

TELKONET INC
Form PRER14A
April 15, 2009

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
SCHEDULE 14A
(Rule 14a-101)
INFORMATION REQUIRED IN PROXY STATEMENT
SCHEDULE 14A INFORMATION
Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934 (Amendment No. 1)

Filed by the Registrant
Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to Rule 14a-11(c) or Rule 14a-12
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TELKONET, INC.
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

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1) Amount previously paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

Telkonet, Inc.
20374 Seneca Meadows Parkway
Germantown, Maryland 20876-7004

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To the Stockholders:

The 2009 Annual Meeting of Stockholders of Telkonet, Inc. (the "Company") will be held at The Union League of Philadelphia, located at 140 South Broad Street, Philadelphia, PA 19012, on Thursday, May 28, 2009, at 10:00 a.m., local time, for the following purposes:

1. To elect five (5) directors, each to serve until the next annual meeting of stockholders and until his successor has been elected and qualified;
2. To approve an amendment to Telkonet's Articles of Incorporation to increase the number of authorized shares from 130,000,000 shares to 155,000,000 shares;
3. To approve the potential issuance of shares of our common stock equal to 20% or more of Telkonet's outstanding common stock to YA Global Investments, L.P.;
4. To ratify the appointment of independent accountants for 2009; and
5. To transact such other business as may properly come before the meeting or any adjournment or postponement thereof.

Only stockholders of record at the close of business on March 30, 2009 are entitled to notice of, and to vote at, the meeting or any adjournment or postponement thereof.

All stockholders are cordially invited to attend the meeting in person. However, to assure your representation at the meeting, we urge you to complete, sign, date and return the enclosed proxy card in the enclosed envelope as promptly as possible.

By order of the Board of Directors,

/s/ JASON L. TIENOR
Jason L. Tienor
Chief Executive Officer

Dated: April __, 2009

YOUR VOTE IS IMPORTANT.
PLEASE SIGN, DATE AND RETURN THE ENCLOSED PROXY CARD
IMMEDIATELY, WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING.

Telkonet, Inc.
20374 Seneca Meadows Parkway
Germantown, Maryland 20876-7004

PROXY STATEMENT

Date, Time and Place of Meeting

This proxy statement is furnished in connection with the solicitation of proxies by and on behalf of the Board of Directors of Telkonet, Inc. for use at Telkonet's 2009 Annual Meeting of Stockholders, to be held at The Union League of Philadelphia, located at 140 South Broad Street, Philadelphia, PA 19012, on Thursday, May 28, 2009 at 10:00 a.m. local time, and at any adjournment or postponement of the annual meeting. This proxy statement, the accompanying proxy card and Telkonet's Annual Report to Stockholders for the fiscal year ended December 31, 2008 are first being sent to stockholders on or about _____, 2009.

Solicitation and Voting

The solicitation of proxies is made by and on behalf of Telkonet's Board of Directors. The cost of the solicitation of proxies will be borne by Telkonet. In addition to solicitation of proxies by mail, employees of Telkonet or its affiliates may solicit proxies by telephone or facsimile.

The Board of Directors has fixed the close of business on March 30, 2009 as the record date for determining the holders of shares of common stock who are entitled to notice of, and to vote at, the annual meeting. At the close of business on March 30, 2009, Telkonet had outstanding 93,058,566 shares of common stock, par value \$0.001 per share. Each stockholder is entitled to one vote per share of Telkonet's common stock registered in such stockholder's name on Telkonet's books as of the close of business on March 30, 2009.

Shares of common stock represented by properly executed proxies received at or prior to the annual meeting that have not been revoked will be voted at the annual meeting in accordance with the instructions indicated on the proxies. Stockholders are requested to complete, sign, date and promptly return the enclosed proxy card in the enclosed postage-prepaid envelope to ensure that their shares are voted. If the enclosed proxy is signed and returned, the shares represented thereby will be voted in accordance with any specification made therein by the stockholder. In the absence of any such specification, the shares will be voted to elect each of the director nominees set forth under "Election of Directors" below, for the proposals set forth under "Approval of the Amendment to Telkonet's Articles of Incorporation," "Approval of Share Issuance," and "Ratification of Appointment of Independent Public Accountants," and in the discretion of management on any other matter which may properly come before the annual meeting.

Revocability of Proxy

Any proxy given pursuant to this solicitation may be revoked by the person giving it at any time before it is voted. Attendance at the annual meeting will not, in and of itself, revoke a proxy. Proxies may be revoked by:

- Filing with the Secretary of Telkonet, at or before the taking of the vote at the annual meeting, a written notice of revocation dated later than the proxy;
- Executing a later dated proxy relating to the same shares of common stock and delivering it to the Secretary of Telkonet, including by facsimile, before the taking of the vote at the annual meeting; or
- Attending the annual meeting and voting in person.

Any written revocation or subsequent proxy should be sent so as to be delivered to Telkonet, Inc., 20374 Seneca Meadows Parkway, Germantown, Maryland 20876, Attention: Corporate Secretary, or hand delivered to the Secretary of Telkonet or his representative at or before the taking of the vote at the annual meeting.

If the annual meeting is postponed or adjourned, proxies given pursuant to this solicitation will be utilized at any subsequent reconvening of the annual meeting, except for any proxies that previously have been revoked or withdrawn effectively, and notwithstanding that proxies may have been effectively voted on the same or any other matter previously.

Quorum

Telkonet's bylaws provide that the holders of a majority of the outstanding Telkonet shares, present in person or by proxy, will constitute a quorum, and that the affirmative vote of a majority of the shares represented at the annual meeting and constituting a quorum is required for approval of any proposal brought before the annual meeting, unless a greater proportion or number of votes is required by law or by Telkonet's certificate of incorporation or bylaws. The election of directors, approval of the amendment to the Company's Articles of Incorporation, approval of the issuance of shares of common stock to YA Global Investments, L.P. and ratification of the appointment of the Company's independent accountants for 2009 will require the affirmative vote of a majority of the shares present at the annual meeting and constituting a quorum. Abstentions and broker non-votes will be deemed present for purposes of constituting a quorum and will have the same legal effect as a vote "against" each nominee for the Board of Directors and all proposals presented at the annual meeting.

PROPOSAL 1. ELECTION OF DIRECTORS

Telkonet's bylaws establish the number of directors at not less than three members. Pursuant to the bylaws, the Board of Directors may increase or decrease the number of members of the Board of Directors. The Board of Directors has established the number of directors at five. At the annual meeting, the shares represented by properly executed proxies, unless otherwise specified, will be voted for the election of the five nominees named herein, each to serve until the next annual meeting and until his successor is duly elected and qualified. Proxies cannot be voted for more than five nominees.

If for any reason any nominee is not a candidate when the election occurs (which is not expected), the Board of Directors expects that proxies will be voted for the election of a substitute nominee designated by the Board of Directors. The following information is furnished concerning each nominee for election as a director.

The affirmative vote of a majority of the shares of Telkonet's common stock represented at the annual meeting, either in person or by proxy, is required to elect the following nominees as Telkonet directors.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE FOR THE ELECTION OF EACH NOMINEE

Nominees for Election at the Annual Meeting

| Director Name | Age | Position With Telkonet | Director Since |
|--------------------|-----|------------------------|----------------|
| Warren V. Musser | 82 | Chairman of the Board | 2003 |
| Anthony J. Paoni | 64 | Director (1) (2) | 2007 |
| Thomas C. Lynch | 67 | Director (1) (2) | 2003 |
| Thomas M. Hall | 57 | Director (1) (2) | 2004 |
| Seth D. Blumenfeld | 68 | Director | 2005 |

- (1) Member of the Audit Committee
- (2) Member of the Compensation Committee

WARREN V. MUSSER, Chairman of the Board of Directors, has taken over 50 companies public during his distinguished and successful career as an entrepreneur. He is the founder and Chairman Emeritus of Safeguard Scientifics, Inc. (a high-tech venture capital company, formerly Safeguard Industries, Inc.). Mr. Musser is currently the President and CEO of The Musser Group (a business consulting firm). In addition, Mr. Musser is Chairman of InfoLogix, Inc. (a provider of enterprise mobility solutions for the healthcare and commercial industries), a Director of Internet Capital Group, Inc. (a business-to-business venture capital company), NutriSystem, Inc. (a weight

management company), Health Benefits Direct Corp. (a direct marketing/sales company of health/life insurance) and MSTI Holdings, Inc. ("MSTI") (the majority-owned subsidiary of the Company). Mr. Musser serves on a variety of civic, educational and charitable boards of directors, and serves as Chairman of the Eastern Technology Council, Economics PA, and Vice President of Development of Cradle of Liberty Council, Boy Scouts of America.

ANTHONY J. PAONI, Director, has been a faculty member at Northwestern University's Kellogg School of Management since 1996. Previously, he spent 28 years in the information technology industry with market leading organizations that provided computer hardware, software and consulting services. For the first 15 years of his career, Professor Paoni managed sales and marketing organizations and in the later stages of his career he moved into general management positions starting with PANSOPHIC Systems Incorporated. This Lisle, Illinois based firm was the world's fifth largest international software company prior to its acquisition by Computer Associates, Incorporated. Subsequently, he became chief operating officer of Cross Access, a venture capital funded software firm that provided industry-leading solutions to the heterogeneous database connectivity market segment. In addition, he has been president of two wholly-owned U.S. subsidiaries of Ricardo Consulting, a U.K.-based international engineering consulting firm focused on computer based automotive powertrain design. Prior to joining the Kellogg faculty, Professor Paoni was chief executive officer of Eolas, an Internet software company with patent pending Web technology that was one of the key technology drivers responsible for the rapid adoption of the Internet platform.

THOMAS C. LYNCH, Director, is Senior Vice President and Director of The Staubach Company's Federal Sector (a real estate management and advisory services firm) in the Washington, D.C. area. Mr. Lynch joined The Staubach Company in November 2002 after six years as Senior Vice President at Safeguard Scientifics, Inc. (NYSE: SFE) (a high-tech venture capital company). While at Safeguard, he served nearly two years as President and Chief Operating Officer at CompuCom Systems, a Safeguard subsidiary. After a 31-year career of naval service, Mr. Lynch retired in the rank of Rear Admiral. Mr. Lynch's naval service included Chief, Navy Legislative Affairs, command of the Eisenhower Battle Group during Operation Desert Shield, Superintendent of the United States Naval Academy from 1991 to 1994 and Director of the Navy Staff in the Pentagon from 1994 to 1995. Mr. Lynch presently serves as a Director of Armed Forces Benefit Association, Mikros Systems, Buckeye Insurance Company, MSTI Holdings, Inc., and Epitome Systems.

THOMAS M. HALL, M.D., Director, is the Managing Member of Marrell Enterprises LLC (a company that specializes in international business development). Dr. Hall serves on the board of directors of Coris International SA (a Paris-based insurance services company with subsidiaries in 36 countries). For 12 years (until 2002), Dr. Hall was the Chief Executive Officer of Medical Advisory Systems, Inc. (a company providing international medical services and pharmaceutical distribution). Dr. Hall holds a bachelor of science and a medical degree from the George Washington University and a master of international management degree from the University of Maryland.

SETH D. BLUMENFELD, Director, served as President of International Services for MCI International (a provider of telecommunication services) from 1998 until his retirement in January of 2005. Mr. Blumenfeld was President and Chief Operating Officer of several of MCI's international subsidiaries from 1984 to 1998. Mr. Blumenfeld earned his Doctorate of Jurisprudence from Fordham University Law School in 1965. He practiced law on Wall Street prior to serving as infantry captain for the U.S. Army in Vietnam. From 1976 through 1978, Mr. Blumenfeld lived in Japan. Mr. Blumenfeld's involvement on professional boards and community associations have included Executive Committee member of the United States Council for International Business, Member of the Board of Directors of the United States Telecommunications Training Institute, Member of the State Department Advisory Council on International Communications and Information Policy, Member of the University of Colorado Institute for International Business Board of Advisors, Member of the American Graduate School of International Management (Thunderbird) Board of Advisors, Member of the Advisory Board of Visitors to Fordham University School of Law, and honorary Chairman of the Connecticut Association of Children with Learning Disabilities.

Meetings of the Board and Committees

The Board of Directors held twelve meetings in 2008. Each member of the Board of Directors attended at least 75 percent of the meetings of the Board of Directors and the committees of which such director was a member. The Company has not established a formal policy requiring director attendance at all Board meetings, but the Company expects each director to attend such meetings, absent unusual circumstances. The Company also expects its directors to attend the Annual Meeting of Stockholders (which is usually held the same day as a meeting of the Board of Directors). Four of the Company's directors attended the 2008 Annual Meeting of Stockholders.

Code of Ethics

The Board has approved, and the Company has adopted, a Code of Ethics that applies to all directors, officers and employees of the Company. This Code of Ethics was included as an Exhibit to the Company's Form 10-KSB filed with the Securities and Exchange Commission on March 30, 2004.

Director Independence

The Board of Directors has determined that Dr. Hall and Messrs. Lynch and Paoni are "independent" under the listing standards of the NYSE AMEX (formerly, the American Stock Exchange) (NYSE AMEX). Each of Dr. Hall and

Messrs. Lynch and Mr. Paoni serve on, and are the only members of, the Company's Audit and Compensation Committees.

Communications with the Board of Directors

Stockholders can communicate directly with the Board, with any Committee of the Board, or specified directors by writing to: The Board of Directors of the Company, at the Company's principal business address or by calling at (240) 912-1800. All communications will be reviewed by management and then forwarded to the appropriate director, directors, committee, or to the full Board of Directors.

Committees of the Board of Directors

The Board has an Audit Committee and a Compensation Committee, but the Board does not presently have a Nominating Committee because the Board has concluded that a Nominating Committee is unnecessary due to the nomination procedures in effect as described below.

Director Nominations

Although the Company does not maintain a standing Nominating Committee, nominees for election as directors are considered and nominated by a majority of the Company's independent directors in accordance with the NYSE AMEX listing standards. "Independence" for these purposes is determined in accordance with Section 121(A) of the NYSE AMEX Rules and Rule 10A-3 under the Securities Exchange Act of 1934. Since the Company does not maintain a standing Nominating Committee, it has not adopted a formal Nominating Committee charter.

When considering potential candidates for election to the Company's Board of Directors, the independent directors evaluate various criteria, including, but not limited to, each candidate's business and professional skills, experience serving as management or on the board of directors of companies such as the Company, financial literacy and personal integrity in judgment. Candidates for vacant board seats will be considered if they are able to read and understand fundamental financial statements; have no identified conflicts of interest; have not been convicted in a criminal proceeding other than traffic violations during the five years before the date of selection; and are willing to comply with the Company's Code of Ethics. One or more directors must have requisite financial expertise to qualify as an "audit committee financial expert" as defined by Item 401 of Regulation S-K promulgated under the Securities Exchange Act of 1934. The independent directors reserve the right to modify these minimum qualifications from time to time. Exceptional candidates who do not meet all of these criteria may still be considered.

The independent directors review the qualifications and backgrounds of the directors, as well as the overall composition of the Board from time to time. In the case of any candidate for a vacant Board seat, the independent directors will consider whether such candidate meets the applicable independence standards and the level of the candidate's financial expertise. Any new candidates will be interviewed by the independent directors, and the full Board will approve the final nominations. The Chairman of the Board, acting on behalf of the full Board, will extend the formal invitation to become a nominee of the Board of Directors.

Stockholders may nominate director candidates for consideration by the Board of Directors by writing to the Chairman and providing to the Chairman the candidate's name, biographical data and qualifications, including five-year employment history with employer names and a description of the employer's business; whether such individual can read and understand fundamental financial statements; other board memberships (if any); and such other information as is reasonably available and sufficient to enable the Board to evaluate the minimum qualifications described above. The submission must be accompanied by the written consent of the individual to stand for election if nominated by the Board of Directors and to serve if elected by the stockholders. If a stockholder nominee is eligible, and if the nomination is proper, the independent directors then will deliberate and make a decision as to whether the candidate will be submitted to the Company's stockholders for a vote. The Board will not change the manner in which it evaluates candidates, including the applicable minimum criteria set forth above, based on whether the candidate was recommended by a stockholder.

Audit Committee

The Audit Committee is currently comprised of Messrs. Lynch and Paoni and Dr. Hall. The Company's Board of Directors has determined that each of Dr. Hall and Messrs. Lynch and Paoni is an "audit committee financial expert" as defined by Item 401 of Regulation S-K promulgated under the Securities Exchange Act of 1934. The Board of

Directors also has determined that each of Dr. Hall and Messrs. Lynch and Paoni are “independent” as such term is defined in Section 121(A) of the NYSE AMEX Rules and Rule 10A-3 promulgated under the Securities Exchange Act of 1934.

The Audit Committee recommends annually to the Board of Directors the selection of independent auditors for each fiscal year, confirms and assures their independence and approves the fees and other compensation to be paid to the auditors. The Audit Committee recommends to the Board the advisability of having the independent auditors make specified studies and reports as to auditing matters, accounting procedures, tax or other matters. The Audit Committee also reviews, prior to its filing with the SEC, the Company’s Form 10-K and annual report to stockholders. The Audit Committee provides an open avenue of communication among the independent auditors, management and the Board of Directors and will review any significant disagreement among management and the independent auditors in connection with the preparation of any of the Company’s financial statements. The Audit Committee reviews, with the Company’s legal counsel, legal and regulatory matters that may have a significant impact on the Company’s financial statements. The Audit Committee held six meetings in 2008 and all of members of the Audit Committee attended each of these meetings.

The Board of Directors has adopted an Audit Committee Charter, which was ratified by the stockholders at the 2004 Annual Meeting of Stockholders. A copy of the Audit Committee Charter was attached as Appendix A to the proxy statement for the 2007 Annual Meeting.

REPORT OF THE AUDIT COMMITTEE

Notwithstanding anything to the contrary set forth in any of the Company's previous filings under the Securities Act of 1933 or the Securities Exchange Act of 1934 that might incorporate future filings or this proxy statement, the following report shall not be deemed to be incorporated by reference into any such filings. In addition, the following report shall not be deemed to be "soliciting material" or "filed" with the SEC.

The Audit Committee for the year ended December 31, 2008, whose members are identified below, has reviewed and discussed the audited financial statements as of and for the year ended December 31, 2008 with the Company's management and has discussed the matters required to be discussed by SAS 61 with the Company's independent auditors. The Audit Committee has also received the written disclosures and the letter from the Company's independent auditors required by applicable requirements of the Public Accounting Oversight Board regarding the independent auditors' communications with the Audit Committee concerning independence and has discussed with the independent auditors the independent auditors' independence. Based upon its review of the foregoing materials and its discussions with the Company's management and independent auditors, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. The Audit Committee also considered whether the provision of other non-audit services by the independent auditor to the Company is compatible with maintaining the independence of the independent auditor and concluded that the independence of the independent auditor is not compromised by the provision of such services.

The Audit Committee has a written charter which was adopted by the Board of Directors on October 3, 2003, a copy of which is filed as Appendix A to the proxy statement for the 2007 Annual Meeting of Stockholders. The Audit Committee has established procedures for the receipt, retention and treatment of any complaints received by the Company regarding accounting, internal accounting controls or auditing matters and the confidential, anonymous submission by the Company's employees of any concerns regarding questionable accounting or auditing matters.

By the Audit Committee.

Thomas M. Hall
Thomas C. Lynch
Anthony J. Paoni

Compensation Committee

Dr. Hall and Messrs. Lynch and Paoni serve on the Company's Compensation Committee. The Compensation Committee oversees the Company's compensation programs, which are designed specifically for the Company's most senior executive officers, including the Chief Executive Officer, Chief Financial Officer and the other executive officers named in the Summary Compensation Table. Additionally, the Compensation Committee is charged with the review and approval of all annual compensation decisions relating to named executive officers. The Board of Directors has adopted a Compensation Committee charter. A copy of the Compensation Committee charter was attached as Appendix B to the proxy statement for the 2007 annual meeting.

The Compensation Committee met two times in 2008, and all members of the Compensation Committee attended the meetings.

REPORT OF THE COMPENSATION COMMITTEE

Notwithstanding anything to the contrary set forth in any of the Company's previous filings under the Securities Act of 1933 or the Exchange Act that might incorporate future filings or this proxy statement, the following report shall not be deemed to be incorporated by reference into any such filings. In addition, the following report shall not be deemed to be "soliciting material" or "filed" with the SEC.

The base salary, bonus, benefits and other compensation payable to the Company's executive officers for the year ended December 31, 2008 were fixed under written employment agreements (except for Mr. Leimbach, who does not have a written employment agreement) described below under the heading "Employment Contracts and Termination of Employment Arrangements."

Prior to establishing Mr. Tienor's compensation pursuant to his employment agreement (as well as the compensation of the other executive officers), the Board of Directors reviewed compensation recommendations prepared by the Company's compensation committee, which recommendations provide information regarding compensation levels at peer companies.

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis contained in this proxy statement with management and, based upon this review and these discussions, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be include in this proxy statement.

By,

Thomas M. Hall
Thomas C. Lynch
Anthony J. Paoni

Compensation Discussion and Analysis

Oversight of Executive Compensation Program

The Compensation Committee of the Board of Directors oversees the Company's compensation programs, which are designed specifically for the Company's most senior executive officers, including the Chief Executive Officer, Chief Financial Officer and the other executive officers named in the Summary Compensation Table (collectively, the "named executive officers"). Additionally, the Compensation Committee is charged with the review and approval of all annual compensation decisions relating to named executive officers.

The Compensation Committee is composed of 3 independent, non-management members of the Board of Directors. Each year the Company reviews any and all relationships that each director has with the Company and the Board of Directors subsequently reviews these findings.

The responsibilities of the Compensation Committee, as stated in its charter, include the following:

- annually review and approve for the CEO and the executive officers of the Company the annual base salary, the annual incentive bonus, including the specific goals and amount, equity compensation, employment agreements, severance arrangements, and change in control agreements/provisions, and any other benefits, compensation or arrangements.
- make recommendations to the Board with respect to incentive compensation plans, including reservation of shares for issuance under employee benefit plans.
- annually review and recommend to the Board of Directors for its approval the compensation, including cash, equity or other compensation, for members of the Board of Directors for their service as a member of the Board of Directors, a member of any committee of the Board of Directors, a Chair of any committee of the Board of Directors, and the Chairman of the Board of Directors.
- annually review the performance of the Company's Chief Executive Officer.
- make recommendations to the Board of Directors on the Company's executive compensation practices and policies, including the evaluation of performance by the Company's executive officers and issues of management succession.
- review the Company's compliance with employee benefit plans.
- make regular reports to the Board.
- annually review and reassess the adequacy of the Compensation Committee charter and recommend any proposed changes to the Board for approval.

The Compensation Committee is also responsible for completing an annual report on executive compensation for inclusion in the Company's proxy statement. In addition to such annual report, the Compensation Committee maintains written minutes of its meetings, which minutes are filed with the minutes of the meetings of the Board.

Overview of Compensation Program

In order to recruit and retain the most qualified and competent individuals as senior executives, the Company strives to maintain a compensation program that is competitive in the global labor market. The purpose of the Company's compensation program is to reward exceptional organizational and individual performance.

The following compensation objectives are considered in setting the compensation programs for our named executive officers:

- drive and reward performance which supports the Company's core values;
- provide a percentage of total compensation that is "at-risk," or variable, based on predetermined performance criteria;
- design competitive total compensation and rewards programs to enhance the Company's ability to attract and retain knowledgeable and experienced senior executives; and
- set compensation and incentive levels that reflect competitive market practices.

Compensation Elements and Rationale

Compensation for Named Executive Officers Other than the CEO

Compensation for the named executive officers, other than the CEO, is made in the CEO's sole and exclusive discretion. While the Compensation Committee provides its recommendations with respect to compensation for the named executive officers (other than the CEO) as described in greater detail below, the CEO is only required to consider the Compensation Committee's recommendations, but is not bound by its findings.

Compensation for the Company's CEO

To reward both short and long-term performance in the compensation program and in furtherance of the Company's compensation objectives noted above, the Company's compensation program for the CEO is based on the following objectives:

(i) Performance Goals

The Compensation Committee believes that a significant portion of the CEO's compensation should be tied not only to individual performance, but also to the Company's performance as a whole measured against both financial and non-financial goals and objectives. During periods when performance meets or exceeds these established objectives, the CEO should be paid at or more than expected levels. When the Company's performance does not meet key objectives, incentive award payments, if any, should be less than such levels.

(ii) Incentive Compensation

A large portion of compensation should be paid in the form of short-term and long-term incentives, which are calculated and paid based primarily on financial measures of profitability and stockholder value creation. The CEO has the incentive of increasing Company profitability and stockholder return in order to earn a major portion of his compensation package.

(iii) Competitive Compensation Program

The Compensation Committee reviews the compensation of chief executive officers at peer companies to ensure that the compensation program for the CEO is competitive. The Company believes that a competitive compensation program will enhance its ability to retain a capable CEO.

Financial Metrics Used in Compensation Programs

Several financial metrics are commonly referenced in defining Company performance for the CEO's executive compensation. These metrics include quarterly metrics to target cash flow break even and specific revenue goals to define Company performance for purposes of setting the CEO's compensation.

Compensation Benchmarking Relative to Market

The Company sets the CEO's compensation by evaluating peer group companies. Peer group companies are chosen based on size, industry, annual revenue and whether they are publicly or privately held. Based on these criteria, the Compensation Committee has identified 29 companies in the Company's peer group. These peer group companies include Catapult Communications Corp., Endwave Corp., Carrier Access Corp., Crystal Technology, Echelon Corp. and FiberTower Corp. The Compensation Committee has concluded that the CEO's compensation falls within the 50th percentile of compensation for chief executive officers within the peer group companies.

Review of Senior Executive Performance

The Compensation Committee reviews, on an annual basis, each compensation package for the named executive officers. In each case, the Compensation Committee takes into account the scope of responsibilities and experience and balances these against competitive salary levels. The Compensation Committee has the opportunity to meet with the named executive officers at least once per year, which allows the Compensation Committee to form its own assessment of each individual's performance. As indicated above, with the exception of the CEO, recommendations with respect to compensation packages for the named executive officers must be considered by the CEO in connection with establishing compensation for those named executive officers. However, the recommendations of the Compensation Committee with respect to the compensation paid to the named executive officers (other than the CEO) will not be binding on the CEO.

Components of the Executive Compensation Program

The Compensation Committee believes the total compensation and benefits program for named executive officers should consist of the following:

- base salary;
- stock incentive plan;
- retirement, health and welfare benefits;
- perquisites and perquisite allowance payments; and
- termination benefits.

Base Salaries

With the exception of the CEO, whose compensation is set by the Compensation Committee and approved by the Board of Directors, base salaries and merit increases for the named executive officers are determined by the CEO in his discretion after consideration of a competitive analysis recommendation provided by the Compensation Committee. The Compensation Committee's recommendation is formulated through the evaluation of the compensation of similar executives employed by companies in the Company's peer group.

Stock Incentive Plan

Under the Company's Stock Incentive Plan (the "Plan") incentive stock options and non-qualified options to purchase shares of the Company's common stock may be granted to key employees. An important objective of the long-term incentive program is to strengthen the relationship between the long-term value of the Company's stock price and the

potential financial gain for employees as well as the retention of senior management and key personnel. Stock options provide named executive officers with the opportunity to purchase the Company's common stock at a price fixed on the grant date regardless of future market price. Stock options generally vest ratably on a quarterly basis and become exercisable over a five-year vesting period. A stock option becomes valuable only if the Company's common stock price increases above the option exercise price (at which point the option will be deemed "in-the-money") and the holder of the option remains employed during the period required for the option to "vest," thus providing an incentive for an option holder to remain employed by the Company. In addition, stock options link a portion of an employee's compensation to the stockholders' interests by providing an incentive to increase the market price of the Company stock.

The Company practice is that the exercise price for each stock option is equal to the fair market value on the date of grant. Under the terms of the Plan, the option price will not be less than the fair market value of the shares on the date of grant or, in the case of a beneficial owner of more than 5.0% of the Company's outstanding common stock on the date of grant, the option price will not be less than 110% of the fair market value of the shares on the date of grant.

There is a limited term in which Plan participants can exercise stock options, known as the "option term." The option term is generally ten years from the date of grant. At the end of the option term, the right to exercise any unexercised options expires. Option holders generally forfeit any unvested options if their employment with the Company terminates.

Certain key executives may be a party to option agreements containing clauses that cause their options to become immediately and fully vested and exercisable upon a Change of Control, as defined in the Plan. Additionally, death or disability of the executive during his or her employment period may cause certain stock options to immediately vest and become exercisable per the terms outlined in the stock option award agreement.

The Compensation Committee awards options to named executive officers upon commencement of their employment with the Company and for successfully achieving or exceeding predetermined individual and Company performance goals. In determining whether to award stock options and the number of stock options granted to a named executive officer, the Compensation Committee reviews the compensation of executives at peer group companies to ensure that the compensation program is competitive.

Retirement, Health and Welfare Benefits

The Company offers a variety of health and welfare and retirement programs to all eligible employees. The named executive officers generally are eligible for the same benefit programs on the same basis as the rest of the broad-based employees. The Company's health and welfare programs include medical, dental, vision, life, accidental death and disability, and short and long-term disability insurance. In addition to the foregoing, the named executive officers are eligible to participate in the Company's 401(k) Retirement Savings Plan.

401(k) Retirement Savings Plan

The Company maintains a tax-deferred savings plan for employees (the "Telkonet 401(k)") that is administered by a committee of trustees appointed by the Company. All Company employees are eligible to participate upon the completion of six months of employment, subject to minimum age requirements. Contributions by employees under the Telkonet 401(k) are immediately vested and each employee is eligible for distributions upon retirement, death or disability or termination of employment. Depending upon the circumstances, these payments may be made in installments or in a single lump sum.

MSTI maintains a defined contribution profit sharing plan for employees (the "MSTI 401(k)") that is administered by a committee of trustees appointed by MSTI. All MSTI employees are eligible to participate upon the completion of three months of employment, subject to minimum age requirements. Each year MSTI makes a contribution to the MSTI 401(k) without regard to MSTI's current or accumulated net profits. These contributions are allocated to participants in amounts of 100% of the participants' contributions up to 1% of each participant's gross pay, then 10% of the next 5% of each participant's gross pay (a higher contribution percentage may be determined at the Company's discretion). In addition, MSTI makes a one-time, annual contribution of 3% of each participant's gross pay to each participant's contribution account in the MSTI 401(k) plan. Participants become vested in equal portions of their contribution account for each year of service until full vesting occurs upon the completion of six years of service. Distributions are made upon retirement, death or disability in a lump sum or in installments.

Compensation Committee Interlocks and Insider Participation

During the year ended December 31, 2008, Dr. Hall and Messrs. Lynch and Paoni served as members of the Company's Compensation Committee. No member of the Compensation Committee is, or was during the fiscal year ended December 31, 2008, an officer or employee of the Company or any of its subsidiaries, or a person having a relationship requiring disclosure by the Company pursuant to Item 404 of Regulation S-K. During 2008, no executive officer of the Company served as a member of (i) the compensation committee of another entity of which one of the executive officers of such entity served on the Compensation Committee or Board of Directors; or (ii) the board of directors of another entity of which one of the executive officers of such entity served on the Company's Compensation Committee.

Directors' Compensation

The Company reimburses non-management directors for costs and expenses in connection with their attendance and participation at Board of Directors meetings and for other travel expenses incurred on the Company's behalf. The Company compensates each non-management director \$4,000 per month, 10,000 vested stock options per quarter and \$1,000 for each committee meeting of the Board of Directors such director attends.

Mr. Musser, as Chairman of the Board of Directors, is compensated \$8,333 per month (consisting of monthly payments in the amount of \$4,000, which payments are consistent with the monthly payments made to the other non-management directors, and \$4,333 per month, which payments are in lieu of the 10,000 vested stock options per quarter and \$1,000 for each committee meeting that the other non-management directors receive). Payments to Mr. Musser for Board services are made to The Musser Group pursuant to a September 2003 consulting agreement. Mr. Musser is the sole principal and owner of The Musser Group.

The following table summarizes all compensation paid to the Company's directors in the year ended December 31, 2008.

| Name | Fees Earned or Paid in Cash (\$) | Stock Awards (\$) | Option Awards (\$) | Non-Equity Incentive Plan Compensation (\$) | Change in Pension Value and Nonqualified Deferred Compensation Earnings | All Other Compensation (\$) | Total (\$) |
|--------------------|----------------------------------|-------------------|--------------------|---|---|-----------------------------|------------|
| Warren V. Musser | \$ 48,000 | \$ - | \$ - | \$ - | \$ - | \$ 52,000(1) | \$ 100,000 |
| Thomas M. Hall | 48,000 | - | 12,196(2) | - | - | - | 60,196 |
| Thomas C. Lynch | 48,000 | - | 12,196(2) | - | - | - | 60,196 |
| James L. Peeler | 12,000(3) | - | - | - | - | - | 12,000 |
| Seth D. Blumenfeld | 48,000 | - | 12,196(2) | - | - | - | 60,196 |
| Anthony J. Paoni | 48,000 | - | 12,156(2) | - | - | - | 60,196 |

(1) Fees for director services performed by Mr. Musser and paid to the Musser Group pursuant to a September 2003 consulting agreement.

(2) Stock options granted pursuant to the 2008 non-management director compensation plan. The following assumptions were used to determine the fair value of stock option awards: historical volatility of 81%, expected option life of 5.0 years and a risk-free interest rate of 3.5%.

(3) Mr. Peeler resigned from the Board of Directors on April 7, 2008.

Executive Officers

The following table provides the information concerning the Company's executive officers as of March 30, 2009.

| Name | Age | Title |
|---------------------|-----|-------------------------------------|
| Jason L. Tienor | 34 | President & Chief Executive Officer |
| Richard J. Leimbach | 40 | Chief Financial Officer |
| Jeffrey J. Sobieski | 33 | Chief Operating Officer |

Jason L. Tienor—President and Chief Executive Officer

Mr. Tienor has served as the Company's President and Chief Executive Officer since December 2007 and, from August 2007 until December 2007, he served as the Company's Chief Operating Officer. Mr. Tienor has also served

as Chief Executive Officer of EthoStream, LLC, a wholly-owned subsidiary of the Company, since March 2007. From 2002 until his employment with the Company, Mr. Tienor served as Chief Executive Officer of Ethostream, LLC, the company that he co-founded. Mr. Tienor received a bachelor of business administration in management information systems and marketing from the University of Wisconsin – Oshkosh and a masters of business administration with an emphasis on computer science from Marquette University.

Richard J. Leimbach—Chief Financial Officer

Mr. Leimbach has served as the Company's Chief Financial Officer since December 2007 and, from June 2006 until December 2007, he served as the Vice President of Finance. He also served as the Company's Controller from January 2004 until June 2006. Mr. Leimbach is a certified public accountant with over fifteen years of public accounting and private industry experience. Prior to joining the Company, Mr. Leimbach was the Controller with Ultrabridge, Inc., an applications solution provider. Mr. Leimbach also served as Corporate Accounting Manager for Snyder Communications, Inc., a global provider of integrated marketing solutions.

Jeffrey J. Sobieski—Chief Operating Officer

Mr. Sobieski was named the Company's Chief Operating Officer in June 2008. Prior to this appointment, Mr. Sobieski served as the Company's Executive Vice President, Energy Management since December 2007 and from March 2007 until December 2007, he served as Chief Information Officer of Ethostream, LLC, wholly-owned subsidiary of the Company. From 2002 until his employment with the Company, Mr. Sobieski served as Chief Information Officer of Ethostream, LLC, the company he co-founded. Mr. Sobieski is also the co-founder of Interactive Solutions, a consulting firm providing support to the Insurance and Telecommunications Industries.

Executive Compensation

The following table sets forth certain information with respect to compensation for services in all capacities for the years ended December 31, 2008, 2007 and 2006 paid to our Chief Executive Officer (principal executive officer) and the two other most highly compensated executive officers who were serving as such as of December 31, 2008.

Summary Compensation Table

| Name and Principal Position | Year | Salary (\$) | Bonus (\$) | Stock Awards (\$) | Option Awards (\$)(1)(2) | Non-Equity Incentive Plan Compensation (\$) | Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$) | All Other Compensation (\$) | Total (\$) |
|--|------|-------------|------------|-------------------|--------------------------|---|--|-----------------------------|------------|
| Jason L. Tienor President and Chief Executive Officer | 2008 | \$194,421 | \$0 | \$0 | \$0 | \$0 | \$0 | \$7,431 | \$201,852 |
| | 2007 | \$133,022 | \$0 | \$0 | \$111,230 | \$0 | \$0 | \$6,139 | \$250,391 |
| | 2006 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |
| Richard J. Leimbach Chief Financial Officer | 2008 | \$180,039 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$180,039 |
| | 2007 | \$133,491 | \$25,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$158,491 |
| | 2006 | \$111,231 | \$5,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$116,231 |
| Jeffrey J. Sobieski Chief Operating Officer | 2008 | \$186,421 | \$0 | \$0 | \$31,180 | \$0 | \$0 | \$7,431 | \$225,032 |
| | 2007 | \$122,003 | \$0 | \$0 | \$0 | \$0 | \$0 | \$6,139 | \$128,142 |
| | 2006 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |

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- (1) In 2007 the following assumptions were used to determine the fair value of stock option awards granted: historical volatility of 70%, expected option life of 5.0 years and a risk-free interest rate of 4.8%.
- (2) In 2008 the following assumptions were used to determine the fair value of stock option awards granted: historical volatility of 74%, expected option life of 5.0 years and a risk-free interest rate of 3.0%.

Employment Agreements

Jason L. Tienor, President and Chief Executive Officer, is employed pursuant to an employment agreement dated March 15, 2007. Mr. Tienor's employment agreement has a term of three years, which may be extended by mutual agreement of the parties thereto, and provides for an annual base salary of \$148,000 per year and bonuses and benefits based on the Company's internal policies. On August 20, 2007, Mr. Tienor's annual salary was increased to \$200,000 and he remains eligible to participate in the incentive and benefit plans pursuant to his existing employment agreement and the Company's internal policies.

Richard J. Leimbach, Chief Financial Officer, has been employed by the Company since January 26, 2004. Mr. Leimbach's annual salary was increased from \$130,000 to \$190,000 in December 2007 in connection with his appointment as Chief Financial Officer. He is also eligible to receive bonuses and benefits based upon the Company's internal policies. Mr. Leimbach does not have a written employment agreement.

Jeffrey J. Sobieski, Chief Operating Officer, is employed pursuant to an employment agreement, dated March 15, 2007. Mr. Sobieski's employment agreement has a term of three years, which may be extended by mutual agreement of the parties thereto, and provides for a base salary of \$148,000 per year and bonuses and benefits based upon the Company's internal policies. On December 11, 2007, Mr. Sobieski's salary was increased to \$190,000 and he remains eligible to participate in the incentive and benefit plans pursuant to his existing employment agreement and the Company's internal policies.

In addition, to the foregoing, stock options are periodically granted to employees under the Company's Plan at the discretion of the Compensation Committee of the Board of Directors. Executives of the Company are eligible to receive stock option grants, based upon individual performance and the performance of the Company as a whole.

Grant of Plan Based Awards

The following table sets forth information concerning stock options granted in the fiscal year ended December 31, 2008, to the persons listed on the Summary Compensation Table.

| Name | Grant Date | All Other Option Awards: | | |
|---------------------|------------|---|---|--|
| | | Number of Securities Underlying Options Granted (#) | Exercise Price or Base Price of Option Awards (\$/sh) | Grant Date Fair Value of Stock and Option Awards |
| Jason L. Tienor | n/a | n/a | n/a | n/a |
| Richard J. Leimbach | n/a | n/a | n/a | n/a |
| Jeffrey J. Sobieski | 02/19/2008 | 50,000 | \$1.00 | \$31,180 |

Outstanding Equity Awards at Fiscal Year-End Table

The following table shows outstanding stock option awards classified as exercisable and unexercisable as of December 31, 2008 for the named executive officers.

| Name | Option Awards | | | | Stock Awards | | | | |
|------------------------|---|---|--|-------------------------------------|------------------------------|---|--|--|--|
| | Number of Securities Underlying Unexercised Options (#) Exercisable | Number of Securities Underlying Unexercised Options (#) Unexercisable | Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#) | Option Exercise Price (\$) | Option Expiration Date | Number of Shares or Units of Stock That Have Not Vested (#) | Market Value of Units of Stock That Have Not Vested (\$) | Equity Incentive Plan Awards: Number of Shares, or Other Rights That Have Not Vested (#) | Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, or Other Rights That Have Not Vested (\$) |
| Jason L. Tienor | 30,000 | 70,000 | - | \$1.80 | 4/24/2012 (2) | - | - | - | - |
| Richard J. Leimbach | 77,500 | 10,000 | - | (1) | 4/24/2012 (2) | - | - | - | - |
| | 7,500 | 42,500 | - | \$1.00 | | - | - | - | - |

Jeffrey J.
Sobieski

4/24/2012
(2)

-
- (1) Includes 35,000 and 2,500 vested and unvested options, respectively, exercisable at \$2.59, and 42,500 and 7,500 vested and unvested options, respectively, exercisable at \$5.08 per share.
- (2) All options granted in accordance with the Company's Plan have an outstanding term equal to the shorter of ten years, or the expiration of the Plan. The Plan expires on April 24, 2012.

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Option Exercises and Vesting of Stock Awards

There were no options exercised by, or stock awards vested for the account of, the named executive officers during 2008.

Potential Payments upon Termination or Change in Control

Each of Mr. Tienor's and Mr. Sobieski's Employment Agreements obligate the Company to continue to pay each executive's base salary and provide continued participation in employee benefit plans for the duration of the term of their employment agreements in the event such executive is terminated without "cause" by the Company or if the executive terminates his employment for "good reason." "Cause" is defined as the occurrence of any of the following: (i) theft, fraud, embezzlement, or any other act of dishonesty by the executive; (ii) any material breach by the executive of any provision of the employment agreement which breach is not cured within a reasonable time (but not to exceed thirty (30) days after written notification thereof to the executive by the Company); (iii) any habitual neglect of duty or misconduct of the executive in discharging any of his duties and responsibilities under the employment agreement after a written demand for performance was delivered to the executive that specifically identified the manner in which the board believed the executive had failed to discharge his duties and responsibilities, and the executive failed to resume substantial performance of such duties and responsibilities on a continuous basis immediately following such demand; (iv) commission by the executive of a felony or any offense involving moral turpitude; or (v) any default of the executive's obligations under the employment agreement, or any failure or refusal of the executive to comply with the policies, rules and regulations of the Company generally applicable to the Company's employees, which default, failure or refusal is not cured within a reasonable time (but not to exceed thirty (30) days) after written notification thereof to the executive by the Company. If cause exists for termination, the executive shall be entitled to no further compensation, except for accrued leave and vacation and except as may be required by applicable law. "Good reason" is defined as the occurrence of any of the following: (i) any material adverse reduction in the scope of the executive's authority or responsibilities; (ii) any reduction in the amount of the executive's compensation or participation in any employee benefits; or (iii) the executive's principal place of employment is actually or constructively moved to any office or other location 50 miles or more outside of Milwaukee, Wisconsin.

In the event the Company fails to renew the employment agreements upon expiration of the term, then the Company shall continue to pay the executive's base salary and provide the executive with continued participation in each employee benefit plan in which the executive participated immediately prior to expiration of the term for a period of three months following expiration of the term. Each of Messrs. Tienor and Sobieski have agreed not to compete with the Company or solicit any Company employees for a period of one year following expiration or earlier termination of the employment agreements. Assuming Mr. Tienor's and Mr. Sobieski's employment agreements were terminated as of December 31, 2008, the total estimated compensation that would have been paid under these agreements would be \$468,000 in the aggregate.

Security Ownership of Certain Beneficial Owners and Management

The following table sets forth, as of March 30, 2009, the number of shares of the Company's common stock beneficially owned by each director and executive officer of the Company, by all directors and executive officers as a group, and by each person known by the Company to own beneficially more than 5.0% of the Company's outstanding common stock. As of March 1, 2009, there were no issued and outstanding shares of any other class of the Company's equity securities.

| Name and Address of Beneficial Owner | Amount and Nature of Beneficial Ownership | Percentage of Class |
|---|---|---------------------|
| Officers and Directors | | |
| Jason Tienor, President and Chief Executive Officer 20374 Seneca Meadows Parkway Germantown, MD 20876 | 736,803(1) | 0.8% |
| Richard Leimbach, Chief Financial Officer 20374 Seneca Meadows Parkway Germantown, MD 20876 | 431,000(2) | 0.5% |
| Jeffrey Sobieski, Executive Vice President 20374 Seneca Meadows Parkway Germantown, MD 20876 | 714,303(3) | 0.8% |
| Warren V. Musser, Chairman 20374 Seneca Meadows Parkway Germantown, MD 20876 | 2,000,000(4) | 2.1% |
| Thomas C. Lynch, Director 20374 Seneca Meadows Parkway Germantown, MD 20876 | 210,000(5) | 0.2% |
| Dr. Thomas M. Hall, Director 20374 Seneca Meadows Parkway Germantown, MD 20876 | 747,790(6) | 0.8% |
| Seth D. Blumenfeld, Director 20374 Seneca Meadows Parkway Germantown, MD 20876 | 130,000(7) | 0.1% |
| Anthony J. Paoni, Director 20374 Seneca Meadows Parkway Germantown, MD 20876 | 80,000(8) | 0.1% |
| All Directors and Executive Officers as a Group | 5,049,896 | 5.3% |

(1)

- Includes 701,803 shares of the Company's common stock and options exercisable within 60 days to purchase 35,000 shares of the Company's common stock at \$1.80 per share.
- (2) Includes 351,000 shares of the Company's common stock and options exercisable within 60 days to purchase 37,500 and 42,500 shares of the Company's common stock at \$2.59 and \$5.08 per share, respectively.
 - (3) Includes 701,803 shares of the Company's common stock and options exercisable within 60 days to purchase 12,500 shares of the Company's common stock at \$1.00 per share.
 - (4) Includes options exercisable within 60 days to purchase 2,000,000 shares of the Company's common stock at \$1.00 per share.
 - (5) Includes options exercisable within 60 days to purchase 40,000, 20,000, 70,000 and 80,000 shares of the Company's common stock at \$1.00, \$2.00, \$2.66 and \$3.45 per share, respectively.
 - (6) Includes 557,790 shares of the Company's common stock and options exercisable within 60 days to purchase 40,000, 70,000 and 80,000 shares of the Company's common stock at \$1.00, \$2.66 and \$3.45 per share, respectively.
 - (7) Includes 50,000 shares of the Company's common stock and options exercisable within 60 days to purchase 40,000 and 40,000 shares of the Company's common stock at \$1.00 and \$2.66 per share, respectively.
 - (8) Includes options exercisable within 60 days to purchase 40,000 and 40,000 shares of the Company's common stock at \$1.00 and \$2.30 per share, respectively.

Certain Relationships and Related Transactions

Description of Related Party Transactions

In February 2006, the Company entered into a professional services agreement with Global Transport Logistics, Inc. (“GTI”), for the provision of consulting services for which GTI is paid a fee of \$10,000 per month. GTI is 100% owned by Eileen Matarazzo, the sister-in-law of MSTI’s Chief Executive Officer. This agreement expired in February 2009.

The Chief Administrative Officer at MSTI, Laura Matarazzo, is the sister of MSTI’s Chief Executive Officer and receives an annual base salary of approximately \$134,000 with bonuses and benefits based upon the Company’s internal policies.

Company’s Policies on Related Party Transactions

Under the Company’s policies and procedures, related-party transactions that must be publicly disclosed under the federal securities laws require prior approval of the Company’s independent directors without the participation of any director who may have a direct or indirect interest in the transaction in question. Related parties include directors, nominees for director, principal shareholders, executive officers and members of their immediate families. For these purposes, a “transaction” includes all financial transactions, arrangements or relationships, ranging from extending credit to the provision of goods and services for value and includes any transaction with a company in which a director, executive officer immediate family member of a director or executive officer, or principal shareholder (that is, any person who beneficially owns five percent or more of any class of the Company’s voting securities) has an interest by virtue of a 10-percent-or-greater equity interest. The Company’s policies and procedures regarding related-party transactions are not a part of a formal written policy, but rather, represent the Company’s historical course of practice with respect to approval of related-party transactions.

Director Independence

The Board of Directors has determined that Dr. Hall and Messrs. Lynch and Paoni are “independent” under the listing standards of the NYSE AMEX. Each of Dr. Hall and Messrs. Lynch and Paoni serve on, and are the only members of, the Company’s Audit Committee and Compensation Committee. Although the Company does not maintain a standing Nominating Committee, nominees for election as directors are considered and nominated by a majority of the Company’s independent directors in accordance with the NYSE AMEX listing standards. “Independence” for these purposes is determined in accordance with Section 121(A) of the NYSE AMEX Rules and Rule 10A-3 under the Securities Exchange Act of 1934.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our directors and certain of our officers to file reports of holdings and transactions in shares of the Company common stock with the Securities and Exchange Commission. Based on our records and other information, we believe that in 2008 our directors and our officers who are subject to Section 16 met all applicable filing requirements.

Independent Public Accountants

The following table sets forth fees billed to the Company by our auditors during the fiscal years ended December 31, 2008 and 2007.

| | December 31, 2008 | December 31, 2007 |
|---------------|----------------------|----------------------|
| 1. Audit Fees | \$ 309,755 | \$ 379,828 |

| | | |
|-----------------------|------------|------------|
| 2. Audit Related Fees | 46,262 | 136,525 |
| 3. Tax Fees | -- | -- |
| 4. All Other Fees | -- | -- |
| Total Fees | \$ 356,017 | \$ 516,353 |

Audit fees consist of fees billed for professional services rendered for the audit of the Company's consolidated financial statements and review of the interim consolidated financial statements included in quarterly reports and services that are normally provided by RBSM LLP in connection with statutory and regulatory filings or engagements.

Audit-related fees consist of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of the Company's consolidated financial statements, which are not reported under "Audit Fees."

Tax fees consist of fees billed for professional services for tax compliance, tax advice and tax planning. The tax fees relate to federal and state income tax reporting requirements.

All other fees consist of fees for products and services other than the services reported above.

Prior to the Company's engagement of its independent auditor, such engagement is approved by the Company's audit committee. The services provided under this engagement may include audit services, audit-related services, tax services and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular service or category of services and is generally subject to a specific budget. Pursuant to the Company's Audit Committee Charter, the independent auditors and management are required to report to the Company's audit committee at least quarterly regarding the extent of services provided by the independent auditors in accordance with this pre-approval, and the fees for the services performed to date. The audit committee may also pre-approve particular services on a case-by-case basis. All audit fees, audit-related fees, tax fees and other fees incurred by the Company for the year ended December 31, 2008, were approved by the Company's audit committee.

PROPOSAL 2. TO AMEND TELKONET'S ARTICLES OF INCORPORATION TO
INCREASE THE AUTHORIZED CAPITAL STOCK

On April 7, 2009, the Board of Directors unanimously adopted a resolution, subject to stockholder approval, to amend the Company's Articles of Incorporation to increase the aggregate number of shares of common stock that the Company is authorized to issue from 130,000,000 shares to 155,000,000 shares.

The Board of Directors has determined that this proposed amendment is advisable and in the best interest of the Company and its stockholders.

Reason for the Amendment

The Company's Articles of Incorporation currently authorize the issuance of 130,000,000 shares of common stock, par value of \$0.001 per share. As of March 30, 2009, 93,058,566 shares were issued and outstanding, and another 11,260,878 shares were subject to unexercised options granted pursuant to the Company's Plan, or reserved for issuance in connection with future grants under the Plan. In addition, up to 25,200,646 shares of the Company's common stock are potentially subject to issuance pursuant to warrants to purchase common stock and convertible debentures held by YA Global Investments, L.P. (assuming such issuance took place on April 6, 2009). While the Company is not permitted to issue more than 2,725,205 additional shares of common stock to YA Global Investments, L.P. under these warrants and debentures unless and until the stockholders approve the proposal set forth under "Approval of Share Issuance," in the event that proposal is approved, the number of authorized shares under the Company's Articles of Incorporation will be insufficient to satisfy the aggregate amount of common stock potentially issuable to YA Global Investments, L.P. under the warrants and debentures.

Adoption of this proposal would permit the Board of Directors, without further approval of the stockholders (except as may be required by applicable law), to issue additional shares of common stock from time to time as the Board of Directors may determine, for such consideration as the Board of Directors establishes. In addition to providing the Company with the ability to issue shares under its stock-based compensation plan and to YA Global Investments, L.P. (if approved by the stockholders as described below), the availability of additional shares of common stock would provide flexibility in structuring possible acquisitions of other businesses and enable the Company to raise additional equity capital if and when needed. The Company has no present plans, arrangements, or understandings with respect to possible acquisitions or financings requiring the availability of additional authorized common stock.

The proposed Amendment to the Company's Articles of Incorporation will increase the total number of authorized shares of common stock by an amount that is necessary to achieve currently contemplated corporate objectives. The Amendment may be viewed as having the possible effect of diluting the stock ownership of current stockholders, as well as discouraging, under certain circumstances, an unsolicited attempt by another person or entity to acquire control of the Company. Although the Board of Directors has no present intention of doing so, the Company's authorized but unissued common stock could be issued in one or more transactions which would make a takeover of the Company more difficult or costly. Notwithstanding the foregoing, the proposed Amendment will ensure that the Company continues to have additional shares available for future issuance from time to time as approved by the Board of Directors for any proper corporate purpose, including those described above.

Effective Date of the Amendment

If the Amendment is adopted by the required vote of stockholders, the Amendment will become effective when the appropriate Articles of Amendment to the Company's Articles of Incorporation are filed with the Utah Department of Commerce, Division of Corporations. The Company anticipates that this filing will be made promptly following the Annual Meeting, or as soon as practicable thereafter.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS
VOTE FOR THIS PROPOSAL

PROPOSAL 3. APPROVAL OF SHARE ISSUANCE

On May 30, 2008, the Company entered into a Securities Purchase Agreement with YA Global Investments, L.P. pursuant to which the Company agreed to issue and sell to YA Global Investments, L.P. up to \$3,500,000 of secured convertible debentures and warrants to purchase up to 2,500,000 shares of the Company's common stock. The sale of the debentures and warrants was effectuated in three separate closings, the first of which occurred on May 30, 2008, and the remainder of which occurred in July 2008. At the May 30, 2008 closing, the Company sold debentures having an aggregate principal value of \$1,500,000 and warrants to purchase 2,100,000 shares of common stock. In July 2008, the Company sold the remaining debentures having an aggregate principal value of \$2,000,000 and warrants to purchase 400,000 shares of common stock.

The debentures accrue interest at a rate of 13% per annum and mature on May 29, 2011. The debentures may be redeemed at any time, in whole or in part, by the Company upon payment by the Company of a redemption premium equal to 15% of the principal amount of debentures being redeemed, provided that an Equity Conditions Failure (as defined in the debentures) is not occurring at the time of such redemption. YA Global Investments, L.P. may also convert all or a portion of the debentures into the Company's common stock at any time at a price equal to the lesser of (i) \$0.58, or (ii) ninety percent (90%) of the lowest volume weighted average price of the Company's common stock during the ten (10) trading days immediately preceding the conversion date. The warrants expire five years from the date of issuance and entitle YA Global Investments, L.P. to purchase shares of common stock at a price per share of \$0.61.

The holders of our common stock are entitled to receive dividends when, as and if declared by the board of directors and paid by us out of funds legally available therefore and to share ratably in our assets available for distribution after the payment of all prior claims in the event we liquidate, dissolve or wind-up our business, and after payment to any holders of any of our preferred stock. Holders of our common stock are entitled to one vote per share on all matters requiring a vote of stockholders. Our common stock does not have cumulative voting rights. The rights of the holders of our common stock will be subject to any preferential rights of any class or series of our preferred stock that we might issue. As of the date of this proxy statement, we had no shares of preferred stock issued or outstanding. Holders of our common stock have no preemptive or other subscription rights, and there are no conversion, redemption or sinking fund provisions applicable thereto.

The securities purchase agreement pursuant to which the debentures and warrants were sold expressly prohibits YA Global Investments, L.P. from acquiring in excess of 19.99% of the outstanding shares of the Company's common stock, as of May 30, 2008, pursuant to the debentures and/or the warrants. As of April 7, 2009, the Company has issued an aggregate of 12,773,795 shares of common stock to YA Global Investments, L.P. in connection with conversion of debentures, which amount represented 16.4% of the Company's issued and outstanding common stock measured as of May 30, 2008, the date the listing application with respect to those shares was approved by NYSE AMEX. Up to 25,200,646 additional shares of the Company's common stock are subject to issuance to YA Global Investments, L.P. upon conversion of the outstanding debentures and exercise of the warrants, assuming such issuance took place on April 6, 2009, which amount constitutes 27.1% of the Company's issued and outstanding common stock on such date. In the event the issuance of these additional shares is approved by the stockholders and some or all of these additional shares are issued to YA Global Investments, L.P., such issuance will be dilutive to existing stockholders. In addition, since any additional shares issued to YA Global Investments, L.P. in conversion of the debenture will be valued at less than market value, such issuance could adversely affect the market price of the Company's common stock.

Our common stock is listed for trading on the NYSE AMEX (formerly, the American Stock Exchange). Pursuant to Section 713 of the NYSE AMEX Company Guide, which defines the Company's obligations with respect to the continued listing of its common stock on the NYSE AMEX, the Company is obligated to seek stockholder approval as a prerequisite to approval of an application to list additional shares when the additional shares will be issued in connection with a transaction involving the issuance, or potential issuance, by the issuer of 20% or more of the issuer's

outstanding common stock at a price less than the greater of book or market value (the "Exchange Cap") . Since the maximum aggregate amount of the Company's common stock issuable to YA Global Investments, L.P. under the debenture and warrants would result in the issuance to YA Global Investments, L.P. of 20% or more of the Company's issued and outstanding common stock, the Company is obligated to obtain stockholder approval of any and all issuances that cause the aggregate amount of common stock issued to YA Global Investments, L.P. to meet or exceed the Exchange Cap . Although the securities purchase agreement expressly provides that the Company is not obligated to issue shares of common stock to YA Global Investments, L.P. to the extent such issuance would cause the Exchange Cap to be exceeded, upon the request of YA Global Investments, L.P., the Company is obligated to use its best efforts to call a meeting of the stockholders for the purpose of approving the issuance of shares in excess of the Exchange Cap. In addition, the Company's Board of Directors is obligated to recommend such approval to the stockholders. On February 20, 2009, the Company executed an Agreement of Clarification with YA Global Investments, L.P. pursuant to which, among other things, the parties agreed that the Company would seek approval of the share issuance at the 2009 annual meeting of stockholders and, in the event such share issuance is approved by the stockholders, the Company will be obligated, upon request by YA Global Investments, L.P., to issue shares to YA Global Investments, L.P. in excess of the Exchange Cap. Assuming the Company has used its best efforts to obtain stockholder approval of the issuance as requested by YA Global Investments, L.P., there are no negative consequences to the Company in the event the share issuance is not approved by the Company's stockholders.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS
VOTE FOR THIS PROPOSAL

PROPOSAL 4. RATIFICATION OF APPOINTMENT OF
INDEPENDENT PUBLIC ACCOUNTANTS

RBSM, LLP served as the Company's independent public accountants in 2008 and are expected to be retained to do so in 2009. The Board of Directors has directed that management submit the selection of RBSM, LLP for ratification by the stockholders at the annual meeting. A representative of RBSM, LLP is expected to be present at the annual meeting, will have an opportunity to make a statement, should the representative desire to do so, and will be available to respond to appropriate questions.

Stockholder ratification of the selection of RBSM, LLP as the Company's independent public accountants is not required. However, the Board of Directors is submitting the selection of RBSM, LLP to the stockholders for ratification as a matter of good corporate practice. If the stockholders do not ratify the selection, the Audit Committee will reconsider whether to retain the firm. In such event, the Audit Committee may retain RBSM, LLP, notwithstanding the fact that the stockholders did not ratify the selection, or select another accounting firm without re-submitting the matter to the stockholders. Even if the selection is ratified, the Audit Committee reserves the right in its discretion to select a different accounting firm at any time during the year if it determines that such a change would be in the best interests of the Company and its stockholders.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS
VOTE FOR THIS PROPOSAL

OTHER MATTERS

The Board of Directors is not aware of any other matter that may be presented for action at the annual meeting. If any other matter comes before the annual meeting, the persons named in the enclosed proxy will vote the proxy with respect thereto in accordance with their best judgment, pursuant to the discretionary authority granted by the proxy.

STOCKHOLDERS SHARING AN ADDRESS

Stockholders sharing an address with another stockholder may receive only one set of proxy materials at that address unless they have provided contrary instructions. Any such stockholder who wishes to receive a separate set of proxy materials now or in the future may write or call the Company at the following address and telephone number to request a separate copy of these materials:

Telkonet, Inc.
20374 Seneca Meadows Parkway
Germantown, Maryland 20876-7004
240-912-1800

Similarly, stockholders sharing an address with another stockholder who have received multiple copies of the Company's proxy materials may write or call the Company to request delivery of a single copy of these materials.

STOCKHOLDER PROPOSALS

The Company intends to hold its 2010 Annual Meeting of Stockholders in June of 2010. Stockholders may submit written proposals to be considered for stockholder action at the Company's 2010 Annual Meeting of Stockholders. To be eligible for inclusion in the Company's Proxy Statement for the 2010 Annual Meeting, stockholder proposals must be received by the Company by __, 2010 and must otherwise comply with applicable Securities and Exchange Commission regulations and the Company's Bylaws. Stockholder proposals should be addressed to the Company at 20374 Seneca Meadows Parkway, Germantown, Maryland 20876-7004, Attention: Corporate Secretary. In addition, if

a stockholder intends to present a proposal at the Company's 2010 Annual Meeting of Stockholders without the inclusion of the proposal in the Company's proxy materials and written notice of the proposal is not received by the Company on or before __, 2010, proxies solicited by the Board of Directors for the 2010 annual meeting will confer discretionary authority to vote on the proposal if presented at the meeting. The Company reserves the right to reject, rule out of order or take other appropriate action with respect to any proposal that does not comply with these and other applicable requirements.

Brokers and other persons holding the Company's common stock in their names, or in the names of a nominee, will be requested to forward this proxy statement and the accompanying materials to the beneficial owners of the common stock and to obtain proxies, and the Company will defray reasonable expenses incurred in forwarding such material.

The Company's Annual Report to Stockholders, including audited financial statements and schedules, accompanies this proxy statement. Upon the written request of a holder of shares as of the record date, the Company will, without charge, provide a copy of the Company's Form 10-K for the year ended December 31, 2008. Such written requests should be sent to 20374 Seneca Meadows Parkway, Germantown, Maryland 20876-7004. Attn: Corporate Secretary.

INCORPORATION BY REFERENCE

The SEC allows us to “incorporate by reference” information into this proxy statement. The information incorporated by reference is considered to be part of this proxy statement. We are incorporating by reference the following portion of our annual report on Form 10-K for the year ended December 31, 2008, a copy of which accompanies this proxy statement:

- Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”
- Part II, Item 7A, “Quantitative and Qualitative Disclosures About Market Risk”
- Part II, Item 8, “Financial Statements”
- Part II, Item 9, “Changes in and Disagreements With Accountants on Accounting and Financial Disclosure”

By order of the Board of Directors,

/s/ JASON L. TIENOR
Jason L. Tienor
Chief Executive Officer

TELKONET, INC.

The Annual Meeting of the Stockholders of Telkonet, Inc. will be held on Thursday, May 28, 2009 at 10:00 a.m. local time, at The Union League of Philadelphia, located at 140 South Broad Street, Philadelphia, PA 19012.

1. ELECTION OF DIRECTORS - Nominees:

- | | | |
|-----------------------|---------------------|--------------------|
| 01-Seth D. Blumenfeld | 02-Thomas M. Hall | 03-Thomas C. Lynch |
| 04-Warren V. Musser | 05-Anthony J. Paoni | |

- .. FOR all nominees
- .. WITHHELD as to all nominees
- .. FOR all nominees except vote withheld from the following nominee(s): _____

2. TO APPROVE THE AMENDMENT TO TELKONET'S ARTICLES OF INCORPORATION TO INCREASE THE AUTHORIZED CAPITAL STOCK.

- .. FOR
- .. AGAINST
- .. ABSTAIN

3. TO APPROVE THE ISSUANCE OF SHARES OF COMMON STOCK TO YA GLOBAL INVESTMENTS, L.P.

- .. FOR
- .. AGAINST
- .. ABSTAIN

4. TO RATIFY THE APPOINTMENT OF INDEPENDENT PUBLIC ACCOUNTANTS.

- .. FOR
- .. AGAINST
- .. ABSTAIN

5. IN THEIR DISCRETION, TO VOTE UPON SUCH OTHER BUSINESS AS MAY PROPERLY COME BEFORE THE MEETING.

- .. FOR
- .. AGAINST
- .. ABSTAIN

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SEE REVERSE SIDE

SEE REVERSE SIDE

(CONTINUED AND TO BE SIGNED ON REVERSE SIDE)

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS OF TELKONET, INC. FOR USE ONLY AT THE ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON THURSDAY, MAY 28, 2009, AND ANY ADJOURNMENT OR POSTPONEMENT THEREOF.

The undersigned, being a stockholder of TELKONET, INC. ("Telkonet"), hereby authorizes Richard J. Leimbach and Jason L. Tienor, and each of them, with the full power of substitution, to represent the undersigned at the Annual Meeting of Stockholders of Telkonet to be held at The Union League of Philadelphia, located at 140 South Broad Street, Philadelphia, PA 19012, on Thursday, May 28, 2009 at 10:00 a.m., local time, and at any adjournment or postponement thereof, with respect to all votes that the undersigned would be entitled to cast, if then personally present, as appears on the reverse side of this proxy.

In their discretion, the proxies are authorized to vote with respect to matters incident to the conduct of the meeting and upon such other matters as may properly come before the meeting. This proxy may be revoked at any time before it is exercised.

Shares of the Common Stock of Telkonet will be voted as specified. If no specification is made, shares will be voted FOR the nominees for director named on the reverse side, FOR approval of the amendment to Telkonet's Articles of Incorporation, FOR the issuance of shares of common stock to YA Global Investments, L.P., FOR ratification of the appointment of the independent accountants and IN ACCORDANCE WITH THE DISCRETION OF THE PROXIES as to any other matter which may properly come before the annual meeting.

The undersigned hereby acknowledges receipt of a Notice of Annual Meeting of Stockholders of Telkonet, Inc. called for Thursday, May 28, 2009, and a Proxy Statement for the Meeting prior to the signing of this proxy.

_____ Dated:
_____, 2009

_____ Dated:
_____, 2009

Please sign exactly as your name(s) appears(s) on this proxy. When signing in a representative capacity, please give title.

PLEASE MARK, SIGN, DATE AND PROMPTLY RETURN THIS PROXY CARD USING THE ENCLOSED ENVELOPE.

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YOUR VOTE IS IMPORTANT
VOTE TODAY IN ONE OF TWO WAYS:

1. VOTE BY INTERNET:

- Log-on to www.votestock.com
- Enter your control number printed below
- Vote your proxy by checking the appropriate boxes
- Click on "Accept Vote"

OR

2. **VOTE BY MAIL:** If you do not wish to vote by Internet, please complete, sign, date and return the above proxy card in the pre-paid envelope provided.

YOUR CONTROL NUMBER IS:

You may vote by Internet 24 hours a day, 7 days a week.
Your Internet vote authorizes the named proxies to vote in the same
manner as if you
marked, signed and returned your proxy card.