ELECTRIC CITY CORP
Form DEF 14A
April 28, 2006

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UNITED STATES 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 þ
Filed by a Party other than the Registrant o
Check the appropriate box:

o Preliminary Proxy Statement
o Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
þ Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to §240.14a-12

ELECTRIC CITY CORP.
(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):

þ No fee required.
o 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:

o Fee paid previously with preliminary materials.
o 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:

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1280 Landmeier Road
Elk Grove Village, Illinois 60007
April 28, 2006
Dear Fellow Stockholder:
On behalf of the Board of Directors, I cordially invite you to attend the 2006 Annual Meeting of Stockholders to be held at 9:00 a.m., local time, on Wednesday, June 7, 2006 at the Holiday Inn Hotel, 1000 Busse Road, Elk Grove Village, Illinois 60007. The formal notice of the Annual Meeting appears on the following page.
The attached Notice of Annual Meeting and Proxy Statement contain detailed information about the matters that we expect to act upon at the Annual Meeting.
Please sign, date and specify your choices on the enclosed proxy card and promptly return it in the enclosed business reply envelope. This will help insure that your shares are represented at the Annual Meeting, whether or not you plan to attend the Annual Meeting. If you attend the meeting, you may revoke your proxy and personally cast your vote.
We look forward to seeing you at the Annual Meeting and urge you to return your proxy card as soon as possible.
Sincerely,

/s/ David R. Asplund

Electric City Corp.
David R. Asplund
Chief Executive Officer

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ELECTRIC CITY CORP.
1280 Landmeier Road
Elk Grove Village, Illinois 60007

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
To be held June 7, 2006

To the Stockholders of
ELECTRIC CITY CORP.:

NOTICE IS HEREBY GIVEN that the Annual Meeting of Stockholders of Electric City Corp. will be held at the Holiday Inn Hotel, 1000 Busse Road, Elk Grove Village, Illinois 60007 at 9:00 a.m. local time, on Wednesday, June 7, 2006, for the following purposes:

1. To elect six directors to our Board of Directors;

2. To amend our 2001 Stock Incentive Plan; and

3. To transact such other business as may properly come before the Annual Meeting or any adjournment thereof.

The foregoing items of business are more fully described in the proxy statement accompanying this notice. The Board of Directors has fixed the close of business on April 21, 2006 as the record date for determining stockholders entitled to notice of, and to vote at, the Annual Meeting or any adjournment thereof.

The Board of Directors encourages you to complete, sign and date the enclosed proxy card and promptly return it in the enclosed postage prepaid envelope, regardless of whether you plan to attend the Annual Meeting.

By Order of the Board of Directors,

Richard Kiphart
Chairman of the Board of Directors

Elk Grove Village, Illinois
April 28, 2006

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ELECTRIC CITY CORP.
1280 Landmeier Road
Elk Grove Village, Illinois 60007

PROXY STATEMENT
FOR ANNUAL MEETING OF STOCKHOLDERS
To be held Wednesday, June 7, 2006

This proxy statement and the enclosed proxy card are being furnished to our stockholders in connection with the solicitation of proxies by the Board of Directors of Electric City Corp., a Delaware corporation (Electric City or the Company), for use at our Annual Meeting of Stockholders to be held at the Holiday Inn Hotel, 1000 Busse Road, Elk Grove Village, Illinois 60007 at 9:00 a.m. local time, on Wednesday, June 7, 2006, and any adjournments thereof. This proxy statement and the accompanying form of proxy are first being mailed to stockholders on or about April 28, 2006.

Solicitation

The cost of this proxy solicitation will be borne by Electric City. We may request banks, brokers, fiduciaries, custodians, nominees and certain other record holders to send proxies, proxy statements and other materials to their principals at our expense. Those banks, brokers, fiduciaries, custodians, nominees and other record holders will be reimbursed by us for their reasonable out-of-pocket expenses of solicitation. We do not anticipate that costs and expenses incurred in connection with this proxy solicitation will exceed an amount normally expended for a proxy solicitation for an election of directors in the absence of a contest. In addition to soliciting proxies by mail, Electric City and its directors, officers and regular employees may also solicit proxies personally, by telephone or by other appropriate means. No additional compensation will be paid to directors, officers or other regular employees for such services.

Record Date and Outstanding Shares

Our Board of Directors fixed the close of business on April 21, 2006 as the record date for the determination of stockholders entitled to notice of, and to vote at, the Annual Meeting or any adjournments thereof. As of the close of business on the record date, we had 51,297,120 shares of Common Stock and 232,613 shares of Preferred Stock with voting rights as to certain matters outstanding. Each outstanding share of Common Stock on such date is entitled to one vote on each matter to be voted on at the Annual Meeting, and each outstanding share of Series E Convertible Preferred Stock is entitled to one hundred votes on each matter, other than the election of directors, to be voted at the Annual Meeting.

Required Vote

The affirmative vote of a majority of the shares of Common Stock voted in person or by proxy at the Annual Meeting is required to elect the nominees to the Board of Directors. Stockholders will not be allowed to cumulate their votes in the election of directors.

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Quorum; Abstentions And Broker Non-Votes

The required quorum for transaction of business at the Annual Meeting will be a majority of the total votes of the shares of Common Stock and Preferred Stock issued and outstanding as of the record date, except that for purposes of electing directors the required quorum will be a majority of the total votes of the shares of Common Stock issued and outstanding as of the record date. Votes cast by proxy or in person at the Annual Meeting will be tabulated by the election inspector appointed for the meeting and will be taken into account in determining whether or not a quorum is present. Abstentions and broker non-votes, which occur when a broker has not received customer instructions and indicates that it does not have the discretionary authority to vote on a particular matter on the proxy card, will be included in determining the presence of a quorum at the Annual Meeting. Neither abstentions nor broker non-votes will have any effect on the vote for the election of directors.

Voting of Proxies; Revocability of Proxies

Our Board of Directors selected Jeffrey R. Mistarz and Anna M. Baluyot, the persons named as proxies on the proxy card accompanying this proxy statement, to serve as proxy. Mr. Mistarz is our executive vice president, chief financial officer, treasurer and assistant secretary and Ms. Baluyot is our senior vice president of utility development and corporate strategy. The shares of Common Stock represented by each executed and returned proxy will be voted in accordance with the directions indicated thereon, or if no direction is indicated, the proxy will be voted in accordance with the recommendations of the Board of Directors contained in this proxy statement. Members of the Company s management intend to vote their shares in favor of each of the proposals.

All shareholders may vote in person at the Annual Meeting. You may also be represented by another person at the Meeting by executing a proper proxy designating that person. If you are a beneficial owner of shares, you must obtain a legal proxy from your broker, bank or other holder of record and present it to the inspectors of election with your ballot to be able to vote at the Meeting.

You can revoke a proxy you have given at any time before the shares it represents are voted by giving our secretary either (1) an instrument revoking the proxy or (2) a duly executed proxy bearing a later date. Additionally, you may change or revoke a previously executed proxy by voting in person at the Annual Meeting. However, your attendance at the Annual Meeting will not, by itself, revoke your proxy.

Annual Report to Stockholders

We are simultaneously furnishing to you with this proxy statement our Annual Report to Stockholders for the fiscal year ended December 31, 2005, which contains financial and other information pertaining to us.

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PROPOSAL 1
ELECTION OF DIRECTORS

At the Annual Meeting, six nominees to the Board of Directors will be elected to hold office for a one year term ending at our 2007 Annual Meeting of stockholders or until their respective successors are duly elected and qualified. All nominees listed below are currently members of our Board of Directors and have consented to being named in this proxy statement and to serve as directors, if elected. If, at the time of the Annual Meeting, any nominee becomes unavailable or declines to serve as a director for any reason, the persons named in the proxy will vote for the substitute nominee(s) as the Board of Directors recommends, or vote to allow the vacancy created by the nominee who is unable or declines to serve to remain open until filled by the Board of Directors, as the Board of Directors recommends. The Board of Directors has no reason to believe that any nominee will be unable or decline to serve if elected to office.

The number of directors has been set at 12 by resolution of the Board. The holders of our outstanding Series E Convertible Preferred Stock have the right to elect up to (i) four directors for so long as at least 90,000 shares of Series E Preferred Stock are outstanding, (ii) three directors for so long as at least 65,000 but less than 90,000 shares of Series E Preferred Stock are outstanding, (iii) two directors for so long as at least 45,000 but less than 65,000 shares of Series E Preferred Stock are outstanding and (iv) one director for so long as at least 20,000 but less than 45,000 shares of Series E Preferred Stock are outstanding. If less than 20,000 shares of Series E Preferred Stock are outstanding, unless otherwise provided by law, each holder of record of Series E Convertible Preferred Stock has the right to vote on an as-converted basis together with the holders of Common Stock on all matters on which holders of Common Stock are entitled to vote, including the election of directors.

On April 21, 2006, the preferred stockholders held 232,613 shares of the Series E Preferred Stock. Accordingly, the holders of the Series E Preferred Stock are entitled to elect up to four directors (out of 12) to our board. Except for the election of directors nominated by our Board of Directors for election, holders of the Series E Preferred Stock are entitled to vote with the holders of our Common Stock on an as-converted basis on all matters on which our holders of Common Stock are entitled to vote.

Nominees For Director

The following table presents the names of the nominees for the office of director, as well as certain information about them. As of the date of this filing, the Board of Directors has not nominated any individuals for the two vacant director positions, because it has not identified additional qualified candidates who are willing to serve. Proxies can not be voted for a greater number of persons than the number of nominees named.

Name	**Age**	**Position Held with the Company**	**Served as Director Since**
David R. Asplund	48	Chief Executive Officer and Director	2002
Richard P. Kiphart	64	Chairman of the Board of Directors and Director *(2)*	2006
Gregory T. Barnum	51	Director	2006
William R. Carey, Jr.	58	Director	2006
Daniel W. Parke	50	Director	2005
Gerald A. Pientka	50	Director *(1)(2)*	2000

(1) Member of our Audit Committee.

(2) Member of our Compensation Committee.

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Directors Appointed and Elected By The Holders Of Our Series E Convertible Preferred Stock

The following table presents the name of the director appointed and elected by the holders of our Series E Preferred Stock, as well as certain information about him. This information, as well as the informational disclosures regarding him, is presented for information purposes only. The Series E Preferred holders are entitled to appoint and elect three additional directors (for a total of 4 directors) which positions are vacant as of April 21, 2006.

Name	Age	Position Held with the Company	Served as Director Since
David W. Valentine	36	Director *(1)(3)*	2004

(1) Member of our Audit Committee.

(3) Member of our Governance and Nominating Committee

Nominees for Election

David R. Asplund has been one of our directors since June 2002 and has been our chief executive officer since January 2006. Mr. Asplund has a degree in mechanical engineering from the University of Minnesota. Prior to becoming CEO of Electric City, Mr. Asplund was president of Delano Group Securities, LLC, an investment banking firm in Chicago, Illinois, which he founded in 1999. Mr. Asplund is also serves on the board of Agenet, Inc.

Gregory T. Barnum has been one of our directors since March 2006. Mr. Barnum is currently the vice president of finance and chief financial officer of Datalink Corporation, an information storage architect. Prior to joining Datalink in March 2006, Mr. Barnum was the vice president of finance, chief financial officer and corporate secretary of Computer Network Technology Corporation. From September 1992 to July 1997, Mr. Barnum served as senior vice president of finance and administration, chief financial officer and corporate secretary at Tricord Systems, Inc., a manufacturer of enterprise servers. From May 1988 to September 1992, Mr. Barnum served as the executive vice president, finance, chief financial officer, treasurer and corporate secretary for Cray Computer Corporation, a development stage company engaged in the design of supercomputers. Prior to that time, Mr. Barnum served in various accounting and financial management capacities for Cray Research, Inc., a manufacturer of supercomputers. Mr. Barnum is a Certified Public Accountant and a member of the American Institute of Certified Public Accountants.

William R. (Max) Carey has been one of our directors since March 2006. Mr. Carey is the chairman and founder of Corporate Resource Development, a sales and marketing consulting firm he founded in 1981. He is also a managing director of Entrepreneur Equity Corporation, an insurance broker that creates specialty products for middle market companies. Mr. Carey also serves on the boards of Outback Steakhouse Inc., Kforce, Inc., Crosswalk.com and J.B. Hanauer & Co.

Richard P. Kiphart has been one of our directors since January 2006. Mr Kiphart is the head of the Corporate Finance Department and a Principal of William Blair & Company Investment firm. In addition, Mr. Kiphart currently serves as a member of the board of directors of First Data Corp., and previously served on the Concord EFS board of directors from 1997 until 2004 and was chairman of the Concord board of directors from February 2003 until March 2004. Mr. Kiphart is also currently a director of SAFLINK Corporation, Advanced Biotherapy, Inc. and Nature Vision, Inc. In addition he is the chairman of the Merit Music School and is on the board of directors for the Lyric Opera of Chicago, the Erikson Institute and DATA (Debt AIDS Trade Africa). Mr. Kiphart is the father in-law of David Valentine, one of our directors.

Daniel W. Parke is currently a principal of Parke P.A.N.D.A. Corporation, an energy efficiency company that focuses on small to medium sized commercial and industrial institutions primarily located in Southern California. Mr. Parke was previously a founder of Parke Industries, Inc. which was acquired in February 1998 by Strategic Resource Solutions, an unregulated subsidiary of Carolina Power & Light.

Gerald A. Pientka has been one of our directors since May 2000. Mr. Pientka is currently, and has been since February 2006 the executive vice president of development for First Industrial Realty Trust, Inc. From September 2003 to February 2006 he was the founder and principal of Verus Partners, a real estate development company located in Chicago, Illinois. Prior to this, from May 1999 through March 2003, Mr. Pientka was president of Higgins Development Partners, LLC (the successor to Walsh, Higgins & Company), a national real estate development company controlled by the Pritzker family interests. From May 1992 until May 1999, Mr. Pientka served as president of Walsh, Higgins & Company. Mr. Pientka is also a member of Leaf Mountain Company, LLC, which is a holder of shares of our Series E Convertible Preferred Stock. Mr. Pientka is also board president of Christopher House, a Chicago-based social services agency.

Directors Appointed and Elected By the Holders of Our Series E Convertible Preferred Stock

David W. Valentine has been one of our directors since May 2004 and is an appointee of the holders of our Series E Convertible Preferred Stock. Mr. Valentine is currently a Senior Investment Professional of a private investment firm. Prior to his current employ Mr. Valentine was the Global Head of Debt Private Placements at UBS Investment Bank where he had previously been a Director of Leveraged Finance. Before joining UBS, Mr. Valentine held various investment banking positions at Nesbitt Burns Securities Inc. and ABN Amro Chicago Corporation. Mr. Valentine is the son in-law of Richard Kiphart, our chairman.

The Board of Directors recommends that the stockholders vote
FOR
the election of all of the nominees for the office of director.

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PROPOSAL 2
PROPOSAL TO AMEND
OUR 2001 STOCK INCENTIVE PLAN

The 2001 Stock Incentive Plan (the Incentive Plan) was adopted by the Board of Directors on May 30, 2001 and approved by our stockholders on August 30, 2001. As of April 21, 2006, the maximum number of shares of Common Stock reserved for issuance upon the exercise of stock options or other awards granted under the Incentive Plan was 3,279,569 shares. As of that date, 3,054,084 of those shares were subject to outstanding stock options, 225,485 shares had been issued pursuant to stock grants, and 20,431 shares remained available for future grant.

If stockholders approve this proposal to amend the Incentive Plan the following changes will be made to the plan:

- the maximum number of shares of Common Stock reserved for issuance under the Incentive Plan will be increased by an additional 6,000,000 shares of Common Stock from 3,300,000 to 9,300,000 shares and those additional 6,000,000 shares of Common Stock will accordingly be available for issuance upon the exercise of stock options or stock appreciation rights or for the issuance of other awards granted under the Incentive Plan;

- the number of shares by which the plan will automatically increase each year, beginning on January 1, 2007 will increase from 500,000 shares to 2,000,000 shares; and

- the number of shares issuable to one participant during any one calendar year will be increased from 1,500,000 shares to 4,500,000 shares.

A copy of the proposed amendment to the Incentive Plan is attached hereto as Annex A.

The Board of Directors believes that the future success of the Company depends, in large part, upon the ability of the Company to maintain a competitive position in attracting, retaining and motivating key personnel. The Company s management relies on equity-based compensation both to provide a performance incentive to employees and to encourage broad employee stock ownership in the Company. The Board of Directors believes that the Incentive Plan is essential to permit Electric City s management to continue the pursuit of these objectives. Moreover, equity-based grants are designed to align the interests of each participating employee with those of the stockholders and provide each such individual with a significant incentive to view Electric City from the perspective of an owner with an equity stake.

Consistent with this view, in January 2006, the Board agreed to grant Mr. Asplund, the Company s new Chief Executive Officer, options to purchase 4,500,000 shares of the Company s common stock as part of his employment agreement. As of the date of his hire the Company only had 520,431 shares available under the Incentive Plan, of which it reserved 500,000 for shares issuable to Mr. Asplund. The granting of options to purchase the remaining 4,000,000 shares is subject to stockholder approval of this amendment to our Incentive Plan. Under the terms of Mr. Asplund s contract, if our stockholders do not approve this amendment Mr. Asplund shall have the option of terminating his contract and resigning his position. If he elects to terminate and resign, the Company shall pay to Mr. Asplund, as a lump sum, an amount equal to his base salary from the date of such termination through January 22, 2007 plus $65,000, plus any accrued unused vacation as of the date of termination. In addition, upon electing to terminate his contract in such circumstances the 500,000 options shall immediately vest and will be exercisable for a period of 90 days. If the amendment to the Incentive Plan is approved, options covering 4,000,000 shares will be granted to Mr. Asplund. The total of 4,500,000 options will vest in three equal annual installments, commencing January 23, 2007. See Employment Contracts, Termination of Employment and Change-in-Control Arrangements for further information regarding Mr. Asplund s employment contract.

The following is a brief summary of the existing Incentive Plan. The following summary is qualified in its entirety by reference to the existing Incentive Plan, which is attached hereto as Annex B.

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Types of Awards

The Incentive Plan provides for the grant of incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended (the Code), non-qualified stock options, stock appreciation rights and stock awards other than options (collectively, Awards).

Incentive Stock Options and Non-qualified Stock Options. Optionees receive the right to purchase a specified number of shares of Common Stock at a specified option exercise price and subject to such other terms and conditions as are specified in connection with the option grant. Subject to the limitations described below, options may be granted at an exercise price which may be less than, equal to or greater than the fair market value of the Common Stock on the date of grant. Under present law, however, incentive stock options and options intended to qualify as performance-based compensation under Section 162(m) of the Code may not be granted at an exercise price less than 100% of the fair market value of the Common Stock on the date of grant (or less than 110% of the fair market value in the case of incentive stock options granted to optionees holding more than 10% of the voting power of the Company). Under the Code, to qualify as an incentive stock option the aggregate fair market value of the shares (determined on the grant date) granted to any participant may not exceed $100,000 in the first year that they can be exercised. On April 21, 2006, the fair market value per share of Common Stock was $0.56, based on the closing selling price per share on that date.

Options may not be granted for a term in excess of ten years. The Incentive Plan permits the following forms of payment of the exercise price of options: (i) payment by cash or check, (ii) through a same-day exercise and sale procedure through a broker pursuant to which the shares purchased under the option are immediately sold and a portion of the sale proceeds are remitted to the Company in payment of the exercise price and the applicable withholding taxes; (iii) surrender to the Company of shares of Common Stock; or (iv) any combination of these forms of payment.

Stock Appreciation Rights. A stock appreciation right gives the holder the right to receive an amount in cash, shares of stock or both equal in value to the excess of the Fair Market Value of one share of stock over (i) such value per share of stock as shall be determined by the Administrator at the time of grant (if the Stock Appreciation Right is granted on a stand-alone basis), or (ii) the exercise price per share specified in the related Stock Option (if the Stock Appreciation Right is granted in conjunction with all or part of any Stock Option), multiplied by the number of shares in respect of which the Stock Appreciation Right shall have been exercised, with the Administrator having the right to determine the form of payment.

Stock Awards. Stock Awards may be directly issued under the Plan (without any intervening options), subject to such terms, conditions, performance requirements, restrictions, forfeiture provisions, contingencies and limitations as the Administrator shall determine. Stock Awards may be issued which are fully and immediately vested upon issuance or which vest in one or more installments over the Participant s period of employment or other service to the Company or upon the attainment of specified performance objectives, or the Company may issue stock Awards which entitle the Participant to receive a specified number of vested shares of stock upon the attainment of one or more performance goals or service requirements established by the Administrator.

If any Award expires or is terminated, surrendered, canceled or forfeited, the unused shares of Common Stock covered by such Award will again be available for grant under the Incentive Plan, subject, however, in the case of incentive stock options, to any limitations under the Code.

Eligibility to Receive Awards

Employees, officers, directors, consultants and advisors of the Company and its subsidiaries and affiliates are eligible to be granted Awards under the Incentive Plan. Under present law, however, incentive stock options may only be granted to employees of the Company and its corporate subsidiaries.

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New Plan Benefits

As of April 21, 2006, approximately 31 persons were eligible to receive Awards under the Incentive Plan, including the Company s three executive officers. The granting of Awards under the Incentive Plan is discretionary, and the Company cannot now determine the number or type of Awards to be granted in the future to any particular person or group, other than those granted to Mr. Asplund pursuant to his employment agreement. The table below shows the awards that the Company anticipates will be granted to the Named Executive Officers if the amendment to the 2001 Stock Incentive Plan is approved by stockholders:

Name and Position	Dollar Value ($)	Number of Options
David Asplund, *chief executive officer(1)*	*(2)*	4,000,000
John Mitola, *former chief executive officer*		
Jeffrey Mistarz, *chief financial officer*	*(3)*	*(3)*
Leonard Pisano, *chief operating officer*	*(3)*	*(3)*
Denis Enberg, *former executive vice president*		
Eugene Borucki, *former president Great Lakes Controlled Energy Corporation*		
Executive Group	*(3)*	*(3)*
Non-executive Director Group	*(3)*	*(3)*
Non-Executive Officer Employee Group	*(3)*	*(3)*

(1) As part of Mr. Asplund s recently completed employment contract, upon approval of this amendment, he is to receive additional options to purchase 4,000,000 shares of Common Stock.

(2) The value of these options is not determinable at this time. The options will vest 1,000,000 options on January 22, 2007, 1,500,000 options on January 22, 2008 and

1,500,000 on January 22, 2009, with exercise prices equal to the higher of the average closing price on the 30 days prior to the vesting date or the closing price on the vesting date.

(3) The granting of awards is discretionary, and we cannot now determine the number or type of Awards we will grant in the future to our executive officers. We expect that from time to time, at the Board s discretion, we will grant Awards to our executive officers under the Plan under such terms consistent with the Plan as the Board deems appropriate at the time of those grants.

Administration

The Incentive Plan is administered by the Board of Directors. The Board of Directors has the authority to adopt, amend and repeal the administrative rules, guidelines and practices relating to the Incentive Plan and to interpret the provisions of the Incentive Plan. Pursuant to the terms of the Incentive Plan, the Board of Directors may delegate authority under the Incentive Plan to one or more committees or subcommittees of the Board of Directors. The Board of Directors may authorize the compensation committee to administer certain aspects of the Incentive Plan, including the granting of options to executive officers, and may authorize one or more executive officers the authority to grant options to employees who are not executive officers.

Subject to any applicable limitations contained in the Incentive Plan and to the extent permitted by applicable law, the Board of Directors, the compensation committee, or any other committee to whom the Board of Directors delegates authority, as the case may be, selects the recipients of Awards and determines (i) the number of shares of Common Stock covered by options and the dates upon which such options become exercisable, (ii) the exercise price of options, (iii) the duration of options (which may not exceed 10 years), and (iv) the number of shares of Common Stock subject to any stock appreciation or other stock-based Awards and the terms and conditions of such Awards.

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The Board of Directors, the compensation committee, or any other committee to whom the Board of Directors delegates authority, as the case may be, will also have the discretionary authority to accelerate the vesting of any outstanding Awards or waive any forfeiture provisions or other restrictions applicable to those Awards.

Changes in Capitalization

In the event any change is made to the outstanding shares of Common Stock by reason of any recapitalization, stock dividend, stock split, combination of shares, exchange of shares, spin-offs or other similar change in the Company s capital structure corporate structure, appropriate adjustments will be made to: (i) the maximum number and/or class of securities issuable under the Incentive Plan; (ii) the maximum number and/or class of securities for which any one person may be granted Awards under the plan per calendar year and (iii) the number and/or class of securities and the exercise price in effect under each outstanding option. Such adjustments will be designed to preclude any dilution or enlargement of benefits under the Incentive Plan or the outstanding awards thereunder.

Change of Control

The Incentive Plan contains provisions addressing the consequences of any Change of Control (as defined in the Incentive Plan). Upon the occurrence of a Change of Control, any Stock Options and Stock Appreciation Rights outstanding as of the date such Change in Control is determined to have occurred and not then exercisable and vested shall become fully exercisable and vested to the full extent of the original grant if such acceleration is provided for in the original grant. In addition, the restrictions applicable to any outstanding stock Award shall lapse, and the stock relating to such Award shall become free of all restrictions and become fully vested and transferable to the full extent of the original grant and all outstanding repurchase rights of the Company with respect to any outstanding Award shall terminate. Outstanding Awards are to be assumed by the acquiring or succeeding corporation or replaced with equivalent substitute Awards. However, in the absence of any agreement with the Company effecting such Change in Control, each share of stock subject to an outstanding Award shall be settled for the Change in Control Price (as defined in the Incentive Plan)(less, to the extent applicable, the per share exercise price), or, if the per share exercise price equals or exceeds the Change in Control Price, the outstanding Award shall terminate and be canceled.

Amendment or Termination

No Award may be made under the Incentive Plan after the tenth anniversary of the date on which the Incentive Plan was adopted by the Board of Directors, but Awards previously granted may extend beyond that date. The Board may amend, alter, or discontinue the Plan, but no amendment, alteration or discontinuation shall be made which would adversely affect the rights of a Participant under an Award theretofore granted without the Participant s consent, except such an amendment (i) made to avoid an expense charge to the Company or an Affiliate, or (ii) made to permit the Company or an Affiliate a deduction under the Code. No such amendment shall be made without the approval of the Company s stockholders to the extent such approval is required by law, agreement or the rules of any stock exchange or market on which the stock is listed.

Stockholder Rights and Transferability

No optionee will have any stockholder rights with respect to the option shares until such optionee has exercised the option and paid the exercise price for the purchased shares. Options are in general not assignable or transferable other than by will or the laws of inheritance following optionee s death, and during the optionee s lifetime, the option may only be exercised by the optionee or by the guardian or legal representative of the Optionee.

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A participant will have certain stockholder rights with respect to any unvested shares of Common Stock acquired under the Stock Incentive Plan. Accordingly, the participant will have the right to vote such shares and to receive dividends paid on such shares, but will not have the right to transfer such shares prior to vesting.

Special Tax Election

The Board of Directors, the compensation committee, or any other committee to whom the Board of Directors delegates authority, as the case may be, may provide one or more participants in the Incentive Plan with the right to have the Company withhold a portion of the shares otherwise issuable to them individuals in satisfaction of the withholding taxes to which they become subject in connection with the exercise of their options or the vesting of unvested shares acquired under the Incentive Plan.

Federal Income Tax Consequences

The following is a summary of the United States federal income tax consequences that generally will arise with respect to Awards granted under the Incentive Plan and with respect to the sale of Common Stock acquired under the Incentive Plan. This summary is based on the federal tax laws in effect as of the date of this proxy statement. Changes to these laws could alter the tax consequences described below.

Incentive Stock Options. No taxable income is recognized by the optionee at the time of the option grant, and no taxable income is recognized for regular tax purposes at the time the option is exercised, although taxable income may arise at that time for alternative minimum tax purposes. The optionee will recognize taxable income in the year in which the purchased shares are sold or otherwise made the subject of certain other dispositions. For federal tax purposes, dispositions are divided into two categories: (i) qualifying and (ii) disqualifying. A qualifying disposition occurs if the sale or other disposition is made more than two (2) years after the date the option for the shares involved in such sale or disposition is granted and more than one (1) year after the date the option is exercised for those shares. If the sale or disposition occurs before these two periods are satisfied, then a disqualifying disposition will result.

Upon a qualifying disposition, the optionee will recognize long-term capital gain in an amount equal to the excess of (i) the amount realized upon the sale or other disposition of the purchased shares over (ii) the exercise price paid for the shares. If there is a disqualifying disposition of the shares, then the excess of (i) the fair market value of those shares on the exercise date or (if less) the amount realized upon such sale or disposition over (ii) the exercise price paid for the shares will be taxable as ordinary income to the optionee. Any additional gain recognized upon the disposition will be a capital gain.

If the optionee makes a disqualifying disposition of the purchased shares, then the Company will be entitled to an income tax deduction, for the taxable year in which such disposition occurs, equal to the amount of ordinary income recognized by the optionee as a result of the disposition. The Company will not be entitled to any income tax deduction if the optionee makes a qualifying disposition of the shares.

Non-qualified Options. No taxable income is recognized by an optionee upon the grant of a non-qualified option. The optionee will in general recognize ordinary income, in the year in which the option is exercised, equal to the excess of the fair market value of the purchased shares on the exercise date over the exercise price paid for the shares, and the Company will be required to collect the withholding taxes applicable to such income from the optionee.

Shares purchased under a non-qualified option will have a tax basis equal to the exercise price plus any income recognized upon the exercise of the option. Upon selling those shares, the optionee generally will recognize capital gain or loss in an amount equal to the difference between the amount realized upon the sale of the shares and his or her tax basis in those shares. This capital gain or loss will be a long-term gain or loss if the optionee has held the shares Stock for more than one year prior to the date of the sale.

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Stock Appreciation Rights. Currently, no taxable income is generally recognized upon the receipt of stock appreciation right, or SAR, granted with a per share exercise price that is not less than the fair market value of a common share as of the date of grant, but upon exercise of the SAR the fair market value of the shares received generally will be taxable as ordinary income to the recipient in the year of such exercise. The Company generally will be entitled to a compensation deduction for the same amount which the recipient recognizes as ordinary income.

Restricted Stock and Deferred Stock. A participant to whom restricted or deferred stock is issued generally will not recognize taxable income upon such issuance and we generally will not then be entitled to a deduction unless, with respect to restricted stock, an election is made by the participant under Section 83(b) of the Internal Revenue Code. However, when restrictions on shares of restricted stock lapse, such that the shares are no longer subject to a substantial risk of forfeiture, the participant generally will recognize ordinary income and we generally will be entitled to a deduction for an amount equal to the excess of the fair market value of the shares at the date such restrictions lapse over the purchase price. If a timely election is made under Section 83(b) with respect to restricted stock, the participant generally will recognize ordinary income on the date of the issuance equal to the excess, if any, of the fair market value of the shares at that date over the purchase price therefore, and we will be entitled to a deduction for the same amount. Similarly, when deferred stock vests and is immediately issued to the participant, the participant generally will recognize ordinary income and we generally will be entitled to a deduction for the amount equal to the fair market value of the shares at the date of issuance. A Section 83(b) election is not permitted with regard to the grant of deferred stock.

Stock Awards. A participant who receives a stock award with no restrictions, deferral or risk of forfeiture will recognize ordinary income on the date of grant, and we will be entitled to a corresponding deduction.

Deductibility of Executive Compensation. The Company anticipates that any compensation deemed paid by it in connection with the disqualifying disposition of incentive stock option shares or the exercise of non-qualified options with an exercise price per share equal to the fair market value per share of Common Stock on the grant date will qualify as performance-based compensation for purposes of Internal Revenue Code Section 162(m) and will not have to be taken into account for purposes of the $1 million limitation per covered individual on the deductibility of the compensation paid to certain of the Company s executive officers. Accordingly, the compensation deemed paid with respect to such options granted under the Incentive Plan will remain deductible by us without limitation under Section 162(m). However, any compensation deemed paid by the Company in connection with options granted with a below-market exercise price or restricted stock awards will be subject to the $1 million limitation.

Required Vote

The affirmative vote of the holders of a majority of the outstanding shares of our Common Stock (including, for this purpose, shares of Series E Preferred Stock on an as-converted basis) present in person or represented by proxy at the meeting and entitled to vote on Proposal No. 2 is required for approval of the proposed amendment to the Incentive Plan. Should such approval not be obtained, then the proposed amendment will not be implemented. However, the Stock Incentive Plan, as it existed immediately prior to such increase, will continue in full force and effect until its May 30, 2011 expiration date, and option grants may continue to be made under the plan until such expiration date or until the currently existing share reserve is issued

The Board of Directors believes that the ability to issue equity incentives to the Company s management and employees is important in recruiting, retaining and motivating employees and therefore is in the best interest of the Company and its stockholders.

The Board of Directors recommends that the stockholders vote FOR the approval of the foregoing amendment to the 2001 Stock Incentive Plan.

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Director Attendance

During the fiscal year ended December 31, 2005, the Board of Directors held nine formal meetings. In addition, there were five meetings of the Audit Committee, two meetings of the Compensation Committee and one meeting of our Governance and Nominating Committee. During 2005, all members of the Board of Directors attended at least 75% of the total of all board meetings and applicable committee meetings. We encourage our Board members to attend our Annual Meeting, but we do not have a formal policy requiring attendance. All but one of our Board members attended last year s Annual Meeting.

Independent Directors

Of the nine directors currently serving on the Board, the Board has determined that each of Messrs. Barnum, Bukovski, Carey, Kiphart, Parke, Pientka, Stelter and Valentine are independent directors as defined in Section 121(A) of the American Stock Exchange listing standards. Messrs. Bukovski and Stelter are not standing for election to the Board of Directors at this Annual Meeting and will no longer be directors after the meeting.

Compensation of Directors

Effective April 1, 2000, the Company adopted a stock option plan for all non-employee directors, which is separate and distinct from the 2001 Stock Incentive Plan described under Stock Options and Incentive Compensation . The directors stock option plan provides that eligible directors receive an initial option grant upon being appointed to our Board of Directors to purchase 75,000 shares of our Common Stock, and a grant of options to purchase an additional 25,000 shares on each anniversary of their appointment to the Board if they are still a member of the Board of Directors on such anniversary date. These options have an exercise price equal to the greater of the closing price of our Common Stock on the grant date, or $1.00, and a term of ten years. The options vest in three equal amounts, beginning on the grant date and on each of the next two anniversaries of the grant date, if the individual is still a member of the Board of Directors on each such anniversary date.

The Company granted options to purchase 200,000 shares under the directors stock option plan during 2005, and options to purchase 1,466,669 shares were outstanding under this plan as of December 31, 2005.

Directors who are also employees of the Company receive no additional compensation for their services as directors. Directors who are not employees of the Company, in addition to stock options, are reimbursed for travel expenses and other out-of-pocket costs incurred in connection with their attendance at the meetings.

Committees of the Board of Directors

The Board of Directors has an Audit Committee, Compensation Committee and a Governance and Nominating Committee.

The **Audit Committee**, which is composed entirely of non-employee, independent directors, held five meetings during 2005. Each of the members of the Audit Committee attended at least 75% of the meetings of the Committee held in 2005. The Audit Committee meets periodically and separately in executive sessions with management and the independent auditors to review the activities of each. The Audit Committee possesses and may exercise the powers of the Board of Directors relating to accounting, auditing, and financial reporting matters of the Company, except when such powers are by statute or the Certificate of Incorporation or Bylaws reserved to the full Board or delegated to another committee of the Board. The Audit Committee reports regularly to the full Board on these matters. The Audit Committee is directly responsible for the appointment, compensation, and oversight of the Company s independent auditors. Among other duties, the Audit Committee:

selects the independent auditors;

pre-approves all audit and non-audit services provided to the Company by the independent auditors;

monitors the independence of the independent auditors;

reviews and approves:

- the scope and timing of work to be performed by the independent auditors

- compensation to be paid to the independent auditors

- financial accounting and reporting principles used by the Company

- results of the audit and the report of the independent auditors

- transactions involving the Company and its officers, directors, affiliates and significant stockholders

discusses the Company s annual audited financial statements and quarterly financial statements with management and the independent auditors;

considers allegations made, if any, of possible financial fraud or other financial improprieties;

prepares an Audit Committee report as required by the SEC to be in this proxy statement; and

reviews and reassesses the adequacy of the Audit Committee charter at least annually.

The Audit Committee s current members are directors John Bukovski (Committee Chairman), Gerald Pientka and Michael Stelter. Our Board of Directors has determined that Mr. Bukovski qualifies as an Audit Committee financial expert as defined in Item 401(h) of SEC Regulation S-K. The Board also believes that Messrs. Bukovski, Pientka and Stelter are independent directors as defined by Section 121(A) of The American Stock Exchange listing standards. The Board of Directors adopted an Audit Committee Charter effective April 19, 2000, which was amended effective January 31, 2001 to combine the Conflicts Committee with the Audit Committee. A copy of the Audit Committee s charter is available on our website (www.elccorp.com) under the heading Investors & Media and subheading Corporate Governance. Mr. Bukovski and Stelter are not standing for election to the Board of Directors at this Annual Meeting and will no longer be directors after the meeting. We anticipate that Mr. Barnum will assume the role of financial expert on the Audit Committee if he is re-elected to the Board of Directors at our 2006 Annual Meeting of Stockholders.

The **Compensation Committee**, which is composed of David Valentine (Committee Chairman), Gerald Pientka and Richard Kiphart, was formed on January 31, 2001 upon the Board of Directors adoption of a Compensation Committee Charter. The Compensation Committee held two meeting during 2005 each of which was attended by all members. The Compensation Committee s responsibilities are to:

review and recommend to the Board of Directors the annual salary, bonus, stock options and other benefits of the Company s senior executives;

review executive compensation programs and the administration thereof;

plan for executive development and succession;

review expense accounts and fringe benefits of executive management;

administer the Company s stock option and stock incentive programs; and review and recommend to the Board of Directors the compensation of members of the Board of Directors**.**

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The **Governance and Nominating Committee,** which is composed of Michael Stelter (Committee Chairman), John Bukovski, and David Valentine, was formed on April 7, 2004 upon the Board of Directors adoption of a Governance and Nominating Committee Charter. A copy of the Governance and Nominating Committee s charter is available on our website (www.elccorp.com) under the heading Investors & Media and subheading Corporate Governance. The Board believes that Messrs. Stelter, Bukovski and Valentine are independent directors as defined by Section 121(A) of The American Stock Exchange listing standards. Prior to the establishment of the Governance and Nominating Committee, the recruitment and selection of candidates for Board of Directors was handled by the Compensation Committee. The Governance and Nominating Committee held one meeting in 2005. The Governance and Nominating Committee s responsibilities are to:

- develop and recommend to the Board of Directors policies and processes designed to provide for effective and efficient governance;
- plan Board education activities, including new member orientation;
- evaluate the size and composition of the Board of Directors, develop criteria for membership on the Board of Directors, and evaluate the independence of existing and prospective directors, and make recommendations to the Board concerning such matters;
- seek and evaluate qualified individuals to become directors;
- evaluate the nature, structure and composition of other committees of the Board of Directors and make recommendations to the Board concerning such matters; and
- assess the performance of the Board of Directors.

Selection of Board Nominees

Our Governance and Nominating Committee is responsible for identifying and evaluating Board candidates using one or more informal processes deemed appropriate for the circumstances. All of our directors and executive officers play a significant role in bringing potential candidates to the attention of the Committee. Last year, Mr. Asplund recommended Messrs. Barnum, Carey and Parke to the Committee. Mr. Parke became a member of the Board on October 5, 2005 and Messrs. Barnum and Carey joined the Board in March 2006. A determination of whether to pursue discussions with a particular individual will be made after discussion by the Committee and may be preceded by formal or informal discussions involving one or all of the other Board members. Information considered by the Committee may include information provided by the candidate, the chief executive officer and one or more Committee or Board members. The Committee seeks candidates whose qualifications, experience and independence complement those of existing Board members. Board candidates are expected to possess high personal and professional ethics, integrity and values, and relevant business experience and to be committed to representing the long-term interests of all stockholders. They are also expected to have an inquisitive and objective perspective, practical wisdom and good judgment.

Once appropriate candidates have been identified, the Committee will recommend nominations to our Board. Our Governance and Nominating Committee has not adopted a policy or procedure for the consideration of director candidates recommended by stockholders. Our Board does not recall an instance in which a stockholder (other than a stockholder serving as an officer or director) has recommended a director candidate; however the Governance and Nominations Committee will consider all timely stockholder recommendations. For the 2007 Annual Meeting of Stockholders, nominations may be submitted to the Corporate Secretary, Electric City Corp., 1280 Landmeier Road, Elk Grove Village, IL 60007-2410, which will forward them to the Chairman of the Governance and Nominating Committee. Recommendations must be in writing, must specify the candidate s qualifications for serving as a director and must be received by the Company not later than December 16, 2006, in order for nominees to be considered for election at our 2007 Annual Meeting of Stockholders.

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Stockholder Communications with the Board of Directors

The Company s Annual Meeting provides an opportunity each year for stockholders to ask questions of or otherwise communicate directly with directors on matters relevant to the Company. In addition, stockholders may, at any time, communicate with any of the Company s directors by sending a written communication to such director c/o the Company s Secretary at 1280 Landmeier Road, Elk Grove Village, IL 60007-2410.

All communications by stockholders or other interested parties addressed to the Board will be sent directly to Board members. While the Company s Corporate Secretary may review, sort, and summarize these communications, all direct communications will be presented to the non-management directors unless there is instruction from them to filter such communications (and in such event, any communication that has been filtered out will be made available to any non-management director who wishes to review it).

Proposals of Stockholders for Next Year s Meeting

Stockholders may present proper proposals for inclusion in the proxy statement for our next annual meeting of stockholders by submitting their proposals to us in a timely manner. In order to be included in the proxy statement for our next annual meeting, stockholder proposals must be received by us no later than December 29, 2006, and must otherwise comply with the requirements of the applicable SEC rules. Notice of intention to present proposals at next year s annual meeting must be addressed to Corporate Secretary, Electric City Corp., 1280 Landmeier Road, Elk Grove Village, Illinois 60007-2410. Any Stockholder proposal to be considered at our 2007 Annual Meeting of Stockholders, but not included in the proxy materials, must be submitted to the Company s Corporate Secretary by March 14, 2007, or the persons appointed as proxies may exercise their discretionary voting authority with respect to that proposal. The persons appointed as proxies may also exercise their discretionary voting authority with respect to stockholder proposals submitted prior to March 14, 2007, unless the proponent otherwise complies with the requirements of the Commission s Rule 14a-4 or Rule 14a-8.

Code of Conduct and Business Ethics

The Company has a Code of Conduct and Business Ethics which is applicable to all of the Company s officers, directors and employees. The Code of Ethics is available on our website (www.elccorp.com) under the heading Investors & Media and subheading Corporate Governance. We intend to post amendments to or waivers from the Code of Ethics which are applicable to the Company s directors, principal executive officer and principal financial officer at this location on our website.

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EXECUTIVE OFFICERS

The table below identifies our executive officers who are not identified in the table under Nominees For Director.

Name	Age	Position Held with the Company
Jeffrey R. Mistarz	48	Executive Vice President, Chief Financial Officer, Treasurer and Assistant Secretary
Leonard Pisano	43	Chief Operating Officer, Electric City Corp. and President, Maximum Performance Group, Inc.

Jeffrey R. Mistarz has been our chief financial officer since January 2000, our treasurer since October 2000, an executive vice president since November 2002 and our assistant secretary since February 2003. From January 1994 until joining us, Mr. Mistarz served as chief financial officer for Nucon Corporation, a privately held manufacturer of material handling products and systems, responsible for all areas of finance and accounting, managing capital and stockholder relations. Prior to joining Nucon, Mr. Mistarz was with First Chicago Corporation (now JPMorgan Chase & Co.) for 12 years where he held several positions in corporate lending, investment banking and credit strategy.

Leonard Pisano has been our chief operating officer since May 2005 when we acquired Maximum Performance Group, Inc, where he served as its president since February 2003. In addition to acting as our chief operating officer Mr. Pisano continues to serve as the president of Maximum Performance Group, Inc. Mr. Pisano founded Maximum Energy Services in early 2001 and served as it President until it merged with Pentech Solutions to form Maximum Performance Group in February 2003. During his career Mr. Pisano has held various senior management positions at companies within the energy services sector including Parke Industries and SRS, a division of Carolina Power and Light. Prior to entering the energy services sector Mr. Pisano spent ten years in facilities management at New York University, leaving NYU as Director of Facilities in 1996.

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SECURITY OWNERSHIP OF PRINCIPAL STOCKHOLDERS AND MANAGEMENT

The following tables list certain information, as of April 21, 2006, regarding the beneficial ownership of our outstanding Common Stock by (1) each of our directors and named executive officers, (2) the persons known to us to beneficially own greater than 5% of each class of our voting securities and (3) our directors and executive officers, as a group. Beneficial ownership is determined in accordance with the rules of the SEC. Except as otherwise noted, (1) the persons or entities named have sole voting and investment power with respect to all shares shown as beneficially owned by them and (2) the address of each person listed in the following table (unless otherwise noted) is c/o Electric City Corp., 1280 Landmeier Road, Elk Grove Village, Illinois 60007-2410.

Common Stock

Name	**Common Shares Directly Held**	**Common Shares Issuable Upon Conversion of Preferred Stock *(1)***	**Common Shares Issuable Upon Exercise of Warrants**	**Common Shares Issuable Upon Exercise of Options *(2)***	**Total**	**%**
Directors, Executive Officers and 5% Holders						
David Asplund	261,069*(3)*	348,900	72,773*(3)*	125,001	807,743	1.558%
Gregory Barnum				25,000	25,000	*
John Bukovski				100,001	100,001	*
William Carey				25,000	25,000	*
Cinergy Ventures II *(4)*	863,784	3,514,000	684,375	50,000*(5)*	5,112,159	9.204%
Columbia Wanger Asset Management, L.P. *(6)*	3,000,000				3,000,000	5.848%
DYDX Consulting LLC *(7)*	2,491,954*(8)*			947,546*(9)*	3,439,500	6.583%
Richard P. Kiphart *(10)*	563,594	8,771,800	1,127,928	25,000	10,488,322	17.132%
Nikolas Konstant	2,491,954*(8)*			947,546*(9)*	3,439,500	6.583%
Joseph C. Marino	5,112,581*(11)*			2,150,000*(12)*	7,262,581	13.588%
Jeffrey R. Mistarz	14,200			600,000	614,200	1.183%
CIT Capital Securities, Inc. *(13)*			3,314,830		3,314,830	6.070%
Newcourt Capital USA, Inc. *(13)*			4,064,830*(14)*		4,064,830	7.342%
Daniel R. Parke	316,235			25,000	341,235	*
Gerald A. Pientka *(15)*	22,000			191,667	213,667	*
Pino Manufacturing, LLC *(11)*	4,671,852			1,700,000	6,371,852	12.023%
Leonard Pisano	610,507			208,334	818,841	1.590%
Security Benefit Group (16)	6,079,000		1,750,000		7,829,000	14.759%

Michael S. Stelter	1,034,912			66,667	1,101,579	2.145%
David W. Valentine		143,600		91,667	235,267	*
All directors and executive officers as a group (11 persons)**	2,822,517	9,264,300	1,200,701	1,483,337	14,770,855	23.355%

* Denotes beneficial ownership of less than 1%.

** Eliminates duplication

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Series E Convertible Preferred Stock *(17)*

Name	Series E Shares Directly Held	% of Class
Directors, Executive Officers and 5% Holders		
David Asplund	3,489	1.500%
Augustine Fund, L.P. *(18)*	16,039	6.895%
Gregory Barnum		
John Bukovski		
William Carey		
Cinergy Ventures II *(4)*	35,140	15.107%
Robert L. Gipson *(19)*	18,853	8.105%
Richard P. Kiphart *(10)*	87,718	37.710%
Leaf Mountain Company, LLC *(20)*	19,861	8.538%
Jeffrey R. Mistarz		
Nikolaos D. Monoyios *(21)*	18,853	8.105%
Daniel Parke		
Gerald A. Pientka *(15)*		
Leonard Pisano		
SF Capital Partners Ltd. *(22)*	22,046	9.478%
Michael S. Stelter		
David W. Valentine	1,436	*
All directors and executive officers as a group (11persons)**	92,643	39.827%

* Denotes beneficial ownership of less than 1%.

** Eliminates duplication

(1) Represents shares of Common Stock issuable upon conversion of the Series E Convertible Preferred Stock.

(2) Represents options to purchase Common Stock exercisable within 60 days.

(3) Includes Common Stock and warrants to purchase Common Stock held by Delano Group Securities, LLC, of which Mr. Asplund is the principal owner.

(4) Cinergy Technologies, Inc. is a wholly-owned subsidiary of Cinergy Corp. and is also the sole member of Cinergy Ventures II, LLC. The business address of Cinergy Ventures II, LLC is 139 East Fourth Street, Cincinnati, Ohio 45202.

(5) Reflects stock options awarded pursuant to the Directors Stock Option Program to former directors of the Company who were employees of Cinergy Ventures II, LLC, The policies of Cinergy Ventures II provide that director compensation be paid to the

Cinergy Ventures II rather than to the individual.

(6) The business address of Columbia Wanger Asset Management, L.P. is 227 West Monroe, Suite 3000, Chicago, Illinois 60606

(7) The business address of DYDX Consulting, LLC (DYDX) is 221 N. LaSalle Street, Suite 3900, Chicago, Illinois 60601.

(8) Includes 2,491,954 shares of Common Stock held of record by DYDX. Mr. Konstant holds a 100% membership interest in DYDX and, in such capacity, has sole voting and investment power with respect to the shares of Common Stock held by DYDX and, therefore, is deemed to be the beneficial owner of these shares.

(9)

Includes options to acquire 947,546 shares of Common Stock at $1.10 per share held by DYDX.

(10) The business address of Mr. Kiphart is c/o William Blair & Company, LLC, 222 W. Adams Street, Chicago, Illinois 60606.

(11) Includes 4,671,852 shares of Common Stock held of record by Pino Manufacturing, LLC (Pino). Mr. Marino holds a 100% membership interest in Pino and, in such capacity, has sole voting and investment power with respect to the shares of Common Stock held by Pino and, therefore, is deemed to be the beneficial owner of these shares. The business address for Pino is 49 Marguerite Dr., Rancho Palos Verdes, CA 90275

(12) Includes options to acquire

1,700,000 shares of Common Stock at $1.10 per share held by Pino. In addition, Mr. Marino holds options to acquire 450,000 shares of Common Stock at $3.50 per share, which he received as our Chairman prior to his resignation in December 2000.

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(13) CIT Capital Securities, Inc. (formerly named Newcourt Capital Securities, Inc.) is a wholly owned subsidiary of Newcourt Capital USA, Inc. Accordingly, Newcourt Capital USA is deemed to be the beneficial owner of shares held by CIT Capital Securities. The business address of Newcourt Capital USA, Inc. is 1211 Avenue of the Americas, 22nd Floor, New York, New York 10036.

(14) Includes warrants to acquire 3,314,830 shares of Common Stock at an initial exercise price of $0.90 per share held by CIT Capital Securities, Inc.

(15) Mr. Gerald Pientka, who is

one of our directors, is also a member of Leaf Mountain Company, LLC, a holder of our Series E Convertible Preferred Stock.

(16) The business address for Security Benefit is One Security Benefit Place, Topeka, Kansas 66636-0001.

(17) The Series E Convertible Preferred Stock has the right to elect up to four directors depending on the number of shares of Series E Convertible Preferred Stock outstanding at any time (as adjusted for stock splits, stock combinations and the like) as follows:

for so long as at least 90,000 shares of Series E Convertible Preferred Stock are outstanding, holders of Series E Convertible Preferred Stock, voting as a single class, will be entitled to elect four directors;

for so long as at least 65,000 but less than 90,000 shares of Series E Convertible Preferred Stock are outstanding, holders of Series E Convertible Preferred Stock, voting as a single class, will be entitled to elect three directors;

for so long as at least 45,000 but less than 65,000 shares of Series E Convertible Preferred Stock are outstanding, the holders of Series E Convertible Preferred Stock, voting as a single class, will be entitled to elect two directors; and

for so long as at least 20,000 but less than 45,000 shares of Series E Convertible Preferred Stock are outstanding, the holders of Series E Convertible Preferred Stock, voting as a single class, will be entitled to elect one director.

Except for the election of directors or as otherwise provided by law, the Series E Convertible Preferred Stock is entitled to vote with the holders of our Common Stock on an as-converted basis on all matters on which our holders of Common Stock are entitled to vote. However, if less than 20,000 shares of Series E Convertible Preferred Stock are outstanding, unless otherwise provided by law, each holder of record of Series E Convertible Preferred Stock has the right to vote on an as-converted basis together with the holders of Common Stock on all matters on which holders of Common Stock are entitled to vote, including the election of directors.

Our Board of Directors has fixed by resolution the number of directors at 12. As of April 21, 2006, the holders of our Series E Convertible Preferred Stock had appointed one of the four directors they are entitled to appoint. At our Annual Meeting of Stockholders held on May 4, 2005, our six director nominees were elected by a majority of the votes cast. There are currently three vacancies on our Board of Directors, of which all three are reserved for appointment by the holders of our Series E Convertible Preferred Stock.

Holders of Series E Convertible Preferred Stock also have the following approval rights with respect to certain actions of the Company:

For so long as any shares of Series E Convertible Preferred Stock are outstanding we cannot, without approval of at least 75% of the shares of Series E Convertible Preferred Stock then outstanding:

- enter into any agreement that would restrict our ability to perform under the Series E Securities Redemption and Exchange Agreement;

- amend our Certificate of Incorporation or bylaws in any way that could adversely affect, alter or change the rights, powers or preferences of the Series E Convertible Preferred Stock;

- engage in any transaction that would impair or reduce the rights, powers or preferences of the Series E Convertible Preferred Stock as a class;

- sell control of the Company or sell all or substantially all of the assets of the Company or merge with or into another company, or liquidate the Company (provided that if less than 45,000 shares of the Series E Convertible Preferred Stock are then outstanding and the then holders of Series E Convertible Preferred Stock refuse to consent to such a transaction, we may at our option, in connection with consummating such a transaction, redeem all, but not less than all, of such Series E Convertible Preferred Stock at a redemption price per share equal to the amount the Series E Convertible Preferred Stock would receive upon a liquidation); or

- change the authorized number of directors of our Board of Directors.

For so long as at least 90,000 shares of Series E Convertible Preferred Stock are outstanding we cannot, without the approval of at least 66-2/3% of the shares of Series E Convertible Preferred Stock then outstanding:

- authorize or issue any capital stock with rights senior to or equal to the Series E Convertible Preferred Stock or securities convertible or exchangeable into such capital stock;
- amend or alter any outstanding options, rights or warrants in a manner that reduces or that has the effect of reducing the per share exercise price for any outstanding options, rights or warrants;
- authorize or issue any debt securities of the Company or any of its subsidiaries, other than debt under the existing revolving lines of credit as of March 19, 2004 or the replacement thereof on substantially similar terms, except that we may issue additional debt up to $1,000,000 in the aggregate in the ordinary course of business and may incur trade payables in the ordinary course of business;
- purchase, redeem, or otherwise acquire any of the Company s capital stock, other than the redemption of the Series E Convertible Preferred Stock;
- enter into an acquisition, sale, merger, joint venture, consolidation or reorganization involving the Company or any of its subsidiaries;
- sell or lease assets of the Company or any of its subsidiaries, except in the ordinary course of business;
- declare or pay any cash dividends or make any distributions on any of our capital stock, other than on the Series E Convertible Preferred Stock;
- authorize the payment of, or pay to any individual employee of the Company, cash compensation in excess of $500,000 per annum; or
- enter into any transaction (or series of transactions), including loans, with any employee, officer or director of the Company or to or with his, her or its affiliates or family members (other than with respect to payment of compensation to actual full-time employees in the ordinary course of business) involving $50,000 or more per year individually or $250,000 or more per year in the aggregate.

For so long as at least 130,000 shares of Series E Convertible Preferred Stock are outstanding we cannot, without the approval of the holders representing 66-2/3% of the shares of Series E Convertible Preferred Stock then outstanding:

- terminate or newly appoint the chief executive officer or president of the Company;
- approve any annual capital expense budget if such budget provides for annual capital expenditures by the Company and its subsidiaries in excess of $1,000,000 in the aggregate in any year; or
- approve the incurrence of any single capital expenditure (or series of related capital expenditures) in excess of $500,000.

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(18) The business address of Augustine Fund, L.P. is 141 West Jackson Blvd., Suite 2182, Chicago, Illinois 60604.

(19) The business address for Mr. Gipson is 61 Broadway, New York, NY 10006

(20) The business address of Leaf Mountain Company, LLC is 190 South LaSalle Street, Suite 1700, Chicago, IL 60603.

(21) The business address for Mr. Monoyios is 6 Stewart Drive, Short Hills, NJ 07078

(22) SF Capital Partners, Ltd. is a British Virgin Island company. Staro Asset Management, L.L.C., a Wisconsin limited liability company, acts as investment manager and has sole power to direct the management of SF Capital Partners. Through Staro Asset Management, Mr. Michael A. Roth and Brian J. Stark possess sole voting and dispositive power over all shares owned by SF Capital Partners. The business address for Staro Asset Management, LLC is 3600 South Lake Drive, St. Francis, WI 53235.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16 of the Securities Exchange Act of 1934 requires our directors and officers (as defined in Section 16) and persons who beneficially own greater than 10% of a registered class of our equity securities to file reports of ownership and changes in ownership with the Securities and Exchange Commission. The required reports consist of initial statements on Form 3, statements of changes on Form 4 and annual statements on Form 5. Directors, Officers and greater than 10% stockholders are required by Securities and Exchange Commission rules to furnish the Company with copies of all Section 16(a) reports filed. Based solely on our review of the reports we have received and on written representations from our officers who are reporting persons, we believe that during 2005 all Section 16 filing requirements applicable to our directors, officers and 10% beneficial owners were complied with by these persons.

Certain Relationships And Related Transactions

Effective August 31, 2004, the Company entered into a consulting agreement with Delano Group Securities LLC (Delano), a company formerly owned and controlled by Mr. David Asplund, at the time one of the Company s directors. Under the terms of the agreement, Delano was to act as the Company s financial advisor with respect to matters including capital formation and mergers and acquisitions. For its services the Company paid Delano an initial one-time retainer of $10,000, a warrant to purchase 30,000 shares of common stock at $1.03 per share and ongoing retainer payments of $7,500 per month for the duration of the engagement. In addition, Delano was to receive a commission of 5% on any capital raised through its direct efforts and a success fee for any merger or acquisition transaction facilitated by Delano. The success fee, which was payable in cash or stock at the Company s option, was to be equal to 5% of the first $5 million of transaction consideration, plus 2.5% of the next $5 million in transaction consideration and 1.5% of any transaction consideration in excess of $10 million, but the success fees were not to exceed $700,000 in total (except with respect to one specific transaction then under consideration, as to which such fees were capped at $2 million in total). The agreement was terminated effective June 30, 2005. During the term of the agreement Delano received monthly retainers totaling $60,000, $82,176 and 125,485 shares of common stock for its assistance in the acquisition of Maximum Performance Group, Inc., and $16,250 and 50,000 shares of common stock for its assistance with the May 2005 PIPE transaction in which we raised $5,625,000 through the issuance of equity securities. During 2005 Delano was also paid commissions of $23,252 on funds raised during 2004 from the exercise of warrants held by investors brought to the Company by Delano. Before entering into the consulting agreement with Delano the Board reviewed quotes from other investment banks and determined that the Delano agreement was fair and as favorable to the Company as if negotiated with an unaffiliated third party.

During January 2006, the Company entered into a consulting agreement with Parke Industries to provide sales and marketing consulting services. Parke Industries is a company owned by Daniel Parke, one of the Company s directors. Pursuant to the consulting agreement the Company has agreed to pay Parke Industries $10,000 per month and to reimburse it for any expenses incurred as a result of its work. The initial term of the contract was for three months, but in March 2006, the Company s Board agreed to extend the contact for an additional month.

In February 2006, the Company entered into a Sales Representative agreement with Parke Industries pursuant to which it agreed to pay Parke Industries a commission of 10% on any sales that the Company closes as a direct

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result of Parke s efforts. Parke Industries is a company owned by Daniel Parke, one of the Company s directors. The contract was reviewed and approved by a majority of disinterested members of the Board of Directors.

EXECUTIVE COMPENSATION

Summary Compensation Table

The following table summarizes the total compensation paid or awarded to each of our named executive officers whose total compensation exceeded $100,000 during the fiscal year ended December 31, 2005 and for each of our fiscal years ended December 31, 2004 and 2003. No bonuses were earned during any of the fiscal years reported on the following table.

		Annual Compensation			Long Term Compensation Securities	All Other
Name and Principal Position	**Year Ended**	**Salary** *(1)*	**Bonus**	**Other Annual Compensation**	**Underlying Options (#)**	**Compensation** *(2)*
John P. Mitola	12/31/05	$246,875		$ 6,600*(4)*		$ 8,690
our former chief executive officer(3)	12/31/04	$247,396		$ 6,600*(4)*		$ 8,294
	12/31/03	$233,844		$ 6,660*(4)*	750,000	$ 3,552
Leonard Pisano (5)	12/31/05	$151,322		$ 49,773(6)	475,000	
our chief operating officer	12/31/04					
	12/31/03					
Jeffrey R. Mistarz	12/31/05	$207,375				$ 6,238
our chief financial officer and treasurer	12/31/04	$207,812				$ 6,084
	12/31/03	$159,070			400,000	$ 8,312
Denis Enberg	12/31/05	$207,375				
our former executive vice president	12/31/04	$193,594			50,000	
of engineering	12/31/03	$160,417				$ 759
Eugene Borucki (7)	12/31/05	$148,125			100,000	
the former President of	12/31/04	$144,375			10,000	
Controlled Energy	12/31/03	$128,333				$ 759

(1) Certain employees of the Company, including Messrs. Mitola, Pisano, Mistarz, Enberg and Borucki voluntarily reduced their salaries for all

of 2003 and portions of 2004 and 2005.

(2) Amounts of All Other Compensation are the amounts paid for long-term disability insurance for the Named Officers and the cost of life insurance for Messrs. Mitola and Mistarz.

(3) Mr. Mitola resigned as our chief executive office effective January 22, 2006.

(4) This represents a monthly auto allowance of $550 for Mr. Mitola.

(5) Mr. Pisano became our chief operating officer in May 2005 after the acquisition of Maximum Performance Group, Inc. where he served as president.

(6) This represents a monthly auto allowance of $500 and the payment of $45,773 of deferred salary.

(7) Mr. Borucki is not an executive officer of the Company but is included for purposes of compensation disclosure.

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2005 Option Grants

The following table sets forth information regarding stock option grants made to each of the above named executive and principal officers during the fiscal year ended December 31, 2005.

Name	Number of Shares Underlying Options Granted (#)	Percent of Total Options Granted to Employees in Period	Exercise Price ($/Share)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term 5%	10%
John P. Mitola						
Leonard Pisano	475,000	45.3%	$ 1.00	5/3/2015	$ 298,725	$ 757,028
Jeffrey R. Mistarz						
Denis Enberg						
Eugene Borucki	100,000	9.5%	$ 1.23	6/2/2015	$ 77,354	$ 196,030

Option Values

The following table sets forth information regarding the number and value of unexercised options held by each of the above named executive and principal officers as of December 31, 2005. None of our named executive or principal officers hold any stock appreciation rights and none of them exercised any options during the fiscal year ended December 31, 2005.

	Number of Shares Underlying Unexercised Options at December 31, 2005 (#)		Value of Unexercised In-the-Money Options at December 31, 2005 ($)	
Name	Exercisable	Unexercisable	Exercisable	Unexercisable
John P. Mitola	1,750,000			
Leonard Pisano	75,000	400,000		
Jeffrey R. Mistarz	600,000			
Denis Enberg	158,334	91,666		
Eugene Borucki	171,668	138,332		

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Securities Under Equity Compensation Plans

The following information reflects certain information about our equity compensation plans as of December 31, 2005:

Plan Category	Equity Compensation Plan Information (a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders *(1)*	2,549,500	$ 1.11	25,015
Equity compensation plans not approved by security holders *(2)(3)*	9,450,515	$ 3.63	
Total	12,000,015	$ 3.10	25,015

(1) The 2001 Employee Stock Incentive Plan (Plan) was approved by the Company s stockholders at the 2001 Annual Meeting of Stockholders. The Plan called for 800,000 shares of the Company s Common Stock to be reserved for issuance upon approval of the Plan by the Company stockholders and additional reserves of 500,000 shares of the Company s Common Stock on each January 1, beginning January 1, 2002.

(2) Prior to the adoption of the 2001 Employee Stock Incentive Plan, the Company had granted to certain of its employees stock options on a discretionary basis. These grants were not made pursuant to any formal plan. Grants made to employees pursuant to this method were discontinued following adoption of the Plan.

(3) The Company grants stock options to its non-employee directors pursuant to a Directors Stock Option Plan (See Compensation of Directors), which grants are included in this category.

Stock Options and Incentive Compensation

During the Company s annual meeting of stockholders held on August 30, 2001, our stockholders approved the adoption of the 2001 Stock Incentive Plan (the Plan), which provides that up to 800,000 shares of the Company s Common Stock, par value $0.0001, may be issued under the Plan to certain employees of the Company or any of its subsidiaries and to consultants and directors who are not employees. In addition, the Plan provides for an additional number of shares of Common Stock to be reserved for issuance under the Plan on January 1 of each succeeding year, beginning January 1, 2002, in an amount equal to the lesser of (i) 5% of the number of outstanding shares of Common Stock, or (ii) 500,000 shares. The awards to be granted under the Plan may be incentive stock options eligible for favored treatment under Section 422 of the Internal Revenue code of 1986, as amended from time to time, or non-qualified options that are not eligible for such treatment, or stock of the Company, which may be subject to contingencies or restrictions, as well as grants of stock appreciation rights or grants of shares of Common Stock. Approximately 31 employees and officers of the Company and its subsidiary are currently eligible to participate in the Plan.

As of December 31, 2005, there were 2,800,000 shares of Common Stock reserved under the Plan. The Company granted options to purchase 847,500 under the Plan during 2005, and options to purchase 2,549,500 shares were outstanding under the Plan as of December 31, 2005. Only the directors options described under Compensation of Directors were granted outside of the Plan during 2004 or 2005. During 2005 the Company issued 225,485 shares under the Plan to Mr. Asplund and Mr. Valentine, both directors who acted as consultants to the Company in raising capital and assisting with the acquisition of Maximum Performance Group, Inc.

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Employment Contracts, Termination of Employment and Change-in-Control Arrangements

John Mitola

Effective January 1, 2003, we entered into an employment agreement with John Mitola for a three-year period ending on December 31, 2005. This agreement, which was structured to place more emphasis on achieving important corporate milestones, reduced Mr. Mitola s base salary to $250,000 per year, but provided for a discretionary bonus of up to one hundred percent of his annual salary payable if he met or exceeded certain annual goals as established by the Board of Directors, and a guaranteed bonus of $250,000 upon the achievement of two consecutive calendar quarters of positive net income by the Company (such net income to be that as reflected in the Company s quarterly reports filed with the Securities and Exchange Commission). The agreement also provided for a monthly automobile allowance of $550.00 and the reimbursement of Mr. Mitola s business-related expenses.

As part of the employment agreement, we granted to Mr. Mitola an option to purchase 750,000 shares of our Common Stock at a price per share of $0.845, which is equal to the average closing price of the Company s Common Stock as measured over the thirty (30) trading day period prior to the effective date of the contract. The option granted vested in amounts of 250,000 shares on each December 31st of 2003, 2004 and 2005, except on a change of control in which case all the options would have immediately vest. Except as specifically set forth in the employment agreement, such options are governed by the Company s 2001 Stock Incentive Plan.

The employment agreement imposed on Mr. Mitola non-competition, non-solicitation and confidentiality obligations.

Mr. Mitola resigned from the Company in January 2006.

David R. Asplund

Effective January 23, 2006 we entered employment contract with David Asplund for a three year period ending January 22, 2009 to serve as the Company s Chief Executive Officer. The contract provides for a base annual salary of $285,000 and eligibility for up to $65,000 of bonus compensation each year, based on the Company s performance. For the first year, the bonus will be based on consolidated gross revenue, with $15,000 payable if gross revenue exceeds $10 million, an additional $15,000 payable if gross revenue exceeds $12.5 million, an additional $15,000 payable if gross revenue exceeds $16 million and an additional $20,000 payable if gross revenue exceeds $18 million. The bonus formula for the second and third contract years has not been determined but is to be based on our consolidated net income for such years.

In addition to base salary and bonus, we have agreed to grant to Mr. Asplund options to purchase up to 1.5 million shares for each of the three contract years, with such options vesting in arrears at the end of each year, except on a change of control in which case all the options will immediately vest. The option price for the first 1.5 million shares is $0.62, which was the 30 day average closing price of our common stock, determined on Friday, January 20, 2006, which was the last business day prior to the day Mr. Asplund began serving as CEO. The option price for each of the subsequent grants will be based on the market price on January 23, 2007 and January 23, 2008, respectively, using the 30 day average closing price of our common stock, determined on each such date. Options for 500,000 shares issuable under the first year grant were granted pursuant to our 2001 Incentive Stock Plan. The remaining 4 million options are granted subject to obtaining shareholder approval to an amendment to the Incentive Stock Plan at the 2006 annual meeting of shareholders to increase the number of shares available under the Plan by at least 4 million. If our stockholders do not approve this amendment to the Incentive Stock Plan, for 30 days thereafter Mr. Asplund shall have the option of terminating his contract and resigning as CEO and receiving as a lump sum, an amount equal to his base salary from the date of such termination through January 22, 2007 plus $65,000, plus any accrued unused vacation as of the date of termination, and such amount shall be paid to Mr. Asplund on the date of our next regular payroll. In addition, upon electing to terminate his contract in such circumstances, the 500,000 options granted under the existing Plans shall immediately vest and will be exercisable for a period of 90 days.

The employment agreement imposes on Mr. Asplund non-competition, non-solicitation and confidentiality obligations.

Leonard Pisano

Effective May 3, 2005 our subsidiary, Maximum Performance Group, entered into an employment agreement with Leonard Pisano to serve as its president of our subsidiary for a three-year period ending May 2, 2008. We also appointed him chief operating officer of Electric City Corp. The employment agreement provides for a base salary of $225,000 plus a monthly auto allowance of $500. In addition, Mr. Pisano is eligible to receive a $50,000 bonus upon the Company s achievement of two consecutive quarters of positive EBITDA and to participate in an annual bonus plan with certain other management employees as determined by the Board of Directors. The employment contract also provides that Mr. Pisano is to be granted options to purchase 475,000 shares of our common stock at $1.00 per share. These options vest 75,000 on the effective date of the agreement, 133,334 shares on the first anniversary of the agreement and 133,333 on second and third anniversaries of the agreement, respectively, except on a change of control in which case all the options will immediately vest.

The employment agreement imposes on Mr. Pisano non-competition, non-solicitation and confidentiality obligations.

Jeffrey Mistarz

Effective January 1, 2003, we entered into an employment agreement with Mr. Mistarz for a three-year period ending on December 31, 2005. This agreement provided for an annual base salary of $175,000 through December 31, 2003, which increased to $210,000 effective January 1, 2004. In addition, Mr. Mistarz was eligible to participate in an annual bonus plan with certain other management employees. The agreement provided Mr. Mistarz with options to purchase 400,000 shares of our Common Stock at a price of $1.00 per share, which options vested 133,334 shares on December 31, 2003 and 133,333 shares each on December 31, 2004 and 2005. Except as specifically set forth in the employment agreement, such options are governed by the Company s 2001 Stock Incentive Plan.

The employment agreement imposed on Mr. Mistarz non-competition, non-solicitation and confidentiality obligations.

COMPENSATION COMMITTEE REPORT

The Compensation Committee of the Company s Board of Directors (the Committee) has the authority to set the compensation of the Company s Chief Executive Officer and all executive officers and makes the following report for the year 2005. The Committee has the responsibility to review the design, administration and effectiveness of all programs and policies concerning executive compensation. The Committee administers the Company s 2001 Stock Incentive Plan. In addition, the Committee has responsibility for the review and approval of the Management Incentive Program(s) to be in effect for the Chief Executive Officer, executive officers and key employees each fiscal year. The Committee is comprised of three independent, non-employee directors who had no interlocking relationships as defined by the Securities and Exchange Commission.

General Compensation Philosophy. The Company operates in the competitive and rapidly changing power technology industry. The Committee strives to maintain compensation programs that allow the Company to respond to the competitive pressures within this industry. The Committee s compensation philosophy is to offer compensation opportunities that are linked to the Company s business objectives and performance, individual performance and contributions to the Company s success, and enhancements to Stockholder value. These compensation opportunities are intended to be competitive within this industry and enable the Company to attract, retain and motivate the management talent necessary to achieve the Company s overall business objectives and ensure the Company s long-term growth.

Compensation Components. It is the Committee s objective to have a substantial portion of each executive officer s compensation opportunity conditioned upon the Company s performance (at risk), as well as his or her contribution to the Company meeting its objectives. The Committee has attempted to design a total compensation and incentive structure to motivate and reward success, balancing short and long-term goals. The Company s executive compensation program consists of three major components: (i) base salary; (ii) an annual management incentive bonus; and (iii) long-term incentives. The second and third elements constitute the at risk portion of the Company s overall compensation program.

Base Salary. The Committee periodically reviews each executive officer s base salary. In setting the base salaries of executive officers, the Committee takes into consideration many factors, including the officer s individual performance, the Company s performance in achieving its business goals, and the salary levels for individuals with comparable skills and experience for which the Company competes for management talent. The Committee exercises its judgment based upon the above criteria and does not apply a specific formula or assign a weight to each factor considered. The relative weight given to each factor varies with each individual in the sole discretion of the Committee.

Annual Management Incentive Bonus. All executive officers are eligible to participate in the Company s management incentive bonus program. At the beginning of each year, the Committee establishes objectives for the management incentive bonus program drawn from the fiscal year business plan approved by the Board of Directors. Additionally, at the beginning of each year, the Committee establishes bonus award targets for the executive officers. The bonus plan has a threshold level of performance that the Company must achieve before any bonuses will be awarded. The bonus amounts payable to each executive officer are then determined by considering the Company s performance and individual s performance. Due to the Board s desire to preserve cash, this aspect of the overall executive compensation program has been de-emphasized in recent years in favor of a larger equity component.

Long-Term Incentive Program. The Company s long-term incentive program consists of a stock option plan. The Committee views the granting of stock options as a significant method of aligning management s long-term interests with those of the stockholders, which bring into balance short and long-term compensation with the Company s goals, fostering the retention of key executive and management personnel, and stimulating the achievement of superior performance over time. Awards to executives are based upon criteria which include an individual s current position with the Company, total compensation, unvested stock options, the executive s performance in the recent period, expected contributions to the achievement of the Company s long-term performance goals, and current competitive practice. The relative weight given to each of these factors will vary from executive to executive at the Committee s discretion. After giving consideration to the criteria deemed relevant by the Committee, including prior option grants made to Company executives, a competitive analysis of the Company s option program and overall compensation programs against the programs of companies of similar size and industry, and the recommendations of the Company s management, the Committee approved the stock option grants to the executive officers listed in the Summary Compensation Table set forth in the 2005 Option Grants table. These stock options were granted at exercise prices equal to the fair market value of the stock at the effective date of the grant, become exercisable over three years and have a term of ten years.

Chief Executive Officer Compensation. At the beginning of 2006, the Committee negotiated Mr. Asplund s compensation package as part of his employment agreement. Consistent with the compensation philosophy outlined above, the Committee structured Mr. Asplund s compensation package to place a significant portion of his compensation at risk and to create incentives to improve the Company s performance, thus aligning his interests with those of the Company s stockholders. These incentives include a package of options to purchase 4.5 million shares of the Company s common stock, of which 1.5 million carry an exercise price equal

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to the average market price for the 30 days prior to his filling the role as CEO. The exercise price for each of the subsequent grants will be based on the market price on January 23, 2007 and January 23, 2008, respectively, using the 30 day average closing price of the Company s common stock, determined on each such date. In addition, the Committee provided that Mr. Asplund would be eligible for a cash bonus of up to $65,000 each year based on the Company s financial performance. During the first year of the contact this bonus will be based on consolidated revenue, but will be based on consolidate net income for the final two years of the contract.

MEMBERS OF THE COMPENSATION COMMITTEE
David W. Valentine, *Chair*
Richard P. Kiphart
Gerald A. Pientka

Compensation Committee Interlocks and Insider Participation

David W. Valentine, Richard P. Kiphart and Gerald A. Pientka serve on the Compensation Committee. None of these individuals has ever been an officer or employee of the Company or any of its subsidiaries. During 2005, no executive officer of the Company served as a director or member of the Compensation Committee (or other committee performing similar functions) of any other entity that has an executive officer who serves on the Board of Directors or Compensation Committee of the Company.

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COMMON STOCK PERFORMANCE GRAPH

The following graph compares the performance of the Company s Common Stock to that of the Dow Jones Electric Component & Equipment Index and the Russell 3000. The Company s Common Stock began trading on the American Stock Exchange on December 12, 2000.

	Cumulative Total Return *(1)*					
	12/31/00	12/31/01	12/31/02	12/31/03	12/31/04	12/31/05
Electric City Corp.	$ 100.00	$ 41.67	$ 25.67	$ 78.67	$ 41.33	$ 20.00
Dow Jones Electric Components & Equipment Index	$ 100.00	$ 70.33	$ 41.69	$ 68.09	$ 61.12	$ 63.80
Russell 3000	$ 100.00	$ 87.38	$ 67.45	$ 86.82	$ 95.57	$ 99.66

(1) Assumes an investment of $100 in the Company s Common Stock and each index on December 31, 2000, with reinvestment of dividends.

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INDEPENDENT PUBLIC ACCOUNTANTS

The firm of BDO Seidman, LLP (BDO) audited our financial statements for the fiscal year ended December 31, 2005, and the Board of Directors, at the recommendation of the Audit Committee, intends to continue the services of this firm for the fiscal year ending December 31, 2006. It is expected that representatives of BDO will be present at the Stockholders meeting and will be available to respond to questions. Representatives of BDO will also be given an opportunity to make a statement if they desire to do so.

Principal Accountant Fees and Services

The following table summarizes the total fees paid to our principal accounting firm, BDO for professional services provided during the twelve-month periods ended December 31, 2005 and December 31, 2004:

	2005	2004
Audit fees *(1)*	$ 135,226	$ 112,046
Audit-related fees *(2)*		
Tax fees *(3)*	$ 6,500	$ 10,690
All other fees *(4)*		$ 700
Total	$ 141,726	$ 123,436

(1) Audit fees consist of fees for professional services rendered for the audit of our consolidated financial statements and review of financial statements included in our quarterly reports and services normally provided by the independent auditor in connection with statutory and regulatory filings or engagements.

(2) Audit-related fees are fees billed for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements, but not included in item 1 above.

(3) Tax services fees consist of professional fees billed for products and services rendered by BDO for tax compliance, tax advice and tax planning.

(4) All other fees consist of fees billed by BDO for services other than those listed in categories 1 thru 3 above.

It is the policy of our Audit Committee to pre-approve all audit and non-audit services provided by BDO. Our Audit Committee considered whether the use of BDO s services other than for the annual audit and quarterly reviews in any way impairs their independence and has concluded that it does not. No services were performed by BDO prior to receiving approval from the Audit Committee.

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AUDIT COMMITTEE REPORT

The Audit Committee operates under a written charter adopted by the Board of Directors, which is reassessed periodically for adequacy by the Audit Committee. The directors who serve on the Audit Committee have no financial or personal ties to the Company (other than director compensation and equity ownership as described in this proxy statement) and are all independent for purposes of the Securities and Exchange Commission s regulations and the American Stock Exchange listing standards. The Board of Directors has determined that none of the Audit Committee members has a relationship with the Company that may interfere with the director s independence from the Company and its management. Copies of the Audit Committee s charter a can be viewed on the Company s website at www.elccorp.com under the heading Investor & Media and subheading Corporate Governance.

The Audit Committee oversees our financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the financial statements and their reporting process, including the systems of internal controls. In fulfilling their oversight responsibilities, the Committee has reviewed and discussed with the independent auditors matters such as the quality (in addition to acceptability), clarity, consistency, and completeness of the Company s financial reporting, as required by Statement on Auditing Standards No. 61, Communication with Audit Committees, as amended by Statement on Auditing Standards No. 90, Audit Committee Communications.

Management is responsible for the Company s internal controls and the financial reporting process. BDO, the Company s independent auditor, is responsible for performing an independent audit of the Company s consolidated financial statements in accordance with generally accepted auditing standards. The Audit Committee s responsibility is to monitor and oversee these processes.

The Audit Committee received from BDO the written disclosures and the letter required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees), and has discussed with BDO the issue of its independence from the Company.

Based on the Audit Committee s review of the audited financial statements and its discussions with management and BDO noted above, the Audit Committee recommended to the Board of Directors that the audited consolidated financial statements be included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005. The Committee recommended to the Board of Directors the selection of BDO as the Company s independent auditor.

MEMBERS OF THE AUDIT COMMITTEE
John C. Bukovski, *Chair*
Gerald A. Pientka
Michael S. Stelter

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MISCELLANEOUS AND OTHER MATTERS

Stockholder List

For at least ten days prior to the meeting, a list of stockholders entitled to vote at the Annual Meeting, arranged in alphabetical order, showing the address of and number of shares registered in the name of each stockholder, will be open for examination by any stockholder, for any purpose germane to the Annual Meeting, during ordinary business hours at Electric City s principal executive offices by contacting the Corporate Secretary. The list will also be available for examination at the meeting.

Other Business

The Board of Directors is not aware of any other matters to be presented at the Annual Meeting other than those mentioned in this proxy statement and our enclosed Notice of Annual Meeting of Stockholders. If, however, any other matters properly come before the Annual Meeting, the persons named in the accompanying proxy will vote in accordance with their best judgment.

Incorporation by Reference

The Report of the Audit Committee, the Report of the Compensation Committee, and the Performance Graph do not constitute soliciting material and should not be deemed filed or incorporated by reference into any other filing by the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the Company specifically incorporates such information by reference. The Company s Annual Report on Form 10-K filed with the SEC on March 21, 2006 is incorporated herein by reference.

Financial Statements

We have enclosed a copy of our Annual Report to Stockholders for the fiscal year ended December 31, 2005, which includes our Annual Report on Form 10-K for such period that we filed with the SEC, incorporated herein by reference. Upon the written request of any person who is a stockholder as of the record date, we will provide copies of the exhibits to the Form 10-K upon payment of a reasonable fee which shall not exceed our reasonable expenses in providing the exhibits. You should direct requests for these materials to Electric City Corp., 1280 Landmeier Road, Elk Grove Village, Illinois 60007-2410, Attention: Chief Financial Officer.

BY ORDER OF THE BOARD OF DIRECTORS,
Richard P. Kiphart
Chairman of the Board of Directors
Elk Grove Village, Illinois
April 28, 2006

YOU ARE REQUESTED TO COMPLETE,
DATE, SIGN AND RETURN THE ENCLOSED PROXY PROMPTLY.

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ANNEX A
ELECTRIC CITY CORP.
2006 AMENDMENT TO 2001 STOCK INCENTIVE PLAN

WHEREAS, in March 2006, the Board of Directors of Electric City Corp. (the Company) deemed it to be advisable and in the best interests of the Company to amend the Company s 2001 Stock Incentive Plan, as amended (the Incentive Plan) to 1) increase the maximum number of shares of Common Stock of the Corporation reserved for issuance there under by an additional 6,000,000 shares of Common Stock from 3,300,000 to 9,300,000 shares, 2) increase the number of shares by which the plan will automatically increase each year, beginning on January 1, 2007, from 500,000 shares to 2,000,000 shares, and 3) increase the number of shares issuable to one participant during any one calendar year to 4,500,000; and

WHEREAS, capitalized terms used and not defined herein have the meanings set forth in the Incentive Plan.

NOW, THEREFORE, BE IT RESOLVED, that the Incentive Plan be amended as follows:

Section 3. STOCK SUBJECT TO THE PLAN.

Subject to adjustment as provided in this Section 3, the aggregate number of shares of Stock which may be delivered under this Plan shall not exceed 9,300,000 shares; provided, however, that, as of January 1 of each year, commencing with the year 2007, the maximum number of shares of Stock which may be delivered under the Plan shall automatically increase by a number equal to the lesser of (i) 5% of the total number of shares of stock then outstanding, assuming for the purpose of the conversion into Stock of all outstanding securities that are convertible by their terms (directly or indirectly) into Stock, or (ii)2,000,000 shares.

To the extent any shares of Stock covered by an Award are not delivered to a Participant or beneficiary thereof because the Award expires, is forfeited, canceled or otherwise terminated, or the shares of Stock are not delivered because the Award is settled in cash or used to satisfy the applicable tax withholding obligation, such shares shall not be deemed to have been delivered for purposes of determining the maximum number of shares of Stock available for dyle="border-top: 1px solid #000000">

December 31, 2008

Measured at fair value on a recurring basis:		
Securities available-for-sale	$72,163	$72,163
Measured at fair value on a nonrecurring basis:		
Impaired loans	$3,151	$3,151

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS 107-1 and APB 28-1). FSP FAS 107-1 and APB 28-1 amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, *Interim Financial Reporting*, to require those disclosures in summarized financial information at interim reporting periods.

This FSP is effective for the Corporation for interim periods June 30, 2009 and after. The adoption of the FSP for the quarter ending June 30, 2009 did not have a material impact on the Corporation s financial condition or results of operations.

The following information should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation s disclosures and those of other companies may not be meaningful. The methods and assumptions that follow were used to estimate the fair values of the Corporation s financial instruments at June 30, 2009 and December 31, 2008.

Cash and cash equivalents (carried at cost)

The carrying amounts reported in the balance sheet for cash and short-term instruments approximate those assets fair values.

Securities

The fair values of securities available-for-sale (carried at fair value) and held-to-maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities relationship to other benchmark quoted prices.

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Restricted investment in bank stocks (carried at cost)
The carrying amount of restricted investment in bank stocks approximates fair value, and considers the limited marketability of such securities.
Loans held for sale (carried at lower of cost or fair value)
The fair value of loans held for sale is determined, when possible, using quoted secondary-market prices. If no such quoted prices exist, the fair value of a loan is determined using quoted prices for a similar loan or loans, adjusted for the specific attributes of that loan. At June 30, 2009, the fair value of loans held for sale exceeded the cost basis, therefore, no write-down to fair value, valuation allowance or charge to earnings was recorded.
Loans (carried at cost)
Generally, for variable and adjustable rate loans that reprice frequently and with no significant change in credit risk, fair value is based on carrying value. Fair values for other loans in the portfolio are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal.
Impaired loans (generally carried at fair value)
Impaired loans are those that are accounted for under FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan, in which the Corporation has measured impairment generally based on the fair value of the loan s collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. A portion of the allowance for loan losses is allocated to impaired loans if the value of the collateral supporting such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to require increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when management believes that the uncollectability of a loan is confirmed. These loans are included as Level 3 fair values, based on the lowest level of input that is significant to the fair value measurements. The fair value consists of loan balances of $5,601,000, net of a valuation allowance of $1,946,000. Additional provision for loan losses on these impaired loans was $1,826,000 for the six-months ended June 30, 2009, of this amount $1,596,000 pertained to the second quarter.
Interest receivable and payable (carried at cost)
The carrying amount of interest receivable and interest payable approximates its fair value.
Deposit liabilities (carried at cost)
The fair values disclosed for demand deposits (e.g., noninterest and interest bearing checking, money market and savings accounts), by definition, are equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for variable rate time deposits that reprice frequently are based on carrying value. Fair values for fixed rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities of time deposits.
Short-term borrowings (carried at cost)
The carrying amounts of short-term borrowings approximate their fair values.
Long-term debt (carried at cost)
Fair values of FHLB advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices are obtained from this active market and represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

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Junior subordinated debt (carried at cost)
The fair value of junior subordinated debt is estimated using discounted cash flow analysis, based on market rates and spread characteristics currently offered on such debt with similar credit risk characteristics, terms and remaining maturity.
Off-balance sheet financial instruments (disclosed at cost)
Fair values for the Corporation s off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standing. These amounts were not considered to be material at June 30, 2009.
The estimated fair values of the Corporation s financial instruments were as follows at June 30, 2009 and December 31, 2008.

	June 30, 2009		December 31, 2008	
(dollars in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$ 25,763	$ 25,763	$ 14,875	$ 14,875
Securities, available-for-sale	158,764	158,764	72,163	72,163
Securities, held-to-maturity	2,432	1,985	2,432	2,283
Restricted investment in bank stocks	4,262	4,262	2,692	2,692
Loans held for sale	4,753	4,807	7,373	7,409
Loans	605,968	607,344	568,388	565,982
Interest receivable	3,055	3,055	2,500	2,500
Financial liabilities				
Noninterest bearing demand, NOW, money market and savings deposits	$ 290,966	$ 290,966	$ 251,769	$ 251,769
Time deposits	394,546	399,154	346,360	351,201
Short-term borrowings			18,283	18,283
Long-term debt	69,585	70,387	19,186	19,757
Junior subordinated debt	10,310	2,949	10,310	4,566
Interest payable	938	938	806	806
Off-balance sheet instruments				

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Management s discussion and analysis of the significant changes in the results of operations, capital resources and liquidity presented in the accompanying consolidated financial statements for Codorus Valley Bancorp, Inc. (Codorus Valley or the Corporation), a bank holding company, and its wholly owned subsidiary, PeoplesBank, A Codorus Valley Company (PeoplesBank), are provided below. Codorus Valley s consolidated financial condition and results of operations consist almost entirely of PeoplesBank s financial condition and results of operations. Current performance does not guarantee, and may not be indicative of, similar performance in the future.

Forward-looking statements:

Management of the Corporation has made forward-looking statements in this Form 10-Q. These forward-looking statements are subject to risks and uncertainties. Forward-looking statements include information concerning possible or assumed future results of operations of the Corporation and its subsidiaries. When words such as believes, expects, anticipates or similar expressions occur in the Form 10-Q, management is making forward-looking statements.

Note that many factors, some of which are discussed elsewhere in this report and in the documents that are incorporated by reference, could affect the future financial results of the Corporation and its subsidiaries, both individually and collectively, and could cause those results to differ materially from those expressed in the forward-looking statements contained or incorporated by reference in this Form 10-Q. These factors include:

- operating, legal and regulatory risks;
- the possibility of a prolonged economic downturn;
- political and competitive forces affecting banking, securities, asset management and credit services businesses; and
- the risk that management s analysis of these risks and forces could be incorrect and/or that the strategies developed to address them could be unsuccessful.

The Corporation undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date of this report. Readers should carefully review the risk factors described in other documents that Codorus Valley files periodically with the Securities and Exchange Commission.

Critical accounting estimates:

Disclosure of Codorus Valley s significant accounting policies is included in Note 1 to the consolidated financial statements of the 2008 Annual Report on Form 10-K for the period ended December 31, 2008. Some of these policies require management to make significant judgments, estimates and assumptions that have a material impact on the carrying value of certain assets and liabilities.

Management makes significant estimates in determining the allowance for loan losses. Management considers a variety of factors in establishing this estimate such as current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, financial and managerial strengths of borrowers, adequacy of collateral, if collateral dependent, and present value of future cash flows and other relevant factors. Estimates related to the value of collateral also have a significant impact on whether or not management continues to accrue income on delinquent loans and on the amounts at which foreclosed real estate is recorded on the balance sheet. Additional information is contained in Management s Discussion and Analysis regarding critical accounting estimates, including the provision and allowance for loan losses, located on pages 27 and 34 of this Form 10-Q.

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The Corporation records its available-for-sale securities portfolio at fair value. Fair values for these securities are determined based on methodologies in accordance with SFAS No. 157, and as clarified by several FASB staff positions. Fair values for debt securities are volatile and may be influenced by any number of factors, including market interest rates, prepayment speeds, discount rates, credit ratings and yield curves. Fair values for debt securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on the quoted prices of similar instruments or an estimate of fair value by using a range of fair value estimates in the market place as a result of the illiquid market specific to the type of security. When the fair value of a debt security is below its amortized cost, and depending on the length of time the condition exists and the extent the fair value is below amortized cost, additional analysis is performed to determine whether an other-than-temporary impairment condition exits. Available-for-sale and held-to-maturity debt securities are analyzed quarterly for possible other-than-temporarily impairment. The analysis considers whether the Corporation has the intent to sell its debt securities prior to market recovery or maturity and whether it is more likely than not that the Corporation will be required to sell its debt securities prior to market recovery or maturity. Often, information available to conduct these assessments is limited and rapidly changing; making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of the debt security may be different than previously estimated, which could have a material effect on the Corporation s results of operations and financial condition.

Management discussed the development and selection of critical accounting estimates and related Management Discussion and Analysis disclosure with the Audit Committee. There were no material changes made to the critical accounting estimates during the periods presented within this report.

Three months ended June 30, 2009,
compared to three months ended June 30, 2008

FINANCIAL HIGHLIGHTS

The Corporation earned net income available to common shareholders of $49,000 or $0.01 per share ($0.01 diluted) for the three-month period ended June 30, 2009, compared to $971,000 or $0.25 per share ($0.24 diluted), for the second quarter of 2008. The $922,000 or 95 percent decrease in net income available to common shareholders was attributable to increases in the provision for loan losses, noninterest expenses and preferred dividends, which offset increases in net interest income and noninterest income and a decrease in income taxes.

The $729,000 or 80 percent increase in the provision for loan losses was due to a decline in loan quality as a result of the long-drawn economic recession, declining real estate values and increased unemployment. A significant increase in the loan portfolio balance during the current period also contributed to the increase in the provision. The $1,278,000 or 26 percent increase in noninterest expenses was due primarily to increases in personnel expense and Federal Deposit Insurance Corporation (FDIC) insurance premiums. The $482,000 or 18 percent increase in personnel expense resulted from staff additions associated with planned business growth, particularly expansion of the banking franchise in the prior year. The $550,000 or 573 percent increase in FDIC insurance premiums was the result of an industry-wide increase in assessment rates, an increase in the volume of deposits upon which the assessment is based, and a special assessment totaling $382,000 (or $252,000 after tax). Effective June 30, 2009, the FDIC imposed a special assessment on all commercial financial institutions, based on 5 basis points of total assets less Tier 1 capital.

Net interest income for the three-month period ended June 30, 2009, was $5,692,000, an increase of $590,000 or 12 percent above the second quarter of 2008 due primarily to an increase in the average volume of earning assets, principally business loans and investment securities. The net interest margin was 3.09 percent for the second quarter of 2009, compared to 3.69 percent for the second quarter of 2008. Net interest margin is net interest income (tax equivalent basis) as a percentage of average earning assets. The $238,000 or 13 percent increase in noninterest income was due primarily to an increase in gains from a larger volume of sales of mortgages. The $501,000 decrease in income tax was the result of a decrease in pretax income and an increase in tax exempt income.

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A more detailed analysis of the factors and trends affecting corporate earnings follows.

INCOME STATEMENT ANALYSIS

Net interest income

Net interest income for the three-month period ended June 30, 2009, was $5,692,000, an increase of $590,000 or 12 percent above the second quarter of 2008 due primarily to an increase in the average volume of earning assets. The net interest margin, on a tax equivalent basis, was 3.09 percent for the second quarter of 2009, compared to 3.69 percent for the second quarter of 2008. The decrease in the net interest margin reflects: the low level of market interest rates, which has depressed yields on variable (floating) rate loans, overnight investments and investment securities; an elevated level of nonperforming assets; and excess liquidity.

For the second quarter of 2009, total interest income increased $1,086,000 or 12 percent above 2008 due primarily to an increase in the average volume of earning assets. Earning assets averaged $777 million and yielded 5.30 percent (tax equivalent basis) for the current quarter, compared to $574 million and 6.34 percent, respectively, for the second quarter of 2008. The $203 million or 35 percent increase in average earning assets was primarily the result of strong growth in the business loan and investment securities portfolios.

For the second quarter of 2009, total interest expense increased $496,000 or 13 percent above the second quarter of 2008 due to a larger volume of interest bearing liabilities. Total interest bearing liabilities averaged $706 million at an average rate of 2.43 percent for the current quarter, compared to $513 million and 2.96 percent, respectively, for the second quarter of 2008. The $193 million or 38 percent increase in average interest bearing liabilities was the result of strong growth in the average volume of time deposits and money market deposits. The increase in the average volume of long-term debt, which provided the financing for a leverage strategy described elsewhere in this report, also contributed to the increase in interest bearing liabilities. In April 2009, PeoplesBank paid off a $15 million/2% Federal Home Loan Bank of Pittsburgh advance prior to its August 2010 maturity to reduce excess liquidity and interest expense. The early payoff resulted in a $24,000 prepayment penalty that was recognized in the current period as a miscellaneous expense.

More information about net interest income is provided in the year-to-date section of this report.

Provision for loan losses

For quarter ended June 30, 2009, the provision for loan losses was $1,639,000, compared to $910,000 for the second quarter of 2008. The $729,000 or 80 percent increase was due to a decline in loan quality as a result of the long-drawn economic recession, declining real estate values and increased unemployment. A significant increase in the loan portfolio balance during the current period also contributed to the increase in the provision.

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Noninterest income

The following table presents the components of total noninterest income for the second quarter of 2009, compared to the second quarter of 2008. Total noninterest income increased $238,000 or 13 percent.

Table 1 Noninterest income

	Three months ended June 30,		Change Increase (Decrease)	
(dollars in thousands)	2009	2008	$	%
Trust and investment services fees	$ 303	$ 362	$ (59)	(16)%
Income from mutual fund, annuity and insurance sales	358	496	(138)	(28)
Service charges on deposit accounts	581	563	18	3
Income from bank owned life insurance	155	68	87	128
Other income	154	124	30	24
Gain on sales of mortgages	403	108	295	273
Gain on sales of securities	128	123	5	4
Total noninterest income	$ 2,082	$ 1,844	$ 238	13%

The discussion that follows addresses changes in selected categories of noninterest income.

Trust and investment services fees The decrease in income from trust operations was the result of depressed capital markets and the impact it had on our fees, which are generally calculated on the market price of assets under management.

Income from mutual fund, annuity and insurance sales The decrease in income from the sale of mutual funds, annuities and insurance products by Codorus Valley Financial Advisors, a subsidiary of PeoplesBank, was a result of depressed capital markets and the impact it had on the volume of sales and fees. A portion of our fees is calculated on market prices of assets under management.

Service charges on deposit accounts In spite of increases in deposit volumes and number of accounts during the current quarter, service charges increased only slightly as deposit clients exhibited conservative spending and money management behavior due to concerns about the economic recession and job security.

Income from bank owned life insurance The increase in income from bank owned life insurance (BOLI) was due to an additional investment of approximately $4 million in November 2008 and an increase in the crediting rates on existing policies that were transferred to new insurance providers.

Other income The increase in other income was due in part to an increase in income from real estate settlement services provided by SYC Settlement Services, a subsidiary of PeoplesBank.

Gain on sales of mortgages The increase in gains from the sale of mortgages was the result of an increase in the volume of sales. During the current quarter, the low level of market interest rates on mortgage products and the first time homebuyers tax credit program, influenced by the federal government to stimulate the economy, increased mortgage refinancing activity.

Gain on sales of securities During the current quarter $128,000 in gains were realized from the sale of U.S. agency mortgage-backed bonds totaling $3.3 million from the available-for-sale securities portfolio to take advantage of the low interest rate environment. Comparable gains from the sale of securities were also realized in the second quarter of 2008.

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Noninterest expense

The following table presents the components of total noninterest expense for the second quarter of 2009, compared to the second quarter of 2008. Total noninterest expense increased $1,278,000 or 26 percent.

Table 2 Noninterest expense

(dollars in thousands)	Three months ended June 30, 2009	2008	Change Increase (Decrease) $	%
Personnel	$ 3,157	$ 2,675	$ 482	18%
Occupancy of premises, net	448	397	51	13
Furniture and equipment	401	368	33	9
Postage, stationery and supplies	139	126	13	10
Professional and legal	99	109	(10)	(9)
Marketing and advertising	115	210	(95)	(45)
FDIC insurance	646	96	550	573
Debit card processing	130	120	10	8
Charitable donations	31	45	(14)	(31)
Telephone	146	36	110	306
Other	807	659	148	22
Total noninterest expense	$ 6,119	$ 4,841	$ 1,278	26%

The discussion that follows addresses changes in selected categories of noninterest expense.

Personnel The increase in personnel expense, comprised of wages/sales commissions, payroll taxes and employee benefits, resulted from staff additions associated with expansion of the banking franchise in the prior year.

Occupancy of premises, net The increase in occupancy expense, comprised of rent, depreciation, maintenance, insurance, real estate taxes and utilities, increased primarily as a result of expanding the banking franchise in the prior year.

Furniture and equipment The increase in furniture and equipment expense was primarily the result of an increase in depreciation expense from capital expenditures that supported expansion of the banking franchise and information technology initiatives.

Marketing and advertising The decrease in marketing and advertising expenses was due primarily to the timing of expenditures and to a lesser degree reductions to the marketing budget.

FDIC insurance The percent increase in Federal Deposit Insurance Corporation (FDIC) insurance premiums was the result of an industry-wide increase in assessment rates, an increase in the volume of deposits upon which the assessment is based, and a special assessment totaling $382,000. Effective June 30, 2009, the FDIC imposed a special assessment on all commercial financial institutions, based on 5 basis points of total assets less Tier 1 capital. The purpose of the special assessment was to help replenish the FDIC s Bank Insurance Fund, which is being depleted as a result of bank failures in other parts of the country.

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Telephone The increase in telephone expense reflected the one-time conversion to a new carrier during the third quarter of 2008, telecommunication enhancements and corporate growth.

Other The increase in other expense, which is comprised of many underlying expenses, increased primarily as a result of a $101,000 increase in carrying costs associated with impaired assets. Current period carrying costs increased as a result of larger portfolios of nonperforming loans and real estate acquired in satisfaction of debt.

Income taxes

The provision for income tax for the second quarter of 2009 was a $277,000 credit, or tax benefit, compared to a $224,000 expense for the same period in 2008. The decrease in income tax was the result of a decrease in pretax income and an increase in tax-exempt income. For both periods the Corporation s statutory federal income tax rate was 34 percent. The Corporation s effective federal income tax rate was negative for the second quarter of 2009 and 18 percent for the second quarter of 2008. The effective tax rate differs from the statutory tax rate due to the impact of low-income housing credits and tax-exempt income including income from bank owned life insurance. The effective tax rate for 2009 decreased primarily as a result of the decrease in pretax income.

Six months ended June 30, 2009,

compared to six months ended June 30, 2008

FINANCIAL HIGHLIGHTS

The Corporation earned net income available to common shareholders of $789,000 or $0.20 per share ($0.20 diluted) for the six-month period ended June 30, 2009, compared to $2,494,000 or $0.63 per share ($0.63 diluted), for the same period of 2008. The $1,705,000 or 68 percent decrease in net income available to common shareholders was primarily the result of increases in the provision for loan losses, noninterest expenses and preferred dividends, which offset increases in net interest income and noninterest income and a decrease in income taxes.

The $823,000 or 78 percent increase in the provision for loan losses was the result of additions to the allowance for impaired commercial real estate loans and significant growth in the loan portfolio balance. Allocations to the allowance were deemed necessary due to continued uncertainty in the economy, softness in the real estate market and an increase in the level of nonperforming loans.

The $2,289,000 or 24 percent increase in noninterest expense was due primarily to an increase in operating expenses associated with expansion of the banking franchise and an increase in Federal Deposit Insurance Corporation (FDIC) deposit insurance premiums. During 2008, the Corporation added three full service financial centers to its banking franchise bringing the total number of financial centers to 17, 15 located in Pennsylvania and 2 located in Maryland. Current period FDIC insurance premiums totaled $876,000, an increase of $724,000 or 476 percent above the six-month period ended June 30, 2008. Of the total insurance premiums, $382,000 (or $252,000 after tax) pertained to a special FDIC assessment effective June 30, 2009, which was imposed on all commercial financial institutions. The remaining increase in deposit insurance premiums was caused by an industry-wide increase in assessment rates by the FDIC and an increase in the volume of deposits upon which the assessment is based. A $242,000 non-recurring cost of restructuring employee benefit plans in the current period also contributed to the increase in noninterest expense. Restructuring the benefit plans resulted in a federal income tax benefit so that the overall transaction had an insignificant impact on net income.

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Net interest income for the six-month period ended June 30, 2009, was $10,788,000, an increase of $245,000 or 2 percent above the same period in 2008 due to a larger volume of earning assets, principally business loans and investment securities. The net interest margin was 3.04 percent for the first six months of 2009, compared to 3.88 percent for the same period in 2008. Total noninterest income was $3,905,000 for the current six-month period, an increase of $322,000 or 10 percent above 2008, as adjusted to exclude securities gains. The increase in noninterest income was attributable to an increase in gains from the sale of mortgages. The provision for income tax for the current period was a $373,000 credit (benefit), compared to a $766,000 expense for the same period in 2008. The decrease in income tax was the result of a decrease in pretax income, an increase in tax-exempt income and the recognition of a non-recurring $242,000 tax benefit associated with restructuring employee benefit plans.

Total assets were approximately $840 million on June 30, 2009, an increase of $203 million or 32 percent above June 30, 2008. Asset growth occurred primarily in the business loans and investment securities portfolios, which were funded primarily by an increase in deposits, principally money market and time deposits, and to a lesser degree, borrowing from the Federal Home Loan Bank of Pittsburgh.

Net income as a percentage of average shareholders equity (ROE) was 3.64 percent for the first six months (annualized) of 2009, compared to 10.08 percent for the same period of 2008. Net income as a percentage of average total assets (ROA) was 0.31 percent for the first six months (annualized) of 2009, compared to 0.82 percent for the same period of 2008. The decrease in both ratios for 2009 reflected the decrease in earnings. The ROE ratio was further depressed as a result of a $16.5 million capital addition described in the Shareholders Equity and Capital Adequacy section of this report. The efficiency ratio (noninterest expense as a percentage of net interest income plus noninterest income on a tax equivalent basis) was 78.8 percent for the first six months of 2009, compared to 67.5 percent for the same period of 2008. The increase in the efficiency ratio during the current period reflected the increase in operating expenses described above.

On June 30, 2009, the nonperforming assets ratio was 3.29 percent, compared to 1.84 percent for June 30, 2008. Net loan charge-offs for the current six month period totaled $428,000, compared to $492,000 for the same period in 2008. Information regarding nonperforming assets is provided in the Risk Management section of this report, including Table 5 Nonperforming Assets. Based on a recent evaluation of probable loan losses and the current loan portfolio, management believes that the allowance is adequate to support losses inherent in the loan portfolio on June 30, 2009. An analysis of the allowance is provided in Table 6 Analysis of Allowance for Loan Losses.

Throughout the current period, Codorus Valley maintained a capital level well above minimum regulatory quantitative requirements. Currently, there are three federal regulatory definitions of capital that take the form of minimum ratios. Note 7 Regulatory Matters, shows that the Corporation and PeoplesBank were well capitalized on June 30, 2009.

A more detailed analysis of the factors and trends affecting corporate earnings follows.

INCOME STATEMENT ANALYSIS

Net interest income

Net interest income for the six-month period ended June 30, 2009, was $10,788,000, an increase of $245,000 or 2 percent above the same period in 2008 due primarily to an increase in the average volume of earning assets. The net interest margin, on a tax equivalent basis, was 3.04 percent for the first six months of 2009, compared to 3.88 percent for the same period in 2008. The decrease in the net interest margin reflected: the low level of market interest rates, which has depressed yields on variable (floating) rate loans, overnight investments and investment securities; an elevated level of nonperforming assets; and excess liquidity.

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Interest income for the first six months of 2009 totaled $19,252,000, an increase of $978,000 or 5 percent above 2008 due primarily to an increase in the average volume of earning assets. Earning assets averaged $749 million and yielded 5.32 percent (tax equivalent basis) for the current period, compared to $564 million and 6.63 percent, respectively, for the first six months of 2008. The $185 million or 33 percent increase in average earning assets was primarily the result of strong growth in the business loan and investment securities portfolios. The increase in business loans reflected additions to the business banking staff and changes in the competitive landscape that benefited the Corporation. The increase in investment securities, principally U.S. agency mortgage-backed bonds and tax-exempt municipal bonds, resulted from the leverage strategy, which is discussed in the Investment Securities section of this report. The leverage strategy is expected to make a positive contribution to net interest income; however, the 2 percent tax equivalent margin spread resulting from this strategy is expected to constrain the Corporation s net interest margin.
Interest expense for the first six months of 2009 totaled $8,464,000, an increase of $733,000 or 9 percent above 2008 due primarily to an increase in the average volume of interest bearing liabilities. Total interest bearing liabilities averaged $679 million at an average rate of 2.51 percent for the current period, compared to $507 million and 3.06 percent, respectively, for the first six months of 2008. The $172 million or 34 percent increase in interest bearing liabilities was the result of increases in the average volume of time deposits, money market deposits and long-term debt. Federally insured bank deposits continue to provide a safe haven to our clients who are increasingly concerned about the economic recession, volatility in the capital markets and rising unemployment. The addition of three financial centers in 2008 and competitive pricing also contributed to the increase in deposit volumes. The increase in long-term debt during the current quarter provided the financing for a leverage strategy, which is discussed in the Long-term Debt section of this report.

Provision for loan losses

For the six-month period ended June 30, 2009, the provision for loan losses was $1,883,000, compared to $1,060,000 for same period in 2008. The $823,000 or 78 percent increase was due primarily to a decline in loan quality as a result of the long-drawn economic recession, declining real estate values and increased unemployment. A significant increase in the loan portfolio balance during the current period also contributed to the increase in the provision. Information about loan quality is provided in the Nonperforming Asset section of this report on page 33.

Noninterest income

The following table presents the components of total noninterest income for the first six months of 2009, compared to the first six months of 2008. After removing the impact of gains from the sale of investment securities, total noninterest income for the current six-month period increased $322,000 or 10 percent above 2008.

Table 3 Noninterest income

	Six months ended June 30,		Change Increase (Decrease)	
(dollars in thousands)	2009	2008	$	%
Trust and investment services fees	$ 614	$ 676	$ (62)	(9)%
Income from mutual fund, annuity and insurance sales	704	984	(280)	(28)
Service charges on deposit accounts	1,106	1,083	23	2
Income from bank owned life insurance	318	135	183	136
Other income	302	246	56	23
Gain on sales of mortgages	570	168	402	239
Gain on sales of securities	291	123	168	137
Total noninterest income	$ 3,905	$ 3,415	$ 490	14%

The discussion that follows addresses changes in selected categories of noninterest income.

Trust and investment services fees The decrease in income from trust operations was the result of depressed capital markets and the impact that it had on our fees, which are generally calculated on the market price of assets under management.

Income from mutual fund, annuity and insurance sales The decrease in income from the sale of mutual fund, annuity and insurance products by Codorus Valley Financial Advisors, a subsidiary of PeoplesBank, was a result of depressed capital markets and the impact it had on the volume of sales and fees. A portion of our fees are calculated on market prices of assets under management.

Service charges on deposit accounts In spite of increases in deposit volumes and number of accounts during the current period, service charges increased only slightly as deposit clients exhibited conservative spending and money management behavior in response to concerns about the economic recession and job security.

Income from bank owned life insurance (BOLI) The increase in BOLI was due to an additional investment of approximately $4 million in November 2008 and an increase in the crediting rates on existing policies that were transferred to new insurance providers. The additional investment in BOLI provides a competitive tax-free return to the Corporation while providing a life insurance benefit to additional members of the management team.

Other income The increase in other income was due primarily to increases in income from real estate settlement services provided by SYC Settlement Services, a subsidiary of PeoplesBank, and merchant credit card services.

Gain on sales of mortgages The increase in gains from the sale of mortgages was the result of an increase in the volume of sales. Throughout most of the current period, a low level of market interest rates on mortgage products, influenced by the Federal Reserve Bank to stimulate the economy, increased mortgage refinancing activity. However, since early June 2009, mortgage interest rates have increased resulting in a sharp reduction in mortgage refinancing activity.

Gain on sales of securities During the current period, $291,000 in gains were realized from the sale of U.S. agency mortgage-backed bonds from the available-for-sale securities portfolio to take advantage of the low interest rate environment.

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Noninterest expense

The following table presents the components of total noninterest expense for the first six months of 2009, compared to the first six months of 2008. Total noninterest expenses increased $2,289,000 or 24 percent.

Table 4 Noninterest expense

	Six months ended June 30,		Change Increase (Decrease)	
(dollars in thousands)	2009	2008	$	%
Personnel	$ 6,503	$ 5,533	$ 970	18%
Occupancy of premises, net	928	777	151	19
Furniture and equipment	836	718	118	16
Postage, stationery and supplies	249	235	14	6
Professional and legal	183	197	(14)	(7)
Marketing and advertising	240	282	(42)	(15)
FDIC insurance	876	152	724	476
Debit card processing	252	241	11	5
Charitable donations	207	600	(393)	(66)
Telephone	255	84	171	204
Other	1,398	819	579	71
Total noninterest expense	$ 11,927	$ 9,638	$ 2,289	24%

The discussion that follows addresses changes in selected categories of noninterest expense.

Personnel The increase in personnel expense, comprised of wages/sales commissions, payroll taxes and employee benefits, resulted primarily from staff additions associated with expansion of the banking franchise in the prior year. During 2008, PeoplesBank added three full service financial centers. A non-recurring cost of $242,000 in the first quarter of 2009 to restructure employee benefit plans also contributed to the increase in personnel expense. However, restructuring the benefit plans resulted in a federal income tax benefit so that the overall transaction had an insignificant impact on net income.

Occupancy of premises, net The percent increase in occupancy expense, comprised of rent, depreciation, maintenance, insurance, real estate taxes and utilities, increased primarily as a result of expanding the banking franchise.

Furniture and equipment The increase in furniture and equipment expense was primarily the result of an increase in depreciation expense from capital expenditures that supported franchise expansion and information technology initiatives.

Marketing and advertising The decrease in marketing and advertising expenses was due primarily to the timing of expenditures and to reductions to the marketing budget.

FDIC insurance The increase in Federal Deposit Insurance Corporation (FDIC) premiums was the result of an industry-wide increase in assessment rates, an increase in the volume of deposits upon which the assessment is based, and a special assessment totaling $382,000. Effective June 30, 2009, the FDIC imposed a special assessment on all commercial financial institutions, based on 5 basis points of total assets less Tier 1 capital. Based on FDIC commentary and its congressional mandate to ensure an adequately funded Deposit Insurance Fund, the imposition of additional special assessments in the future are probable.

Charitable donations The level of charitable donations was particularly large in the prior period. During the first quarter of 2008, the Corporation accrued $444,000 for a donation commitment that qualified for a $400,000 (90%) state tax credit for educational improvement. The tax credit was used to reduce the Pennsylvania shares tax expense included in the other expense category.

Telephone The increase in telephone expense resulted from the one-time conversion to a new carrier during the third quarter of 2008, telecommunication enhancements and corporate growth.

Other The increase in other expense, which is comprised of many underlying expenses, increased primarily as a result of increases in Pennsylvania shares tax and carrying costs on impaired assets. Shares tax expense increased $413,000 because the level of shares tax for 2008 was unusually low as a result of recognizing a $400,000 tax credit, described above, in charitable donations. The $103,000 increase in carrying costs associated with impaired assets was the result of larger portfolios of nonperforming loans and real estate acquired in satisfaction of debt.

In the period ahead, it is probable that noninterest expenses will increase as a result of increased FDIC deposit insurance premiums, increased carrying costs associated with impaired assets, planned improvements to selected corporate facilities, investment in technology initiatives, regulatory compliance and normal business growth.

Income taxes

The provision for income tax was a $373,000 credit, or tax benefit, for the current six-month period, compared to a $766,000 expense for the same period in 2008. The $1,139,000 decrease in the tax provision was the result of a decrease in pretax income, an increase in tax-exempt income and the recognition of a one-time $242,000 tax benefit associated with restructuring employment plans. For both periods, the Corporation s statutory federal income tax rate was 34 percent. The Corporation s effective federal income tax rate was negative for the current six-month period and 22 percent for the first six months of 2008. The effective tax rate differs from the statutory tax rate due to the impact of low income housing credits and tax-exempt income including income from bank owned life insurance. The effective tax rate for 2009 decreased primarily as a result of the decrease in pretax income.

BALANCE SHEET REVIEW

Cash and cash equivalents

On June 30, 2009, cash and cash equivalents totaled $26 million, compared to $15 million at year-end 2008. The increase was due primarily to strong deposit growth, which exceeded the Corporation s investment in loans and securities.

Investment securities

On June 30, 2009, the fair value of the securities available-for-sale portfolio totaled $159 million, compared to $72 million at year-end 2008. The increase in the investment securities portfolio was primarily the result of implementing an $80 million leverage strategy that involved investing in investment grade U.S. agency mortgage-backed bonds (3-4 year average lives) and tax-exempt municipal bonds (5-10 year maturities), which were financed by borrowing from the Federal Home Loan Bank of Pittsburgh. The leverage strategy, which was completed in April 2009, is expected to generate a 2 percent tax-equivalent margin spread, which will cover the dividends payable and related costs associated with the recent issuance of preferred stock described in Note 8 Shareholders Equity. During the current period, PeoplesBank took advantage of the low interest rate environment and sold approximately $9 million in U.S. agency mortgage-backed bonds, which generated $291,000 in gains that were recognized into income. Sale proceeds were reinvested into U.S. agency mortgage-backed bonds and tax-exempt municipal bonds.

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Restricted investment in bank stocks

At June 30, 2009, PeoplesBank held $4,262,000 in restricted common stock, compared to $2,692,000 at year-end 2008. The increase was required to obtain advances from the Federal Home Loan Bank of Pittsburgh (FHLBP) to finance the leverage strategy previously discussed. Investment in restricted stock is a condition to obtaining credit from the FHLBP and the Atlantic Central Bankers Bank (ACBB) organizations. Of the total, $4,187,000 pertained to stock issued by the FHLBP and $75,000 pertained to ACBB. In December 2008, the FHLBP announced the suspension of the payment of dividends on its common stock and its repurchase of capital stock as strategies to preserve its capital.

Loans

On June 30, 2009, total loans were $612 million, an increase of $39 million or 7 percent above year-end 2008. The increase was primarily attributable to an increase in business loans, the result of additions to the business banking staff and changes in the competitive landscape that benefited the Corporation. As a result of the recessionary economy and rising unemployment there has been little or no demand for consumer loans. The average yield (tax equivalent basis) earned on total loans was 5.76 percent for the current period, compared to 7.02 percent for the first six months of 2008. The decline in loan yields, particularly floating rate loans, reflected a series of aggressive interest rate cuts by the Federal Reserve Bank from September 2007 through April 2008 and again during the fourth quarter of 2008 in its continuing efforts to stimulate the recessionary economy. The sharp decreases in LIBOR rates, which are presently at historically low levels, reflect the impact of a global economic crisis and disrupted credit markets.

Deposits

On June 30, 2009, total deposits were approximately $686 million, an increase of $87 million or 15 percent above year-end 2008. The increase in deposits, as shown in Note 5 Deposits, occurred primarily in time deposits and secondarily in money market deposits. Federally insured bank deposits continue to provide safe haven to our clients who are increasingly concerned about the economic recession, volatility in the capital markets and rising unemployment. The addition of three financial centers in 2008 and competitive pricing also contributed to the increase in deposit volumes. The average rate paid on interest-bearing deposits was 2.49 percent for the current period six month period, compared to 2.97 percent for the first six months of 2008.

Long-term debt

On June 30, 2009, long-term debt totaled $70 million, compared to $19 million at year-end 2008. During the current period PeoplesBank borrowed approximately $66 million in term debt from the Federal Home Loan Bank of Pittsburgh (FHLBP). Maturities were staggered over three years at an average rate of 2.04 percent. PeoplesBank borrowed from the FHLBP to finance investments in securities. i.e., effect a leverage strategy, to generate sufficient margin spread to cover the costs of the dividends payable on the preferred stock issued in January 2009 as described below in the shareholders equity and capital adequacy section and in Note 8 Shareholders Equity. In April 2009, PeoplesBank paid off a $15 million/2% FHLBP advance prior to its August 2010 maturity to reduce excess liquidity and interest expense. A listing of outstanding long-term debt obligations is provided in Note 6 Long-term Debt.

Shareholders equity and capital adequacy

Shareholders equity or capital enables Codorus Valley to maintain asset growth and absorb losses. Total shareholders equity was approximately $69 million on June 30, 2009, an increase of approximately $17 million or 32 percent above December 31, 2008. The increase was caused primarily by the issuance of $16.5 million of preferred stock described below.

The Corporation typically pays cash dividends on a quarterly basis. The Board of Directors determines the dividend rate after considering the Corporation s capital requirements, current and projected net income, and other factors. On July 21, 2009, the Board of Directors declared a quarterly cash dividend of $0.03 per common share payable on or before August 11, 2009, to shareholders of record July 28, 2009. This dividend follows a $0.08 per share dividend paid in May, and a $0.12 per share dividend paid in February. The decrease in common cash dividends reflects the decline in earnings and the need to preserve capital for balance sheet growth and for unexpected losses that could arise from a prolonged economic recession. The Corporation s recent participation in the U.S. Department of the Treasury s Capital Purchase Program requires regulatory approval to increase quarterly cash dividends on common stock above the $0.12 cents per share level that prevailed just prior to the issuance of the preferred stock.

As previously disclosed, on January 9, 2009, the Corporation sold 16,500 shares of $1,000 liquidation value ($2.50 par value) nonvoting cumulative perpetual preferred stock to the U.S. Department of the Treasury (Treasury) under the Treasury s voluntary Capital Purchase Program (CPP) and received $16.5 million in capital funds. Codorus Valley, which is well capitalized, plans to use the capital to sustain its loan growth plans, expand its banking franchise and to strengthen its capital base against economic uncertainties. The preferred stock, which qualifies as Tier 1 capital, is generally redeemable at any time in whole or in part (i.e., a minimum of 25 percent of the issue price) with regulatory permission. The dividend on the preferred stock is 5 percent per annum for the first five years, and 9 percent thereafter and is paid quarterly. Under the CPP, the Corporation was also required to issue a warrant (option) to the Treasury to allow the Treasury to purchase 263,859 shares of common stock at an initial exercise price of $9.38 per share (subject to adjustment for stock dividends, splits, etc.). The 10-year warrant can be exercised by the Treasury at any time on or before January 9, 2019. The CPP places restrictions on the ability of participating institutions, without obtaining permission from the Treasury, to increase dividends and repurchase common stock. The CPP also places restrictions on incentive compensation to senior executives. The annual after-tax cost of the preferred stock is approximately $982,000, ($825,000 in dividends plus $157,000 for the average implied cost of the warrant), which is charged to retained earnings. Management initiated an $80 million leverage strategy to generate sufficient income to offset costs associated with the dividends payable on the preferred stock. The leverage strategy, which was completed in April 2009, involved borrowing from the Federal Home Loan Bank of Pittsburgh and investing the proceeds in investment grade securities to achieve a two percent margin spread.

Codorus Valley and PeoplesBank are subject to various regulatory capital requirements administered by banking regulators that involve quantitative guidelines and qualitative judgments. Quantitative measures established by regulators pertain to minimum capital ratios, as set forth in Note 7 Regulatory Matters, to the financial statements. Management believes that Codorus Valley and PeoplesBank were well capitalized on June 30, 2009, based on FDIC capital guidelines. The increase in the capital ratios since year-end 2008 reflects the issuance of $16.5 million of cumulative perpetual preferred stock, which qualifies as Tier 1 capital, to the U.S. Department of the Treasury under its Capital Purchase Program, described above and in Note 8 Shareholders Equity.

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RISK MANAGEMENT

Nonperforming assets

The following table presents asset categories posing the greatest risk of loss. Management generally places a loan on nonaccrual status and ceases accruing interest income, i.e., recognizes interest income on a cash basis, when loan payment performance is unsatisfactory and the loan is past due 90 days or more. Loans past due 90 days or more and still accruing interest, are contractually past due, but well collateralized and in the process of collection. The final category, foreclosed real estate, is real estate acquired to satisfy debts. The paragraphs below explain significant changes in the aforementioned categories for June 30, 2009, compared to December 31, 2008.

Table 5 Nonperforming Assets

(dollars in thousands)	June 30, 2009	December 31, 2008
Nonaccrual loans	$ 16,539	$ 8,396
Accruing loans that are contractually past due 90 days or more as to principal or interest	38	61
Foreclosed real estate, net of allowance	3,671	2,052
Total nonperforming assets	$ 20,248	$ 10,509
Ratios:		
Nonaccrual loans as a % of total period-end loans	2.70%	1.47%
Nonperforming assets as a % of total period-end loans and net foreclosed real estate	3.29%	1.83%
Nonperforming assets as a % of total period-end shareholders equity	29.47%	20.14%
Allowance for loan losses as a multiple of nonaccrual loans	.4x	.6x

On June 30, 2009, nonaccrual loans consisted of collateralized business and mortgage loans, and consumer loans. On June 30, 2009, the nonaccrual loan portfolio balance totaled $16,539,000 and was comprised of 22 unrelated accounts ranging in size from $2,000 to $5,155,000. Three unrelated commercial real estate loan accounts represent 79 percent of the total nonaccrual loan portfolio balance.

The first account has a carrying value of $5,155,000. Based on a recent appraisal of the improved real estate collateralizing the loan and other factors, management has established a $1,649,000 allowance for possible loss. Management is in the process of pursuing its remedies against the borrowers and guarantors. The second account has a carrying value of $4,658,000 and, in management s judgment, is adequately collateralized by improved real estate. A public auction of the property is scheduled in September 2009. The third account has a carrying value of $3,298,000 and, in management s judgment, is adequately collateralized by unimproved land that has been approved for residential development. Presently, management is attempting to work out a payment arrangement with the borrower. Further provision for loan losses may be required on these loans when additional information becomes available, including the outcome of the public auction.

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Management has established a loss allowance for selected accounts where the net realizable value of the collateral is insufficient to repay the loan. Management and the Board of Directors evaluate the adequacy of the allowance for loan losses at least quarterly. Collection efforts, including modification of contractual terms for individual accounts based on prevailing market conditions and liquidation of collateral assets, are being employed to maximize recovery.

On June 30, 2009, foreclosed real estate, net of allowance, totaled $3,671,000, compared to $2,052,000 on December 31, 2008. The current portfolio, which is included in the other assets category, contains four unrelated properties, which management is actively attempting to liquidate. The first property is an unoccupied nine unit condominium building with a carrying value of $1,767,000. The property is being held in a subsidiary of the Corporation pending eventual sale of the individual units. The second property, also improved real estate, has a carrying value of $348,000. Since the beginning of the year, two properties were added to the foreclosed real estate portfolio referred to as the third and fourth properties. The third property, with a carrying value of $699,000, was added during the first quarter and represents PeoplesBank s 25 percent participation loan interest in improved real estate. The fourth property, with a carrying value of $857,000, was added during the second quarter and represents PeoplesBank s 18.4 percent participation loan interest in improved real estate. There was no valuation allowance for foreclosed real estate as management feels there were no declines in the fair value of individual assets since the properties were foreclosed on and a new carrying basis was established.

Allowance for loan losses

The Corporation accounts for the credit risk associated with lending activities through its allowance for loan losses and provision for loan losses. The provision is generally an expense recognized in the income statement to adjust the allowance to its proper balance, as determined through the Corporation s allowance adequacy review procedures. The Corporation stresses the timely detection and prompt communication of potential credit problems among its lending staff and senior management and closely monitors impaired credits on an on-going basis in its efforts to maximize recovery.

The allowance was $6,145,000 or 1.00 percent of total loans, on June 30, 2009, compared to $4,002,000 and 0.81 percent, respectively, on June 30, 2008. The increase in the allowance reflects credit quality issues for selected commercial real estate loans and was based on management s estimate of the amount necessary to bring the allowance to a level reflective of the risk in the loan portfolio and loan growth. Management also considered macro-economic factors that could adversely affect the ability of PeoplesBank s loan clients to repay their loans, including the general economic recession, rising unemployment and continued downturn in the real estate market. The Corporation does not participate in the subprime lending market, and accordingly, it has no direct loss exposure to subprime lending. Based on its evaluation of probable loan losses in the current portfolio, management believes that the allowance is adequate to support losses inherent in the loan portfolio on June 30, 2009.

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Table 6 Analysis of Allowance for Loan Losses

(dollars in thousands)	2009	2008
Balance-January 1,	$ 4,690	$ 3,434
Provision charged to operating expense	1,883	1,060
Loans charged off:		
Commercial	313	1
Real estate-construction	0	481
Real estate-mortgage	19	0
Consumer	121	38
Total loans charged off	453	520
Recoveries:		
Commercial	10	25
Real estate-mortgage	7	1
Consumer	8	2
Total recoveries	25	28
Net charge-offs	428	492
Balance-June 30,	$ 6,145	$ 4,002
Ratios:		
Annualized net charge-offs to average total loans	0.23%	0.21%
Allowance for loan losses to total loans at period-end	1.00%	0.81%
Allowance for loan losses to nonaccrual loans and loans past due 90 days or more	37.1%	56.1%

Liquidity

At June 30, 2009, management believes that liquidity was more than adequate based on the level of overnight investment, the potential liquidation of a $159 million portfolio of available-for-sale securities, valued at June 30, 2009, and available credit from the Federal Home Loan Bank of Pittsburgh (FHLBP). On June 30, 2009, available funding from the FHLBP was approximately $126 million. The Consolidated Statements of Cash Flows, included in this report, present the changes in cash from operating, investing and financing activities. Codorus Valley s loan-to-deposit ratio, which is used as a broad measure of liquidity, was approximately 89.3 percent on June 30, 2009, compared to 95.8 percent on December 31, 2008. The decrease in the ratio was the result of deposit growth outpacing loan growth.

Off-Balance Sheet Arrangements

Codorus Valley s financial statements do not reflect various commitments that are made in the normal course of business, which may involve some liquidity risk. These commitments consist primarily of commitments to grant new loans, unfunded commitments under existing loan facilities, and letters of credit made under the same standards as on-balance sheet instruments. Unused commitments on June 30, 2009, totaled $192,723,000 and consisted of $138,060,000 in unfunded commitments under existing loan facilities, $50,695,000 to grant new loans and $3,968,000 in letters of credit. Normally these commitments have fixed expiration dates or termination clauses and are for specific purposes. Accordingly, many of the commitments are expected to expire without being drawn and therefore, generally do not present significant liquidity risk to the Corporation or PeoplesBank.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable to smaller reporting companies.

Item 4T. Controls and Procedures

The Corporation carried out an evaluation, under the supervision and with the participation of the Corporation s management, including the Corporation s Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Corporation s Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2009, the Corporation s disclosure controls and procedures are effective. The Corporation s disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that information required to be disclosed in the Corporation s reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. A control system, no matter how well conceived and operated, must reflect the fact that there are resource constraints, that the benefits of controls must be considered relative to their costs, and inherent limitations that may not prevent fraud, particularly by collusion of two or more people or by management override of a control.

There has been no change in the Corporation s internal control over financial reporting that occurred during the quarter ended June 30, 2009, that has materially affected or is reasonably likely to materially affect, the Corporation s internal control over financial reporting.

Part II OTHER INFORMATION

Item 1. Legal proceedings

There are no legal proceedings pending against Codorus Valley Bancorp, Inc. or any of its subsidiaries which are expected to have a material impact upon the financial position and/or operating results of the Corporation. Management is not aware of any proceedings known or contemplated by government authorities.

Item 1A. Risk factors

Not applicable to smaller reporting companies.

Item 2. Unregistered sales of equity securities and use of proceeds

Nothing to report.

Item 3. Defaults upon senior securities

Nothing to report.

Item 4. Submission of matters to a vote of security holders

(a) An annual meeting of shareholders was held on May 19, 2009 at 9:00 am, Codorus Valley Corporate Center, 105 Leader Heights Road, York, Pennsylvania 17403.

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(b), (c) Two directors were re-elected at the May 19, 2009 meeting. Votes were as follows:

Re-elected	Term Expires	Votes For	Votes Against or Withheld*
Class A:			
Rodney L. Krebs	2012	3,124,916	234,876
Dallas L. Smith	2012	3,113,201	246,592

* Includes broker non-votes

Directors whose term continued after the meeting:

	Term Expires
Class B:	
William H. Simpson	2010
Donald H. Warner	2010
Michael L. Waugh	2010
Class C:	
D. Reed Anderson, Esquire	2011
MacGregor S. Jones	2011
Larry J. Miller	2011

(c) Advisory (non-binding) approval of the Corporation s Executive Compensation Program. Votes were For 2,827,453, Against 301,240, Abstentions 231,009 and Broker non-votes 0.

Item 5. Other information

Nothing to report.

Item 6. Exhibits

Exhibit Number	Description of Exhibit
3.1	Amended Articles of Incorporation (Incorporated by reference to Exhibit 3(i) to the Registrant s Current Report on Form 8-K, filed with the Commission on October 14, 2005.)
3.2	Amended By-laws (Incorporated by reference to Exhibit 3(ii) to the Registrant s Current Report on Form 8-K, filed with the Commission on November 15, 2007.)
3.3	Certificate of Designations for the Series A Preferred Stock (Incorporated by reference to Exhibit 3.1 to the Registrant s Current Report on Form 8-K, filed with the Commission on January 15, 2009.)
4	Rights Agreement dated as of November 4, 2005 (Incorporated by reference to Exhibit 4 to the Registrant s Current Report on Form 8-K, filed with the Commission on November 8, 2005.)
4.1	Securities Purchase Agreement dated as of January 9, 2009, between the Registrant and the United States Department of Treasury (Incorporated by reference to Exhibit 10.1 to the Registrant s Current Report on Form 8-K, filed with the Commission on January 15, 2009.)

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Exhibit Number	Description of Exhibit
4.2	Warrant, dated January 9, 2009, to purchase shares of Common Stock of the Registrant (Incorporated by reference to Exhibit 4.1 to the Registrant s Current Report on Form 8-K, filed with the Commission on January 15, 2009.)
14	Code of Ethics (Incorporated by reference to Exhibit 14 to the Registrant s Current Report on Form 8-K, filed with the Commission on March 3, 2008.)
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned there unto duly authorized.

	Codorus Valley Bancorp, Inc. (Registrant)
August 11, 2009	/s/ Larry J. Miller
Date	Larry J. Miller President & CEO (Principal executive officer)
August 11, 2009	/s/ Jann A. Weaver
Date	Jann A. Weaver Treasurer & Assistant Secretary (Principal financial and accounting officer)

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Exhibit Index

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31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002