for Principal Executive Officer and Senior Financial Officers, which is a code of ethics that applies to its Chief Executive Officer, Chief Financial Officer, Principal Accounting Officer and other senior finance organization employees. The purpose of this Code of Ethics is to deter wrongdoing and to promote, among other things, honest and ethical conduct and to ensure to the greatest possible extent that the business of the Company is conducted in a consistently legal and ethical manner.

The Company has also adopted the Metrotek Technologies, Inc. Code of Business Conduct and Ethics, which is a code of conduct that applies to all of its directors, officers and employees. Under the Code of Business Conduct and Ethics, each officer, director and employee is required to maintain a commitment to high standards of business conduct and ethics. The Code of Business Conduct and Ethics covers many areas of professional conduct, including conflicts of interest, protection of confidential information, and strict adherence to laws and regulations applicable to the conduct of the Company's business. Directors, officers and employees are required to report any conduct that they believe in good faith to be an actual or apparent violation of the Code of Business Conduct and Ethics.

If the Company makes any amendment to, or grants any waiver from a provision of, either code of conduct with respect to any director, executive officer or senior financial officer, it will disclose the nature of such amendment or waiver on its website, in a Current Report on Form 8-K or both.

The Company also has adopted procedures to receive, retain and treat complaints regarding accounting, internal accounting controls or auditing matters and to allow for the confidential and anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

Availability of Corporate Governance Documents

The Company's Corporate Governance Guidelines, Board committee charters and codes of ethics are available on the Company's website at www.metrotek.com under Investor Info Corporate Governance. In addition, the Company will provide a copy of any of these corporate governance documents without charge upon written request addressed to the Company at Metrotek Technologies, Inc., 303 East 17th Avenue, Suite 660, Denver, Colorado, 80203, attention: Corporate Secretary.

Compensation of Directors

Directors who are also officers or employees of the Company or its subsidiaries do not receive any additional compensation for serving on the Board of Directors or its committees. All directors are reimbursed for their out-of-pocket costs of attending meetings of the Board of Directors and its committees. During fiscal 2005, directors who were not also officers or employees of the Company or its subsidiaries (Non-Employee Directors) received a monthly retainer of \$2,000 for their service on the Board of Directors and on committees of the Board, including attending meetings, which monthly retainer was increased to \$2,500 on April 1, 2005. Effective January 1, 2006, the monthly retainer for Non-Employee Directors was increased to \$3,000.

Non-Employee Directors also receive stock options pursuant to a formula under a provision of the Company's 1998 Stock Plan. Under the formula for these options to Non-Employee Directors, each person who is first elected or appointed to serve as a Non-Employee Director is automatically granted an option to purchase 5,000 shares of Common Stock. In addition, on the date of the annual meeting of stockholders each year commencing this year, each Non-Employee Director who has served on the Board for at least six months is automatically granted options to purchase 2,500 shares of Common Stock. During 2005, in the discretion of the Board of Directors upon the recommendation of the Compensation Committee, on the date of the 2005 annual meeting of stockholders, each Non-Employee Director also received non-formula options to purchase the number of shares of Common Stock equal to the annual retainer for that year divided by the fair market value of the Common Stock on the date of grant, less the 2,500 stock options granted under the formula. All annual options granted to Non-Employee Directors under the 1998 Stock Plan:

- are non-qualified stock options;

- vest and become exercisable immediately upon grant;

- are exercisable at a price equal to the fair market value of the Common Stock on the date of grant (based on the last sale price of the Common Stock as reported on the American Stock Exchange); and

- have a term of ten years, subject to earlier termination in the event of the Non-Employee Director's death or the termination of service on the Board, in which events the options remain exercisable for one year after a Non-Employee Director dies and for that number of years after a Non-Employee Director leaves the Board of Directors (for any reason other than death or removal for cause) equal to the number of full or partial years that the Non-Employee Director served as a director, but not beyond the original ten year term of the option.

Any other stock options granted to a director may contain different terms at the discretion of the Board of Directors.

As an item of business at the Annual Meeting, the Board of Directors, upon the recommendation of the Compensation Committee, is recommending that stockholders eliminate the provision under the 1998 Stock Plan requiring formula grants of stock options to Non-Employee Directors, in order to allow the Board of Directors, upon the recommendation of the Compensation Committee, to make such stock grants under the 1998 Stock Plan as deemed appropriate under the circumstances, subject to change from time to time. See Proposal 2 Amendments to the Company's 1998 Stock Incentive Plan below.

As of May 12, 2006, options to purchase 192,707 shares of Common Stock were outstanding to the Company's current Non-Employee Directors, at exercise prices ranging from \$1.50 to \$17.38 per share.

EXECUTIVE COMPENSATION**Summary Compensation**

The following table sets forth the total compensation that the Company paid or accrued for services rendered to it and its subsidiaries in all capacities during the last three fiscal years by its Chief Executive Officer and by its four other most highly compensated executive officers, based on total salary and bonus, in fiscal 2005 (the Named Executive Officers):

Summary Compensation Table

| Name and Principal Position | Year | Annual Compensation(1) | | | Long Term Compensation Awards | | All Other Compensation (\$)(3) |
|---|------|------------------------|---------------|----------------------------|---------------------------------|-----------------------------------|--------------------------------|
| | | Salary(\$) | Bonus(\$) | Other Compensation (\$)(2) | Restricted Stock Awards (\$)(2) | Underlying Securities Options (#) | |
| W. Phillip Marcum Chairman of the Board, President and Chief Executive Officer | 2005 | \$ 325,000 | \$ 255,000(4) | \$ 0 | 0 | 100,000(5) | \$ 7,438 |
| | 2004 | 311,615 | 50,000(6) | 60,500(7) | 110,000 | 50,000(8) | 7,638 |
| | 2003 | 295,000 | 0 | 0 | 0 | 0 | 7,138 |
| A. Bradley Gabbard Executive Vice President and Chief Financial Officer | 2005 | 200,000 | 235,000(4) | 0 | 0 | 55,000(9) | 7,438 |
| | 2004 | 191,346 | 55,000(6) | 30,250(7) | 55,000 | 25,000(8) | 7,638 |
| | 2003 | 175,000 | 75,000 | 0 | 0 | 0 | 7,117 |
| Sidney Hinton (10) President and CEO, PowerSecure, Inc. | 2005 | 262,019 | 191,000 | 0 | 0 | 50,000(5) | 7,438 |
| | 2004 | 253,850 | 104,186(11) | 18,150(7) | 33,000 | 0 | 7,638 |
| | 2003 | 250,000 | 117,341(11) | 0 | 0 | 0 | 7,138 |
| John Bernard (12) President and CEO, Southern Flow | 2005 | 147,315 | 50,000 | 0 | 0 | 50,000(5) | 6,571 |
| | 2004 | 112,098 | 8,000 | 0 | 0 | 25,000(8) | 4,547 |
| Daniel J. Packard (13) President and CEO, MGT | 2005 | 130,604 | 52,000(14) | 0 | 0 | 25,000(9) | 906 |

(1) Excludes perquisites and other personal benefits, if any, which were less than the lesser of \$50,000 or 10% of the total annual salary and bonus

reported for each Named Executive Officer.

- (2) The dollar value of the restricted stock awards during fiscal 2004 is calculated by multiplying the total number of restricted shares by \$2.20, the closing sale price of the Common Stock on July 15, 2004, the date of the awards, as reported on the OTC Bulletin Board. These dollar values do not reflect any adjustment for risk of forfeiture or for restrictions on transferability. All shares of restricted stock vest in three equal annual installments, which commenced on January 1, 2005, subject to the officer remaining employed with the Company on the vesting dates, and further subject to immediate vesting upon a change in

control. All awards of restricted stock were made under the 1998 Stock Plan.

As of December 31, 2005, based on \$8.95, the closing sale price of the Common Stock on such date as reported on the American Stock Exchange, Mr. Marcum held 33,333 unvested shares of restricted stock valued at \$298,330, Mr. Gabbard held 16,666 unvested shares of restricted stock valued at \$149,161, and Mr. Hinton held 10,000 unvested shares of restricted stock valued at \$89,500. The officer enjoys all the benefits of ownership of unvested shares of restricted stock, including the right to vote the shares and to receive any dividends and other distributions with respect to the shares on the same terms as

any other shares
of Common
Stock, other
than the right to
transfer or
dispose of the
shares.

- (3) Amounts paid or accrued on behalf of the Named Executive Officers in fiscal 2005 in this column include the following:

| Name | 401(k) Matching | Group Term Life Insurance Premiums | Long-Term Disability Insurance Premiums |
|--------------------|--------------------|--|--|
| W. Phillip Marcum | \$ 6,300 | \$ 882 | \$ 256 |
| A. Bradley Gabbard | 6,300 | 882 | 256 |
| Sidney Hinton | 6,300 | 882 | 256 |
| John Bernard | 4,869 | 738 | 256 |
| Daniel Packard | 0 | 650 | 256 |

- (4) Bonus from Executive Incentive Compensation Plan adopted by the Compensation Committee in March 2005, from a bonus pool based primarily on the Company's net income plus other appropriate factors in the discretion of the Compensation Committee. In addition, the bonus to Mr. Marcum includes a \$50,000 bonus unrelated to the Executive

Incentive
Compensation
Plan.

- (5) These options vested immediately upon grant.
- (6) Includes a signing bonus paid in connection with the amended and restated employment agreements of \$50,000 for Mr. Marcum and \$25,000 for Mr. Gabbard.
- (7) Reflects a tax gross-up payment intended to reimburse the executive for taxes payable with respect to the restricted stock grant.
- (8) These options vest in three equal annual installments, commencing on the grant date, subject to immediate vesting upon a change in control.
- (9) Of these options, 30,000 options granted to Mr. Gabbard and 25,000 options granted

to Mr. Packard vest in three equal annual installments, commencing on the grant date, subject to immediate vesting upon a change in control. The remainder of these options vested immediately upon grant.

(10) Became an executive officer during fiscal 2003. Compensation includes all amounts paid or accrued for the entire fiscal 2003.

(11) Bonus resulting from the bonus formula based upon PowerSecure's cash flow from operations, as provided in Mr. Hinton's employment agreement. See Employment Agreements, Change in Control and Termination of Employment Arrangements and Other Compensation Arrangements below.

- (12) Appointed as the President and Chief Executive Officer of Southern Flow on December 1, 2004. Compensation includes all amounts paid or accrued for the entire fiscal 2004.
- (13) Became an executive officer during fiscal 2005. Compensation includes all amounts paid or accrued for the entire fiscal 2005.
- (14) Reflects bonus payments from the Company's equity investee, MM 1995-2, for services rendered on behalf of MM 1995-2.

Employment Agreements, Change in Control and Termination of Employment Arrangements and Other Compensation Arrangements

W. Phillip Marcum and A. Bradley Gabbard. In March 2006, the Company entered into amended and restated employment agreements with W. Phillip Marcum, the Chairman of the Board, President and Chief Executive Officer of the Company, and A. Bradley Gabbard, the Executive Vice President and Chief Financial Officer of the Company. These amended and restated employment agreements set forth the basic terms of employment for each executive.

Under these employment agreements, the employment terms of Messrs. Marcum and Gabbard continue through December 31, 2009 and will be automatically extended for successive one-year periods, unless either the Company or the executive gives six months prior written notice of termination. The base salaries under these employment agreements, which are subject to annual upward adjustments at the discretion of the Board of Directors, are currently set at \$375,000 for

Mr. Marcum and \$245,000 for Mr. Gabbard. In addition to the base salary, the employment agreements provide, among other things, for standard benefits commensurate with the management levels involved. The employment agreements also contain certain restrictions on each executive's ability to compete, use of confidential information and use of inventions and other intellectual property.

The employment agreements with Messrs. Marcum and Gabbard provide that if the employment of the executive is terminated for any reason, other than by the Company for cause (as defined in the employment agreements), including termination by death, by disability, by the Company without cause, by the executive voluntarily or due to the expiration of the employment term or any renewal period, then the executive will be entitled to receive a severance package in the amount of three times, for Mr. Marcum, and two times, for Mr. Gabbard, the sum of his most recent base salary plus his average annual bonus over the three years before the date of termination. The severance package shall be paid pro rata over a six year period for Mr. Marcum and over a two year period for Mr. Gabbard.

The employment agreements also include change in control provisions designed to provide for continuity of management in the event the Company undergoes a change in control. If within three years after a change in control, the officer is terminated by the Company for any reason other than for cause, or if the executive terminates his employment for good reason, as such terms are defined in the employment agreements, then the executive is entitled to receive a lump-sum severance payment equal to three times, for Mr. Marcum, and two times, for Mr. Gabbard, the amount of his then base salary, together with certain other payments and benefits, including continued participation in all the Company's insurance plans for a period of three years for Mr. Marcum and two years for Mr. Gabbard. Under these employment agreements, a change in control will be deemed to have occurred only if:

any person or group becomes the beneficial owner of 50% or more of the Company's Common Stock;

a majority of the present directors of the Company are replaced, unless the election of any new director is approved by a two-thirds vote of the current (or properly approved successor) directors;

the Company approves a merger, consolidation, reorganization or combination, other than one in which the voting securities of the Company outstanding immediately prior thereto continue to represent more than 50% of the total voting power of the Company or of the surviving corporation following such a transaction and the directors of the Company continue to represent a majority of the directors of the Company or of the surviving corporation following such transaction; or

the Company approves a sale of all or substantially all of its assets.

The employment agreements also provide for the Company to establish an incentive compensation fund, to be administered by the Compensation Committee, to provide for incentive compensation to be paid to each officer or employee (including Messrs. Marcum and Gabbard) deemed by the Compensation Committee to have made a substantial contribution to the Company in the event of a change of control of the Company or of the sale of substantially all of its assets or similar transactions. The total amount of incentive compensation from the fund available for distribution will be determined by a formula based on the amount by which the fair market value per share of the Common Stock exceeds \$10.08, multiplied by a factor ranging from 10-20% depending upon the ratio of the fair market value to \$10.08. In the case of the sale of a significant subsidiary or substantially all of the assets of a significant subsidiary, a similar pro rata distribution is required.

Sidney Hinton. In October 2005, PowerSecure entered into an amended and restated employment and non-competition agreement with Sidney Hinton, the President and Chief Executive Officer of PowerSecure. Mr. Hinton's employment term was extended until January 1, 2009, and is renewable for additional one-year renewal periods when the term expires, unless either PowerSecure or Mr. Hinton gives 30 days prior written notice of termination. In addition, Mr. Hinton's severance period and the post-employment non-competition period were extended to two years.

The base salary under Mr. Hinton's employment agreement is currently set at \$315,000, subject to annual upward adjustments at the discretion of the Board of Directors. In addition to the base salary, Mr. Hinton's employment agreement provides, among other things, for standard benefits commensurate with the management level involved, as

well as an annual bonus of 7% of PowerSecure's cash flow from operations.

If Mr. Hinton's employment is terminated for any reason, other than by PowerSecure for cause (as defined in the employment agreement), including termination by death, by disability, by PowerSecure without cause, by Mr. Hinton voluntarily, or due to the expiration of the employment term or any renewal period, then Mr. Hinton will be entitled to

receive a severance package, payable over the subsequent two years, in the amount of two times the sum of his most recent base salary plus his average bonuses for the two years before and for the year of the date of termination, if he had remained employed. Under his employment agreement, Mr. Hinton is prohibited from competing with the business of PowerSecure or its affiliates for a period of two years after the termination of his employment. The employment agreement also contains certain restrictions on Mr. Hinton's use of confidential information and use of inventions and other intellectual property.

Mr. Hinton's employment agreement also includes a change in control provision designed to provide for continuity of management in the event the Company or PowerSecure undergoes a change in control. If within three years after a change in control, Mr. Hinton is terminated by PowerSecure for any reason other than for cause, or if Mr. Hinton terminates his employment for good reason (as such terms are defined in Mr. Hinton's employment agreement), then Mr. Hinton is entitled to receive a lump-sum severance payment equal to the amount of his severance package discussed above, together with certain other payments and benefits, including continued participation in PowerSecure's insurance plans for a period of two years.

John D. Bernard. In October 2005, Southern Flow entered into an employment and non-competition agreement with John D. Bernard, the President and Chief Executive Officer of Southern Flow. Mr. Bernard's employment agreement provides for an employment term through December 31, 2007, and is renewable for additional one-year renewal periods when the term expires, unless either Southern Flow or Mr. Bernard gives 30 days prior written notice of termination. In addition, Mr. Bernard's severance period and the post-employment non-competition period was extended to two years.

The base salary under Mr. Bernard's employment agreement, which is subject to annual upward adjustments at the discretion of the Board of Directors, is currently set at \$170,000. In addition to the base salary, the employment agreement provides, among other things, for Mr. Bernard's participation in Southern Flow bonus plans generally and for standard employee benefits.

If Mr. Bernard's employment is terminated for any reason, other than by Southern Flow for cause (as defined in the employment agreement), including termination by death, by disability, by Southern Flow without cause, by Mr. Bernard voluntarily, or due to the expiration of the employment term or any renewal period, then Mr. Bernard will be entitled to receive a severance package, payable over the subsequent two years, in the amount of one-half (1/2) times, if his employment terminates on or before December 31, 2006, or one (1) time, if his employment terminates on or after January 1, 2007, the sum of his most recent base salary plus his average bonuses for the three years before the date of termination. Under the employment agreement, Mr. Bernard is prohibited from competing with the business of Southern Flow or its affiliates for a period of six months, if his employment terminates on or before December 31, 2006, or one year, if his employment terminates on or after January 1, 2007, after the termination of his employment. The employment agreement also contains certain restrictions on Mr. Bernard's use of confidential information and use of inventions and other intellectual property.

Mr. Bernard's employment agreement also includes a change in control provision designed to provide for continuity of management in the event the Company or Southern Flow undergoes a change in control. If within three years after a change in control, Mr. Bernard is terminated by Southern Flow for any reason other than for cause, or if Mr. Bernard terminates his employment for good reason (as such terms are defined in the employment agreement), then Mr. Bernard is entitled to receive a lump-sum severance payment equal to the amount of his severance package discussed above, together with certain other payments and benefits, including continued participation in of Southern Flow's insurance plans for a period of six months or one year, depending on the date of termination, matching the period of his non-competition covenant discussed above.

Stock Option Grants

The following table sets forth certain information with respect to stock options granted during fiscal 2005 to the Named Executive Officers. The Company did not grant any stock appreciation rights, alone or in tandem with stock options, during fiscal 2005.

Option Grants in Last Fiscal Year

| Name | Number of Securities Underlying Options Granted (#)(1) | Individual Grants | | | Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for | |
|--------------------|--|--|---------------------------|----------------------|--|--------------------|
| | | % of Total Options Granted to Employees in Fiscal Year (2) | Exercise Price (\$/Sh)(3) | Expiration Date (4) | Option Term(5) | 5%(\$) |
| W. Phillip Marcum | 100,000 | 16.2% | \$ 6.65 | 12/05/15 | \$ 418,219 | \$ 1,059,811 |
| A. Bradley Gabbard | 30,000(6) 25,000 | 4.9% 4.1% | 3.06 6.65 | 02/04/15 12/05/15 | 57,733 104,555 | 146,237 264,953 |
| Sidney Hinton | 25,000 25,000 | 4.1% 4.1% | 4.22 6.65 | 09/26/15 12/05/15 | 66,349 104,555 | 168,135 264,953 |
| John Bernard | 25,000 25,000 | 4.1% 4.1% | 4.22 6.65 | 09/26/15 12/05/15 | 66,349 104,555 | 168,135 264,953 |
| Daniel J. Packard | 25,000(6) | 4.1% | 3.06 | 02/04/15 | 48,111 | 121,918 |

(1) These options are incentive stock options granted under the 1998 Stock Plan, have ten year terms and were fully vested on the grant date, except as otherwise noted.

(2) Based upon options to purchase an aggregate of 616,000 shares

of Common
Stock granted to
employees
during fiscal
2005.

- (3) The exercise price of these options is equal to or greater than the fair market value of the Common Stock on the date of grant, based upon the last sale price of the Common Stock on such date as reported on the American Stock Exchange (for options granted on or after August 10, 2005) or on the OTC Bulletin Board (for options granted prior thereto).
- (4) These options may terminate before their terms expire due to the termination of the optionee's employment or the optionee's disability or death.
- (5) The dollar amounts in these columns set forth the hypothetical gains that could be achieved for the respective

option grants, assuming that the market price of the Company's Common Stock appreciates in value from the date of grant through the term of the options at the annualized rates of 5% and 10%, respectively, contained in the table, which rates are specified by SEC rules and do not represent the Company's estimate or projection of the future appreciation of the price of the Common Stock. There is no assurance that the rates of appreciation set forth in this table can be achieved or that the amounts reflected will be received by the optionees. In addition, the potential realizable value set forth in these columns is net of the option exercise price but before taxes associated with any exercise. Actual gains, if any, on option

exercises will be dependent on, among other things, the timing of such exercises and the future performance of the Common Stock.

- (6) These options vest in three equal installments, commencing on the grant date, subject to immediate vesting upon a change in control.

Stock Option Exercises and Values

The following table sets forth information with respect to stock options held by the Named Executive Officers on December 31, 2005. No Named Executive Officer exercised any stock options during fiscal 2005.

**Aggregated Option Exercises in Last Fiscal Year
and Fiscal Year-End Option Values**

| Name | Number of Securities Underlying Unexercised Options at Fiscal Year-End(#) | | Value of Unexercised In-the-Money Options at Fiscal Year-End \$(1) | |
|--------------------|--|---------------|--|---------------|
| | Exercisable | Unexercisable | Exercisable | Unexercisable |
| W. Phillip Marcum | 383,334 | 16,666 | \$ 2,263,837 | \$ 98,163 |
| A. Bradley Gabbard | 289,167 | 28,333 | 1,932,319 | 166,881 |
| Sidney Hinton | 195,000 | | 1,148,500 | |
| John Bernard | 85,876 | 8,333 | 405,653 | 49,081 |
| Daniel Packard | 41,666 | 18,334 | 209,829 | 107,171 |

(1) For purposes of this table and in accordance with SEC rules, the value of unexercised in-the-money options is calculated based solely upon the excess of \$8.95, the closing sale price of the Company's Common Stock on December 31, 2005 as reported on the American Stock Exchange, over the exercise price of the option. An option is in-the-money if the fair market value of the

underlying
shares of
Common Stock
exceeds the
exercise price of
the option.
However, the
actual value, if
any, that an
optionee may
realize upon
exercise of a
stock option
will be
dependent upon
the future
market price of
the Common
Stock and the
optionee's
continued
employment
through the
vesting period.

Compensation Committee Interlocks and Insider Participation

The members of the Compensation Committee of the Board of Directors are Basil M. Briggs, Chairman, Anthony D. Pell and Kevin P. Collins. No member of the Compensation Committee is or has ever been an officer or employee of the Company or of any of its subsidiaries. None of the executive officers of the Company serves as a member of the board of directors or of the compensation committee of any other entity that has one or more executive officers serving as a member of the Board of Directors of the Company or of its Compensation Committee.

REPORT OF THE COMPENSATION COMMITTEE ON EXECUTIVE COMPENSATION

The Compensation Committee of the Board of Directors is responsible for establishing and administering the compensation program and policies for the Company's executive officers. The Compensation Committee approves all compensation paid to the Company's executive officers, generally reviews and approves the Company's general compensation policies and also oversees the administration by the Board of Directors of the Company's stock plans under which grants of stock options and restricted stock may be made to executive officers.

The Compensation Committee consists of three members of the Board of Directors. Each member of the Compensation Committee is independent under the Standards of Director Independence adopted by the Board of Directors and the current listing standards of the American Stock Exchange. The Compensation Committee operates under a formal written charter, which was amended and restated by the Board of Directors on March 20, 2006.

Executive Compensation Policy

The Company's executive compensation policy is based on the belief that competitive compensation is essential to attract, retain, motivate and reward highly qualified and industrious executives. The Company's executive compensation program is intended to accomplish the following purposes:

attract and retain highly talented and productive executive officers,

provide incentives and rewards for superior performance by the Company's executive officers, and

align the interests of executive officers with the interests of the Company's stockholders.

To achieve these objectives, the Compensation Committee has designed an executive compensation program that consists of four basic components:

base salary,

short-term incentive compensation in the form of annual cash bonuses,

long-term incentive compensation in the form of stock options and restricted stock, and

general benefit programs.

Components of Executive Compensation

The Compensation Committee reviews the Company's executive compensation program through the application of the subjective business judgment of each of its members and through an informal survey of executive compensation programs of peer companies. The philosophy of the Compensation Committee is that the compensation and equity incentives of each officer should be significantly influenced by the executive officer's individual performance, and accordingly a significant percentage of the total compensation and equity incentive package of each executive officer is contingent upon individual performance. The Compensation Committee does not generally use a quantitative method or mathematical formula to set the elements of compensation for a particular executive officer, except for certain year-end cash bonus awards. The Compensation Committee uses discretion and considers all elements of an executive's compensation package when setting each portion of compensation, based upon corporate performance and individual initiatives and performance. The principal factors that the Compensation Committee considered with respect to each executive officer's compensation package for fiscal 2005 are summarized below. The Compensation Committee may, however, in its discretion apply entirely different factors with respect to executive compensation for future years.

Base Salary

The base salary for each of the Company's executive officers is subjectively determined primarily on the basis of the following factors: experience, personal performance, contribution to Company performance, level of responsibility, duties and functions, breadth of knowledge, salary levels in effect for comparable positions within and without the Company's industry and internal base salary comparability considerations. These base salaries are reviewed annually and may be

adjusted in the discretion of the Compensation Committee, based upon the factors discussed in the previous sentence, as well as upon individual performance during the previous fiscal year, changes in the duties, responsibilities and functions of the executive officer, general changes in the compensation peer group in which the Company competes for executive talent, and the Company's financial performance generally. The relative weight given to each of these factors differs from individual to individual, as the Compensation Committee deems appropriate.

Annual Cash Bonuses

For fiscal 2005, the Company granted cash bonuses to all its executive officers. Depending on the executive officer, these bonuses were paid either under established plans and arrangements relating to some metrics of Company financial performance or on a discretionary basis as determined by the Compensation Committee, or were based upon some combination thereof. Factors considered by the Compensation Committee in determining discretionary annual cash bonuses are personal performance, Company performance, level of responsibility and the Company's achievement of performance goals, as well as many of the same factors considered by the Compensation Committee and discussed above when it reviews and sets base salaries, except with a greater focus on the prior fiscal year.

In March 2005, the Board of Directors, upon the recommendation of the Compensation Committee, adopted an Executive Incentive Compensation Plan, which provides for annual bonuses to officers and key employees of the Company in such target amounts and based on such factors, such as individual performance and Company performance goals, as annually determined by the Compensation Committee. For fiscal 2005, the Company's Chief Executive Officer and Chief Financial Officer received cash bonuses under the Executive Incentive Compensation Plan, from a bonus pool of \$410,000 in the aggregate, based primarily upon the Company achieving certain goals pertaining to net income from continuing operations (before bonus payments) in fiscal 2005.

Long-Term Incentive Compensation

Long-term incentives are provided through grants of stock options and restricted stock under the Company's 1998 Stock Plan. The grants are designed to align the interests of executive officers with those of stockholders and to provide each executive with a significant incentive to manage the Company from the perspective of an owner with an equity stake in the Company. During fiscal 2005, the Company granted options to purchase a total of 315,000 shares of Common Stock to six executive officers and did not make any grants of restricted stock.

Each stock option grant allows the executive officer to acquire shares of Common Stock at a fixed price per share (typically, and never less than, the closing sale price of the Common Stock on the date of grant) for a fixed period (usually ten years). Each option becomes exercisable, either fully immediately upon grant or in installments over a period of years (customarily two to four years), contingent upon the executive officer's continued employment with the Company. Accordingly, the stock option grant will provide a return to the executive officer only if the executive officer remains employed by the Company during the vesting period, and then only if the market price of the underlying Common Stock appreciates.

The number of shares of Common Stock that are subject to each stock option grant is subjectively determined by the Compensation Committee primarily related to the executive officer's anticipated contributions to the Company's future success, a level intended to create a meaningful opportunity for stock ownership based on the executive officer's current position with the Company, the size of comparable awards made to individuals in similar positions within the industry, the individual's potential for increased responsibility and promotion over the option term and the individual's personal performance in recent periods. The Compensation Committee also considers the number of unvested stock options held by the executive officer in order to maintain an appropriate level of equity incentive for that individual. However, the Compensation Committee does not adhere to any specific guidelines as to the relative stock option holdings of the Company's executive officers.

General Benefits

Executive officers are eligible to participate in medical, life and benefit programs generally available to employees.

Compensation of the Chief Executive Officer

The Compensation Committee carefully reviews the compensation of W. Phillip Marcum, the Company's President and Chief Executive Officer, annually in accordance with the factors discussed above and in accordance with his employment agreement. During fiscal 2005, Mr. Marcum's employment agreement was amended and restated to, among other things, extend his employment term through December 31, 2009.

In evaluating Mr. Marcum's compensation, the Compensation Committee considered, among things, the substantial improvement of the Company's financial results, financial condition and future prospects. For example, in 2005, the Company recorded record revenues in of approximately \$47.3 million and record net income of \$2,334,000. The Company also received records sales orders in 2005, followed up by even larger sales orders in early 2006. For fiscal 2005, the Company rewarded Mr. Marcum for his superior performance by awarding him total bonuses of \$255,000, including \$205,000 under the Executive Incentive Compensation Plan based primarily upon the Company's net income from continuing operations, and granted him options to purchase 100,000 shares of Common Stock. Mr. Marcum's base salary in 2005 was set at \$325,000, which the Compensation Committee increased to \$375,000 for 2006. These compensation actions were taken by the Compensation Committee after deliberation based on its opinion of the critical importance of Mr. Marcum to the future success of the Company and its stockholders, and the level and value of Mr. Marcum's duties and responsibilities. The Compensation Committee believes that Mr. Marcum has continued to provide strong leadership for the Company through its ongoing restructuring to address business challenges, has delivered a profitable company to stockholders and has implemented important steps that position the Company to continue to be profitable in the future and to continue to build long-term value for its stockholders.

Limitations on Tax Deductibility of Executive Compensation Under Section 162(m)

Section 162(m) of the Internal Revenue Code of 1986, as amended, generally disallows a tax deduction to public companies for certain compensation in excess of \$1 million paid to a company's chief executive officer and the four other most highly compensated executive officers. However, qualified performance-based compensation will not be subject to the deduction limit if certain requirements are met. During fiscal 2005, the Compensation Committee did not award compensation to any of the Company's executive officers in excess of the \$1 million limit per executive officer.

The Company intends to structure long-term incentive compensation granted to its executive officers through grants of stock options and restricted stock under the Company's stock plans in a manner that is intended to avoid disallowance of deductions under Section 162(m). In the event that the Compensation Committee considers approving salary or bonus compensation in the future that could exceed the \$1 million deductibility threshold, Board of Directors will consider what actions, if any, should be taken to make such compensation deductible. The Board of Directors and the Compensation Committee reserve the authority to award non-deductible compensation in such circumstances as they deem appropriate.

Conclusion

Through the Company's compensation programs, a significant portion of the Company's executive compensation is linked directly to individual and Company performance in the pursuit of strategic goals. The Compensation Committee believes that the Company's executive compensation policies and programs promote the best interests of the Company and enhance stockholder value. The Compensation Committee will continue to monitor and evaluate the overall effectiveness of these programs.

Compensation Committee

Basil M. Briggs, Chairman
Anthony D. Pell
Kevin P. Collins

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CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The son of Sidney Hinton, the President and Chief Executive Officer of PowerSecure, is employed by PowerSecure in a sales and administrative capacity and, during fiscal 2005, Mr. Hinton's son received total compensation, including salary and bonus, of \$73,666 for services rendered as an employee during fiscal 2005 and was granted options to purchase 35,000 shares of the Company's Common Stock at an exercise price of \$5.89 per share, the closing sale price of the Common Stock as reported in the American Stock Exchange on the date of grant. In addition, during fiscal 2005, Mr. Hinton's brother-in-law was employed by PowerSecure as a project manager and received total compensation, including salary and bonus, of \$53,969 for services rendered as an employee during fiscal 2005 and was granted options to purchase 10,000 shares of the Common Stock at an exercise price of \$6.65 per share, the closing sale price of the Common Stock as reported in the American Stock Exchange on the date of grant.

In March 2006, the Company entered into a Securities Purchase Agreement with certain of its officers and directors, as selling stockholders, and with certain institutional investors as purchasers of the Common Stock, pursuant to which these institutional investors purchased a total of 2,403,000 shares of Common Stock, 2,012,548 shares from the Company and 390,452 shares from certain officers and directors of the Company, for a purchase price of \$14.00 per share in a private placement. Certain of these institutional investors were, or were affiliated with entities that were, holders of more than five percent of our outstanding Common Stock. In addition, in March 2006, the Company entered into a Registration Rights Agreement with these institutional investors, pursuant to which the Company agreed to register the public resale of all shares of Common Stock sold in the private placement by filing a registration statement with the SEC and keeping the registration statement effective until the earliest of the following: (i) five years after the registration statement becomes effective; (ii) such time as all such shares have been publicly resold; or (iii) such time as all such shares may be sold under Rule 144(k) under the Securities Act.

The Company has entered into indemnification agreements with each of its directors and certain of its executive officers. These agreements require the Company to indemnify such directors against certain liabilities that may arise against them by reason of their status or service as officers or directors of the Company, to the fullest extent permitted by Delaware law, to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified. The Company maintains an insurance policy covering its officers and directors under which the insurer has agreed to pay the amount of any claim made against the officers or directors of the Company that such officers or directors may otherwise be required to pay or for which the Company is required to indemnify such officers and directors, subject to certain exclusions and conditions, up to policy limits.

Any material transaction between the Company and any related party must be approved by its Audit Committee, which is comprised solely of independent directors.

PROPOSAL NO. 2

APPROVAL OF AMENDMENTS TO THE 1998 STOCK INCENTIVE PLAN

The Company's 1998 Stock Incentive Plan, as amended and restated to date, was adopted by the Board of Directors of the Company in March 1998, approved by the stockholders of the Company in June 1998, and amended by the stockholders in February 2000 and June 2004. The 1998 Stock Plan replaced the Company's 1991 Stock Option Plan and Directors' Stock Option Plan, the Company's previous stock option plans. The 1998 Stock Plan authorizes the Board of Directors to grant non-qualified stock options (NQSOs), incentive stock options (ISOs), stock appreciation rights (SARs), restricted stock awards, performance awards, and other stock-based awards to officers, directors, employees, consultants and advisors of the Company and its subsidiaries. The purpose of the 1998 Stock Plan is to promote the success of the Company by enabling it to attract, retain, reward, and motivate the best available officers, directors, employees, advisors and consultants of the Company and its subsidiaries by providing them with an equity interest in the Company in order to align their interest with those of the Company's stockholders and to provide such persons with incentives to pursue the long-term growth, profitability and financial success of the Company and its subsidiaries and to increase stockholder value. The 1998 Stock Plan is a critical part of the Company's overall compensation program.

As of May 12, 2006, an aggregate of 1,814,797 shares of Common Stock were subject to outstanding awards under the 1998 Stock Plan to a total of 69 employees and directors. To date, all awards under the 1998 Stock Plan have been stock options, except for the grant of 90,000 shares of restricted stock to three executive officers in 2004. In addition, as of May 12, 2006, an aggregate of 72,111 shares of Common Stock were subject to outstanding options granted under the Company's prior stock plans, the Company's 1991 Stock Option Plan and the Company's Directors' Stock Option Plan. On May 10, 2006, the last reported sale price of the Common Stock as reported on American Stock Exchange was \$14.20 per share.

Proposed Amendments

On March 20, 2006, upon the recommendation of the Compensation Committee, the Board of Directors authorized, subject to stockholder approval, and is recommending that stockholders approve at the Annual Meeting, amendments to the 1998 Stock Plan to:

- increase the number of shares of Common Stock authorized for issuance thereunder by 1,000,000 shares to an aggregate of 3,750,000 shares,

- eliminate the provision setting forth formula grants of stock options to Non-Employee Directors, and

- prohibit the repricing of stock options without stockholder approval, and

- address and comply with Section 409A of the Internal Revenue Code of 1986, as amended (the Code).

Additional Shares. A total of 2,750,000 shares of Common Stock are presently reserved for issuance under the 1998 Stock Plan, of which as of May 12, 2006, no shares remained available for issuance in future awards. Upon the recommendation of the Compensation Committee, the Board of Directors has authorized an amendment to the 1998 Stock Plan, subject to stockholder approval, to increase the number of shares of Common Stock available for issuance thereunder by 1,000,000 shares to a total of 3,750,000 shares. The purpose of that proposed amendment is to ensure that a sufficient number of shares of the Company's Common Stock are available under the 1998 Stock Plan for awards to attract, retain, reward and motivate officers, directors, employees, advisors and consultants as set forth above.

Eliminating Formula Grants to Non-Employee Directors. The Board of Directors is also proposing an amendment to the 1998 Stock Plan to eliminate formula grants of stock options to Non-Employee Directors. The current formula for grants of stock options to Non-Employee Directors is described above in Corporate Governance-Compensation of Directors. The Board of Directors, upon the recommendation of the Compensation Committee, has concluded that the current formula for granting stock options to Non-Employee Directors, which was created in 1991 in a previous plan and carried forward in the 1998 Stock Plan, is no longer appropriate, especially in light of the many changes in recent years in the duties and responsibilities of independent directors. In 2004, the Board

of Directors, upon the recommendation of the Compensation Committee, decided to supplement the formula annual stock option grants by adding additional stock options based upon the amount of the annual retainer paid to Non-Employee Directors and the trading price of the Common Stock. The Board of Directors also believes that the number of stock options to be granted to a new Non-Employee Director is

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probably insufficient compensation to attract and retain qualified, independent new directors. The Compensation Committee is considering changing not only the number of stock options granted to Non-Employee Directors, but also changing the type of equity grants, such as restricted stock grants in lieu of, or in addition to, stock option grants. The Board of Directors desires to grant to the Compensation Committee the flexibility and discretion to determine the type and amount of equity awards that are appropriate to be made to Non-Employee Directors just as it has the flexibility and discretion to determine the type and amount of equity awards to officers and employees under the 1998 Stock Plan. As of the date of this Proxy Statement, no new arrangements for awards under the 1998 Stock Plan have been adopted by the Board of Directors or recommended by the Compensation Committee.

Prohibiting Repricing. In addition, the Board of Directors has proposed to amend the 1998 Stock Plan to prohibit the repricing of stock options without stockholder approval. This amendment would prohibit the Board, or any committee administering the 1998 Stock Plan, from directly or indirectly reducing the exercise price of any outstanding option granted under the 1998 Stock Plan, including but not limited to by exchanging underwater options (options having an exercise price in excess of the then current market value of the Common Stock) for newly granted options at a lower exercise price.

Section 409A. Finally, the Board of Directors has proposed amending the 1998 Stock Plan to incorporate necessary amendments to address and comply with the requirements of Section 409A of the Code. The American Jobs Creation Act of 2004 added a new section to the Code (Section 409A) covering certain deferred compensation plans within the meaning of Section 409A. Equity-based grants can, in certain circumstances, constitute deferred compensation plans within the meaning of Section 409A. Section 409A generally establishes very specific requirements that must be followed with respect to covered deferred compensation plans in order to avoid the imposition of an additional 20% federal income tax (plus interest) on the service provider who is entitled to receive the deferred compensation. Certain awards that may be granted under the 1998 Stock Plan may constitute deferred compensation within the meaning of and subject to Section 409A. The 1998 Stock Plan is intended to be interpreted and operated in accordance with Section 409A, including any regulations or guidance issued by the Treasury Department, and contains a number of provisions intended to avoid the imposition of additional tax on 1998 Stock Plan recipients under Section 409A. To the extent practicable, the Company intends that any awards granted under the 1998 Stock Plan will satisfy the requirements of Section 409A to avoid the imposition of the additional tax. The Board of Directors has proposed amended the 1998 Stock Plan in order to add provisions that will assist the Company in complying with Section 409A including, among other things, the authority to amend the 1998 Stock plan and outstanding awards to preserve the intended benefits of awards granted under the 1998 Stock Plan and to avoid the imposition of an additional tax under Section 409A.

Summary of the 1998 Stock Plan

The major provisions of the 1998 Stock Plan are summarized below. The following summary does not purport to be complete and is qualified in its entirety by reference to the 1998 Stock Plan. The full text of the 1998 Stock Plan, as proposed to be amended subject to stockholder approval, is attached hereto as Appendix B.

Awards. The 1998 Stock Plan provides for the grant of incentive stock options, non-qualified stock options, restricted stock awards, performance awards and other stock-based awards to officers, directors, employees, consultants and advisors of the Company and its subsidiaries.

Shares Authorized. A total of 2,750,000 shares of Common Stock are currently authorized for issuance under the 1998 Stock Plan, which would be increased by the proposed amendments to 3,750,000 shares. The shares of Common Stock issuable under the 1998 Stock Plan may be authorized or unissued shares or treasury shares, including shares repurchased by the Company for purposes of the 1998 Stock Plan. If any shares subject to any award are forfeited or payment is made in the form of cash, cash equivalents or property other than shares, or an award otherwise terminates without payment being made to the participant in the form of shares, the shares subject to such awards will again be available under the 1998 Stock Plan.

Administration. The 1998 Stock Plan is administered by the Board of Directors of the Company. The Board of Directors has the right to delegate the administration of the 1998 Stock Plan to a committee comprised of two or more directors who are not officers or employees of the Company or any its subsidiaries, and who meet certain other requirements under applicable federal securities law and federal tax law provisions. The members of the Board of

Directors, or of any committee appointed by the Board of Directors, are eligible for awards under the 1998 Stock Plan. The Board of Directors is authorized to designate participants, determine the type and number of awards to be granted, set the terms, conditions and provisions of awards, cancel or suspend awards, prescribe forms of award agreements, interpret the 1998 Stock Plan,

establish, amend and rescind rules and regulations related to the 1998 Stock Plan, and make all other determinations which may be necessary or advisable to the administration of the 1998 Stock Plan.

Eligibility. Officers, directors, employees, consultants and advisers of the Company and its existing or future subsidiaries who, in the determination of the Board of Directors, are responsible for or contribute to the management, growth, profitability and successful performance of the Company and its subsidiaries are eligible to receive awards under the 1998 Stock Plan. All of the approximately 274 employees of the Company and its subsidiaries, all five directors of the Company, and all advisors and consultants of the Company are eligible to receive awards under the 1998 Stock Plan.

Limitations. During any calendar year, the maximum number of shares of Common Stock that can be granted to any individual participant subject to awards under the 1998 Stock Plan is 100,000 shares.

Stock Options. Under the 1998 Stock Plan, the Board of Directors is authorized to grant incentive stock options and non-qualified stock options. The exercise price of stock options is determined by the Board of Directors but may not be less than the fair market value of the Common Stock on the date of grant (or 110% of the fair market value in the case of an ISO granted to an employee beneficially owning more than 10% of the outstanding Common Stock). The Board of Directors may grant NQSOs to any eligible participant, but may grant ISOs only to employees. Stock options become exercisable at such time or times in whole or in part as determined by the Board of Directors, except that ISOs may not be exercised after the expiration of 10 years after the date of grant (5 years after grant in the case of ISO, granted to an employee beneficially owning more than 10% of the outstanding Common Stock). Options may be exercised by payment of the exercise price in cash, shares of Common Stock, exchange of outstanding awards or other property, or in any combination thereof having a fair market value equal to the exercise price, as the Board of Directors determines.

Formula Grants of Stock Options to Non-Employee Directors. The 1998 Stock Plan currently provides for formula grants of NQSOs to Non-Employee Directors. See *Corporate Governance-Compensation of Directors* and *Proposed Amendments Eliminating Formula Grants to Non-Employee Directors* above. The proposed amendments would eliminate these formula grants and allow the Board of Directors to grant the number and type of equity awards it determined appropriate, in its discretion and based upon the recommendation of the Compensation Committee, and to change such arrangements from time to time. The Board of Directors desires to grant to the Compensation Committee the flexibility and discretion to determine the type and amount of equity awards under the 1998 Stock Plan to Non-Employee Directors just as it has the flexibility and discretion to determine the type and amount of equity awards to officers and employees. If the proposed amendments to the 1998 Stock Plan are adopted, the Compensation Committee intends to review the equity grants made to Non-Employee Directors and could recommend to the Board of Directors changes to the current equity awards as compensation to Non-Employee Directors. As of the date of this Proxy Statement, no new arrangements for awards under the 1998 Stock Plan have been adopted by the Board of Directors or recommended by the Compensation Committee.

Prohibition on Repricing Stock Options. The proposed amendments would prohibit the direct or indirect repricing of outstanding stock options granted under the 1998 Stock Plan, without stockholder approval. For example, if the stockholders approve the proposed amendments to the 1998 Stock Plan, then the exercise price of options outstanding thereunder could not be reduced, and outstanding options could not be exchanged for options with a lower stock price, without stockholder approval.

Stock Appreciation Rights. The Board of Directors is authorized to grant SARs either alone or in tandem with underlying stock options. SARs entitle the participant upon exercise to receive cash or shares of Common Stock (as determined by the Board of Directors) equal in value to the excess of the fair market value of the shares of Common Stock covered by the SAR on the date of exercise over the grant price of the SAR. The grant price for SARs is fixed by the Board of Directors but will not be less than the fair market value of the Common Stock on the date of grant. SARs are exercisable at such time or times in whole or in part as determined by the Board of Directors, except that they may not be exercised after the expiration of 10 years from the date of grant.

Restricted Stock. The 1998 Stock Plan also authorizes the award of restricted stock. An award of restricted stock is an award of shares of Common Stock that is subject to such restrictions as the Board of Directors determines. The restricted stock vests and may be disposed of by the participant only after such restrictions lapse in whole or in

installments as the Board of Directors determines. Restricted stock awards may be subject to forfeiture if, for example, the participant's employment terminates before the award vests. A participant receiving restricted stock has all the rights of a stockholder of the Company, including the right to vote the shares and the right to receive any dividends, unless the Board of Directors

otherwise determines. The Board of Directors, in its sole discretion, may waive or accelerate the lapsing of restrictions in whole or in part.

Deferred Stock. The 1998 Stock Plan also authorizes the Board of Directors to make deferred stock awards, generally consisting of a right to receive shares of Common Stock at the end of specified deferral periods. Awards of deferred stock are subject to such limitations as the Board of Directors may impose, which limitations may lapse at the end of the deferral period in installments or otherwise. Deferred stock awards carry no voting or dividend rights or other rights associated with stock ownership. Upon termination of employment during the restriction or deferral period, restricted stock or deferred stock will be forfeited subject to such exceptions, if any, as are authorized by the Board of Directors.

Bonus Shares and Awards in Lieu of Obligations. The Board of Directors is authorized under the 1998 Stock Plan to grant shares of Common Stock to eligible persons as a bonus or in lieu of obligations (such as salary requirements) to pay cash or deliver other property, subject to such terms as determined by the Board of Directors.

Performance Awards. Under the 1998 Stock Plan, the Board of Directors may make a performance award, which is an award of a number of units that represents the right to receive a specified number of shares of Common Stock or cash, or both, upon satisfaction of certain specified performance criteria, subject to such terms and conditions as the Board of Directors determines. Performance awards will be earned to the extent such performance goals established by the Board of Directors are achieved over a period of time specified by the Board of Directors. The performance objectives may vary from participant to participant, group to group and period to period. The performance objectives for awards intended to constitute qualified performance-based compensation (see discussion below under the heading

Certain Federal Income Tax Consequences) will be based upon one or more of the following: earnings per share; revenues; cash flow; return on investment; return on net assets, assets, capital or equities; economic value added; operating margins; net income; pre-tax earnings; pre-tax earnings before interest, depreciation and amortization; pre-tax operating earnings after interest expense and before extraordinary or special items; operating earnings; total stockholder returns; price of the shares (and changes thereof); and any of the above goals as compared to the performance of a published or special index deemed applicable by the Board of Directors including, but not limited to, the Standard & Poor's 500 Stock Index or a group of comparable companies. The Board of Directors has the discretion to determine the value of each performance award, to adjust the performance goal as it deems equitable to reflect events affecting the Company or changes in law or accounting principles or other factors, and to determine the extent to which performance awards that are earned may be paid in the form of cash, deferred cash, shares of Common Stock or other awards or property, or combination thereof, as determined by the Board of Directors.

Dividend Equivalents. The Board of Directors is authorized to grant dividend equivalents conferring on a participant the right to receive, quarterly or on a deferred basis, interest or dividends, or interest or dividend equivalents. Dividend equivalents may be paid directly to a participant or may be reinvested under the 1998 Stock Plan.

Other Stock-Based Awards. In order to enable the Company to respond to material developments in the area of taxes and other legislation and regulations and interpretations thereof, and to trends in executive compensation practices, the 1998 Stock Plan authorizes the Board of Directors to grant awards that are denominated or payable in, valued in whole or in part by reference to, or otherwise based on or related to securities of the Company. The Board of Directors shall determine the terms and conditions of such awards, including the consideration paid for awards as purchase rights, which consideration generally may not be less than the fair market value of the Common Stock on the date that the purchase right is granted. These awards may include, without limitation, performance shares and restricted stock units that entitle the participant to receive, upon satisfaction of performance goals or other conditions, a specified number of shares of Common Stock or the cash equivalent thereof.

Transferability of Options. Under the 1998 Stock Plan, awards are generally not assignable or transferable by a participant, except by will or the laws of descent and distribution or pursuant to a qualified domestic relations order, except to the Company under the terms of the 1998 Stock Plan, and except that, upon approval by the Board of Directors, NQSOs and SARs may be transferred by participants to immediate family members, to trusts for the benefit of immediate family members and to partnerships or similar entities in which such participant and his or her immediate family members are the sole parties or members.

Acceleration of Awards Upon Change in Control. The 1998 Stock Plan provides that in the event of a change in control of the Company (as defined in the 1998 Stock Plan and subject to limitations due to Section 409A of the Code), all outstanding awards under the 1998 Stock Plan, regardless of any limitations or restrictions, will immediately vest and become fully exercisable, and all restrictions applicable to outstanding restricted stock, performance awards and other stock-

based awards will lapse, unless otherwise provided by the Board of Directors at the time of grant of the award or unless waived or deferred by the participants. In the event of a change in control of the Company, with certain exceptions, participants may elect to surrender any outstanding award and receive in satisfaction thereof a cash, stock or other payment equal to the value of their outstanding awards based on the change in control price (as defined in the 1998 Stock Plan), which is generally the highest price paid or offered for the Common Stock during the preceding 60-day period, of the shares of Common Stock subject to the award or of the fair market value of any property other than shares of the Company relating to such award, except that with respect to an ISO or an SAR granted in tandem with an ISO, the cash payment will be based on the fair market value of the shares subject to the ISO or SAR on the date on which the change in control occurred.

Amendment and Termination of the 1998 Stock Plan. The Board of Directors has the right to amend, alter, suspend, discontinue or terminate the 1998 Stock Plan at any time without the consent of the stockholders or participants, except that (i) stockholder approval of such action will be required if such approval is required by any federal or state law or regulation or stock exchange or stock market rule, regulation or policy, or if the Board of Directors in its discretion determines that obtaining such stockholder approval is advisable, and (ii) subject to the terms of the 1998 Stock Plan, no amendment or termination of the 1998 Stock Plan may materially and adversely affect the rights of a participant under any award granted under the 1998 Stock Plan without the consent of the affected participant. Unless earlier terminated by the Board of Directors, no award may be granted under the 1998 Stock Plan after June 12, 2008.

If the Board of Directors or the Committee, if any, determines that any awards made under the 1998 Stock Plan will be taxable to a participant under Section 409A, then prior to exercise of stock options or stock appreciation rights by such participant or payment of other awards to such participant, the Board of Directors or the Committee, if any, may amend the 1998 Stock Plan and any outstanding awards, including retroactively, if the Board of Directors or the Committee, if any, determines it is necessary or appropriate to do so to preserve the intended tax treatment of the awards granted under the 1998 Stock Plan. The Board of Directors or the Committee, if any, also may take other actions it determines necessary or appropriate to avoid the imposition of an additional tax under Section 409A.

Summary of Federal Income Tax Consequences

The following is a brief summary of the principle federal income tax consequences of certain kinds of awards that may be granted under the 1998 Stock Plan. This summary is based upon the Internal Revenue Code of 1986, as amended (the Code), the applicable treasury regulations promulgated thereunder, judicial authority and administrative ruling and practice, all as in effect on the date hereof. Legislative, judicial or administrative rules and interpretations are subject to change, potentially on a retroactive basis, at any time, and such changes could alter or modify the statements and conclusions set forth below. This summary does not purport to be complete and does not address all aspects of federal income taxation that may be relevant to a particular participant in light of such participant's personal investment circumstances or participants subject to special treatment under the federal income tax laws. The summary also does not address the effects of foreign, state or local tax consequences. The 1998 Stock Plan is not a tax-qualified deferred compensation plan under Section 401(a) of the Code, and is not subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended. Participants of grants of awards under the 1998 Stock Plan should consult with their personal tax advisors with respect to such grants and transactions in awards and shares acquired pursuant to the 1998 Stock Plan.

ISOs. A participant who is granted an ISO will generally not recognize any taxable income at the time the ISO is granted or exercised, so long as the participant has been an employee of the Company or any of its subsidiaries from the date the ISO was granted until three months before the date of exercise (one year if the employee is disabled), but the amount by which the fair market value of the Common Stock on the date of exercise exceeds the option exercise price is an adjustment item for purposes of the alternative minimum tax. If the participant holds the shares of Common Stock received upon the exercise of the ISO for at least one year after the date of exercise and two years after the date of grant (the holding period), then any difference between the amount realized upon the disposition of the shares and the exercise price will be treated as long-term capital gain or loss to the participant. The Company will not have any tax consequences from the grant or exercise of an ISO (except as discussed below) if the participant satisfies the holding period requirements.

If a participant exercises an ISO but does not satisfy the holding period requirements set forth above, the participant generally will recognize ordinary income in the year of disposition of the shares of Common Stock acquired upon the exercise of an ISO equal to the excess, if any, of the fair market value of the Common Stock on the date of exercise over the option exercise price, and any excess of the amount realized on such disposition over the fair market value of the Common Stock on the date of exercise will be taxed as long-term or short-term capital gain, as applicable. If the participant disposes of the shares of Common Stock prior to the satisfaction of the holding period requirements but the amount realized

is less than the fair market value of the Common Stock on the date of exercise, the participant will recognize ordinary income equal only on the excess of the amount realized upon the disposition of the shares over the option exercise price. In either event, the Company will be entitled to a tax deduction in an amount equal to the amount constituting ordinary income to the participant.

If a participant exercises an ISO by tendering shares of Common Stock (other than the shares acquired upon the exercise of an ISO and not held for the requisite holding period set forth above) in payment of all or part of the option exercise price, the participant will not be required to recognize any taxable income from the exchange and option exercise, and the participant's tax basis and holding period (for capital gain purposes) for the tendered shares of Common Stock will be treated as a substituted basis for the shares received upon the exercise of the ISO. If the participant uses shares received pursuant to the exercise of an ISO as to which the participant had not satisfied the applicable holding period requirements, the exchange will be treated as a taxable disqualifying disposition of the exchanged shares, with the result of the excess of the fair market value of the shares tendered over the participant's basis in such shares would be taxable.

NQSOs. A participant who is granted an NQSO will not recognize any taxable income, and the Company will not have any tax consequences, at the time the NQSO is granted. In general, upon the exercise of a NQSO, a participant will recognize ordinary income in an amount equal to the excess, if any, of the fair market value of the Common Stock on the date of exercise over the option exercise price, and the Company will be entitled to a tax deduction in the same amount in the year the participant exercises the NQSO. Upon subsequent disposition of shares of Common Stock acquired upon the exercise of a NQSO, a participant will have a capital gain or loss equal to the difference between the amount realized on the disposition and the participant's tax basis in the shares, which is generally the amount paid for the shares plus the amount treated as ordinary income at the time the NQSO was exercised. Such capital gain or loss will be long-term if the participant's holding period is longer than one year, and short-term otherwise. The participant's taxable disposition of the shares of Common Stock acquired upon the exercise of a NQSO will not result in any additional tax consequences to the Company.

SARs. The grant of a SAR will create no federal income tax consequences for the participant or the Company. When a participant exercises a SAR, the amount of any cash received and the fair market value on the date of exercise of any shares of Common Stock received will constitute ordinary income to the participant, and the Company will be entitled to a tax deduction in the same amount in the year of exercise.

Restricted Stock. The federal income tax consequences of restricted stock awards depend upon the restrictions imposed on the restricted stock. In the absence of an election under Section 83(b) of the Code election by a participant, the grant of restricted stock will not result in taxable income to the participant or entitle the Company to a tax deduction in the year of grant if the restricted stock received is subject to a substantial risk of forfeiture and is either non-transferable or after transfer remains subject to such substantial risk of forfeiture. In such case, a participant must recognize ordinary income equal to the fair market value of the restricted stock received as of the first date the restricted stock becomes either transferable or not subject to a substantial risk of forfeiture, whichever occurs earlier. However, a participant may, in his or her discretion, make a Section 83(b) election to recognize as ordinary income the value of the restricted stock as of the date of receipt rather than upon lapse of restrictions on transferability or the substantial risk of forfeiture. The Company generally will be entitled to a tax deduction in the amount of the fair market value of the restricted stock transferred to the participant in the year the participant recognizes ordinary income. Prior to the lapse of restrictions, dividends paid on restricted stock will be taxable to the participant as ordinary income in the year such restricted stock is received free of restrictions, and the Company will be entitled to a tax deduction in the same amount.

Performance Awards. A participant who receives a performance award of shares of Common Stock will generally recognize ordinary income in the year the award is received equal to the fair market value of the Common Stock on the date of award. The Company will be entitled to a tax deduction equal to the amount of ordinary income recognized by the participant in the year such income is recognized.

Other Stock-Based Awards. A participant will recognize ordinary income equal to the amount of any cash payments or the fair market value of any Common Stock or other property a participant receives in connection with other stock-based awards (less any amounts paid by the participant) in the year the stock based award is received or

made available to the participant without substantial restrictions or risk of forfeiture in a manner consistent with the treatment of restricted stock. The Company generally will be entitled to a tax deduction in the same amount and at the same time the participant recognizes such ordinary income.

Section 162(m). Section 162(m) of the Code generally limits the deductible amount of annual compensation paid (including, unless an exception applies, compensation otherwise deductible in connection with awards granted under the 1998 Stock Plan) by a public company to the chief executive officer and to the four other most highly compensated executive officers of the Company to no more than \$1,000,000 per person. This limit, however, does not apply to qualified performance-based compensation. The Company generally intends to structure any stock options and other awards granted under the 1998 Stock Plan that might be affected by Section 162(m) of the Code to comply with the performance-based compensation exemption to the deductibility limit.

Section 409A. The tax consequences described above assume that an award is not subject to or does not violate the requirements of Section 409A. Stock options and restricted stock awards that comply with the terms of the 1998 Stock Plan and do not have a deferral feature, and are not amended, are generally exempt from the application of Section 409A of the Code, which is applicable to deferred compensation plans within the meaning of Section 409A. Awards that do not comply with Section 409A can result in the value of the deferred compensation being currently includable in the service provider's federal income tax purposes and being taxed at the service provider's marginal federal income tax rate plus an additional 20%, and interest and penalties may be included.

Section 16 Persons. Special rules apply to a participant who is subject to Section 16 of the Exchange Act.

Accounting Treatment

Pursuant to the accounting standards established by Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (SFAS 123(R)), the Company has been required to recognize all share-based payments, including grants of stock options and restricted stock, in the Company's financial statements since January 1, 2006. Accordingly, stock options that are granted to employees of the Company and to Non-Employee Directors will have to be valued at fair value as of the grant date under an appropriate valuation formula, and that value will have to be charged as stock-based compensation expense over the designated vesting period of the award. Similar option expensing is required for the portion of any options that were unvested and outstanding on January 1, 2006, with the grant date fair value of those unvested options to be expensed against reported earnings over the remaining vesting period.

For shares issuable upon the vesting of restricted stock awarded under the 1998 Stock Plan, the Company will be required to expense over the vesting period a compensation cost equal to the fair market value of the underlying shares on the date of the award. If any other shares are unvested at the time of their direct issuance, the fair market value of those shares at that time will be charged against earnings ratably over the vesting period. Such accounting treatment for restricted stock issuances will be applicable whether vesting is tied to service periods or performance goals. The issuance of a fully-vested stock bonus will result in an immediate charge to earnings equal to the fair market value of the bonus shares on the issuance date. Stock options and stock appreciation rights granted to non-employee consultants will result in a direct charge to earnings based on the fair value of the grant measured on the vesting date of each installment of the underlying shares. Accordingly, such charge will take into account the appreciation in the fair value of the grant over the period between the grant date and the vesting date of each installment comprising that grant.

New Plan Benefits

The grant of awards under the 1998 Stock Plan to eligible directors, officers, employees, consultants and advisors, including the Named Executive Officers, is subject to the discretion of the Board of Directors, other than the provision for formula stock option grants to Non-Employee Directors, which provision will be deleted from the 1998 Stock Plan if the proposed amendments are approved by the stockholders. For a description of the options granted during fiscal 2005 to the Named Executive Officers under the 1998 Stock Plan, please see the *Summary Compensation Table* and the *Option Grants in Last Fiscal Year* table above under *Executive Compensation*. As of the date of this Proxy Statement, no determination has been made as to which or how many of the persons eligible to receive awards under the 1998 Stock Plan will receive future awards under the 1998 Stock Plan if the proposed amendments are adopted and approved by the stockholders, except that it is the current intention of the Board of Directors (subject to change upon the recommendation of the Compensation Committee) to grant stock options to the Non-Employee Directors on the date of the Annual Meeting on the same basis as stock options were granted in fiscal 2005. See *Corporate Governance* *Compensation of Directors*. Accordingly, except as otherwise provided above, the benefits or awards that

will be received by or allocated to persons under the 1998 Stock Plan in the future are not presently determinable.

The following table sets forth the stock options to be granted to the Non-Employee Directors under the 1998 Stock Plan during 2006 if the proposed amendments are adopted and approved by the stockholders, assuming that (i) the current

nominee for director is re-elected at the Annual Meeting, and (ii) the Non-Employee Directors receive options under the 1998 Stock Plan during 2006 on the same basis as they received awards during 2005:

1998 Stock Plan

| Name (or Group) and Position | Dollar Value (\$) | Number of Shares Subject to Options |
|--|--------------------------|--|
| All current directors who are not executive officers, as a group (3 persons) | \$ 108,000 | (1) |
| <p>(1) During 2005, each Non-Employee Director received stock options equal to the rate of the annual retainer for services as a Non-Employee Director in effect on the date of grant (which for 2006 is \$36,000 per Non-Employee Director) divided by the fair market value of the Common Stock on the date of grant (based on the closing sale price of the Common Stock as reported on the American Stock Exchange on such date), which will also be the exercise price of such stock options, and which is not determinable as of the date of this Proxy Statement.</p> | | |

In addition, the compensation of Non-Employee Directors is subject to change from time to time at the discretion of the Board of Directors, upon the recommendation of the Compensation Committee.

Vote Required

The approval of the proposed amendments to the 1998 Stock Plan requires the affirmative vote of the holders of a majority of the outstanding shares of Common Stock present, in person or by proxy, and entitled to vote at the Annual Meeting.

Recommendation

The Board of Directors unanimously recommends that stockholders vote FOR the adoption and approval of the proposed amendments to the 1998 Stock Plan. Proxy cards signed and timely returned to the Company will be so voted, unless contrary instructions are specified thereon.

PROPOSAL NO. 3
RATIFICATION OF APPOINTMENT OF
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Auditors Proposal

The Audit Committee of the Board of Directors of the Company has appointed Hein & Associates LLP (Hein) to serve as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2006.

On September 30, 2004, the Company engaged Hein to serve as the independent registered public accounting firm of the Company and dismissed Deloitte & Touche LLP (Deloitte). The change in independent registered public accounting firms was approved by the Audit Committee of the Board of Directors. Deloitte audited the Company's financial statements as of and for fiscal 2003 and for all prior fiscal years of the Company, and Hein audited the Company's financial statements as of and for fiscal 2004 and fiscal 2005.

The audit report of Deloitte on the Company