

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2008

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-11576

HARRIS & HARRIS GROUP, INC.®

(Exact Name of Registrant as Specified in Its Charter)

New York

(State or Other Jurisdiction  
of Incorporation or Organization)

13-3119827

(I.R.S. Employer  
Identification No.)

111 West 57th Street, New York, New York

(Address of Principal Executive Offices)

10019

(Zip Code)

Registrant's telephone number, including area code (212) 582-0900

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Name of Each Exchange on Which Registered

Common Stock, \$.01 par value

Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

The aggregate market value of the common stock held by non-affiliates of Registrant as of June 30, 2008 was \$147,195,678 based on the last sale price as quoted by the Nasdaq Global Market on such date (only officers and directors are considered affiliates for this calculation).

As of March 12, 2009, the registrant had 25,859,573 shares of common stock, par value \$.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

INCORPORATED AT

Harris & Harris Group, Inc. Proxy Statement for the  
2009 Annual Meeting of Shareholders

Part III, Items 10, 11,  
12, 13 and 14

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## PART I

### Item 1. Business.

Harris & Harris Group, Inc.<sup>®</sup> (the "Company," "us," "our," and "we"), is an internally managed venture capital company specializing in nanotechnology and microsystems that has elected to operate as a business development company ("BDC") under the Investment Company Act of 1940, which we refer to as the 1940 Act. For tax purposes, we have elected to be a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986, which we refer to as the Code. Our investment objective is to achieve long-term capital appreciation, rather than current income, by making venture capital investments in primarily early-stage companies. We incorporated under the laws of the state of New York in August 1981. Our investment approach is comprised of a patient examination of available opportunities, thorough due diligence and close involvement with management. As a venture capital company, we invest in and provide managerial assistance to our portfolio companies, many of which, in our opinion, have significant potential for growth. We are managed by our Board of Directors and officers and have no investment advisor.

We make initial venture capital investments exclusively in companies commercializing or integrating products enabled by nanotechnology or microsystems. Nanotechnology is measured in nanometers, which are units of measurement in billionths of a meter. Microsystems are measured in micrometers, which are units of measurement in millionths of a meter. We use "tiny technology" to describe both of these disciplines. We consider a company to fit our investment thesis if the company employs or intends to employ technology that we consider to be at the microscale or smaller and if the employment of that technology is material to its business plan. Because it is in many respects a new field, tiny technology has significant scientific, engineering and commercialization risks.

At December 31, 2008, our venture capital portfolio comprised 51 percent of our total assets, our U.S. Treasury obligations and cash and cash equivalents comprised 48 percent of our total assets, and other assets comprised the remaining one percent of our total assets. We had no debt outstanding. At December 31, 2008, 99.9 percent of our venture capital portfolio was invested in companies commercializing or integrating products enabled by nanotechnology or microsystems. We may make follow-on investments in any of our portfolio companies. By making these investments, we seek to provide our shareholders with an increasingly specific focus on tiny technology through a portfolio of venture capital investments that address a variety of markets and products. This investment policy is not a fundamental policy and accordingly may be changed without shareholder approval, although we intend to give shareholders at least 60 days prior notice of any change in our policy.

Nanotechnology is multidisciplinary and widely applicable, and it incorporates technology that was not previously in widespread use. Products enabled by nanotechnology are applicable to a large number of industries including pharmaceuticals, medical devices, electronics and alternative (clean) energy. The use of nanotechnology-enabled advanced materials for clean energy in particular is an area of increasing global interest, and these types of materials are the cornerstones of new generations of photovoltaics, batteries, solid-state lighting, fuel cells, biofuels and other energy-related applications that are the focus of a number of recently funded early-stage companies. Although we have not specifically targeted investments in alternative energy companies, as of December 31, 2008, 11 of our 33 active portfolio companies are focused on the commercialization of alternative energy-related products. These companies represent 39.6 percent of our venture capital portfolio based on value as of December 31, 2008.

Neither our investments, nor an investment in us, is intended to constitute a balanced investment program. We expect to be risk seeking rather than risk averse in our investment approach. To such end, we reserve the fullest possible freedom of action, subject to our certificate of incorporation, applicable law and regulations, and policy statements contained herein. There is no assurance that our investment objective will be achieved.

We expect to invest a substantial portion of our assets in securities that we consider to be venture capital investments. These venture capital investments usually do not pay interest or dividends and usually are subject to legal or contractual restrictions on resale that may adversely affect the liquidity and marketability of such securities.

We expect to make speculative venture capital investments with limited marketability and a greater risk of investment loss than less speculative venture capital issues. Although we currently restrict our initial venture capital investments to companies commercializing products enabled by nanotechnology and microsystems, such technology is enabling technology applicable to a wide range of fields and businesses, and we do not seek to invest in any particular industries or categories of investments. Our securities investments may consist of private, public or governmental issuers of any type. Subject to the diversification requirements applicable to a RIC, we may commit all of our assets to only a few investments.

Achievement of our investment objective is basically dependent upon the judgment of a team of five professional, full-time members of management, four of whom are designated as Managing Directors: Douglas W. Jamison, Alexei A. Andreev, Michael A. Janse and Daniel B. Wolfe, and a Vice President, Misti Ushio. One of our directors, Lori D. Pressman, is also a consultant to us. This team collectively has expertise in venture capital investing, intellectual property and nanotechnology. There can be no assurance that a suitable replacement could be found for any of our officers upon their retirement, resignation, inability to act on our behalf, or death. Charles E. Harris was our Chairman and Chief Executive Officer through December 31, 2008. On December 31, 2008, Mr. Harris retired pursuant to the Company's mandatory retirement policy for senior executives. On January 1, 2009, Douglas W. Jamison became the Chairman and Chief Executive Officer.

Subject to continuing to meet the compliance tests applicable to BDCs, there are no limitations on the types of securities or other assets in which we may invest. Investments may include the following:

- Equity, equity-related securities (including warrants) and debt with equity features from either private or public issuers;

- Venture capital investments, whether in corporate, partnership or other form, including development stage or start-up entities;
- Intellectual property or patents or research and development in technology or product development that may lead to patents or other marketable technology;
- Debt obligations of all types having varying terms with respect to security or credit support, subordination, purchase price, interest payments and maturity;
- Foreign securities; and
- Miscellaneous investments.

### **Investments and Strategies**

The following is a summary description of the types of assets in which we may invest, the investment strategies we may utilize and the attendant risks associated with our investments and strategies.

#### **Equity, Equity-Related Securities and Debt with Equity Features**

We may invest in equity, equity-related securities and debt with equity features. These securities include common stock, preferred stock, debt instruments convertible into common or preferred stock, limited partnership interests, other beneficial ownership interests and warrants, options or other rights to acquire any of the foregoing.

We may make investments in companies with operating histories that are unprofitable or marginally profitable, that have negative net worth or that are involved in bankruptcy or reorganization proceedings. These investments would involve businesses that management believes have potential through the infusion of additional capital and management assistance. In addition, we may make investments in connection with the acquisition or divestiture of companies or divisions of companies. There is a significantly greater risk of loss with these types of securities than is the case with traditional investment securities.

We may also invest in publicly traded securities of whatever nature, including relatively small, emerging growth companies that management believes have long-term growth possibilities. In May 2008, the Securities and Exchange Commission ("SEC") amended a rule to expand the definition of eligible portfolio companies in which BDCs can invest to include publicly traded securities of companies with a market capitalization of less than \$250 million. We believe this action greatly increases our opportunity to invest in public companies involved in nanotechnology. As of December 31, 2008, approximately 51 percent of companies listed on a major U.S. stock exchange had market capitalizations of less than \$250 million. We intend to adjust our investment focus as needed to comply with and/or take advantage of the new rule, as well as other regulatory, legislative, administrative or judicial actions in this area.

Warrants, options and convertible or exchangeable securities generally give the investor the right to acquire specified equity securities of an issuer at a specified price during a specified period or on a specified date. Warrants and options fluctuate in value in relation to the value of the underlying security and the remaining life of the warrant or option, while convertible or exchangeable securities fluctuate in value both in relation to the intrinsic value of the security without the conversion or exchange feature and in relation to the value of the conversion or exchange feature, which is like a warrant or option. When we invest in these securities, we incur the risk that the option feature will expire worthless, thereby either eliminating or diminishing the value of our investment.

Most of our current portfolio company investments are in the equity securities of private companies. Investments in equity securities of private companies often involve securities that are restricted as to sale and cannot be sold in the open market without registration under the Securities Act of 1933 or pursuant to a specific exemption from these registrations. Opportunities for sale are more limited than in the case of marketable securities, although these investments may be purchased at more advantageous prices and may offer attractive investment opportunities. Even if one of our portfolio companies completes an initial public offering, we are typically subject to a lock-up agreement for 180 days, and the stock price may decline substantially before we are free to sell. Even if we have registration rights to make our investments more marketable, a considerable amount of time may elapse between a decision to sell or register the securities for sale and the time when we are able to sell the securities. The prices obtainable upon sale may be adversely affected by market conditions or negative conditions affecting the issuer during the intervening time. We may elect to hold formerly restricted securities after they have become freely marketable, either because they remain relatively illiquid or because we believe that they may appreciate in value, during which holding period they may decline in value and be especially volatile as unseasoned securities. If we need funds for investment or working capital purposes, we might sell marketable securities at disadvantageous times or prices.

### **Venture Capital Investments**

We define venture capital as the money and resources made available to privately held start-up firms and privately held and publicly traded small businesses with exceptional growth potential. These businesses can range in stage from pre-revenue to cash flow positive. Substantially all of our long-term venture capital investments are in thinly capitalized, unproven, small companies focused on risky technologies. These businesses also tend to lack management depth, to have limited or no history of operations and to have not attained profitability. Because of the speculative nature of these investments, these securities have a significantly greater risk of loss than traditional investment securities. Some of our venture capital investments will be unprofitable or complete losses, and some will never realize their potential.

We may own 100 percent of the securities of a start-up investment for a period of time and may control the company for a substantial period. Start-up companies are more vulnerable than better capitalized companies to adverse business or economic developments. Start-up businesses generally have limited product lines, markets and/or financial resources. Start-up companies are not well-known to the investing public and are subject to potential bankruptcy, general movements in markets and perceptions of potential growth.

In connection with our venture capital investments, we may participate in providing a variety of services to our portfolio companies, including the following:

- recruiting management;
- formulating operating strategies;
- formulating intellectual property strategies;
- assisting in financial planning;
- providing management in the initial start-up stages; and
- establishing corporate goals.

We may assist in raising additional capital for these companies from other potential investors and may subordinate our own investment to that of other investors. We typically find it necessary or appropriate to provide additional capital of our own. We may introduce these companies to potential joint venture partners, suppliers and customers. In addition, we may assist in establishing relationships with investment bankers and other professionals. We may also assist with mergers and acquisitions. We do not derive income from these companies for the performance of any of the above services.

We may control, be represented on, or have observer rights on the Board of Directors of a portfolio company through one or more of our officers or directors, who may also serve as officers of the portfolio company. We indemnify our officers and directors for serving on the Boards of Directors or as officers of portfolio companies, which exposes us to additional risks. Particularly during the early stages of an investment, we may, in rare instances, in effect be conducting the operations of the portfolio company. As a venture capital-backed company emerges from the developmental stage with greater management depth and experience, we expect that our role in the portfolio company's operations will diminish. Our goal is to assist each company in establishing its own independent capitalization, management and Board of Directors. We expect to be able to reduce our involvement in those start-up companies that become successful, as well as in those start-up companies that fail.

#### **Intellectual Property**

We believe there is a role for organizations that can assist in technology transfer. Scientists and institutions that develop and patent intellectual property perceive the need for and rewards of entrepreneurial commercialization of their inventions.



Our form of investment may be:

- funding research and development in the development of a technology;
- obtaining licensing rights to intellectual property or patents;
- acquiring intellectual property or patents; or
- forming and funding companies or joint ventures to commercialize further intellectual property.

Income from our investments in intellectual property or its development may take the form of participation in licensing or royalty income, fee income, or some other form of remuneration. In order to satisfy RIC requirements, these investments will normally be held in an entity taxable as a corporation. Investment in developmental intellectual property rights involves a high degree of risk that can result in the loss of our entire investment as well as additional risks including uncertainties as to the valuation of an investment and potential difficulty in liquidating an investment. Further, investments in intellectual property generally require investor patience, as investment return may be realized only after or over a long period. At some point during the commercialization of a technology, our investment may be transformed into ownership of securities of a development stage or start-up company, as discussed under "Venture Capital Investments" above.

### **Debt Obligations**

We may hold debt securities for income and as a reserve pending more speculative investments. Debt obligations may include U.S. government and agency securities, commercial paper, bankers' acceptances, receivables or other asset-based financing, notes, bonds, debentures, or other debt obligations of any nature and repurchase agreements related to these securities. These obligations may have varying terms with respect to security or credit support, subordination, purchase price, interest payments and maturity from private, public or governmental issuers of any type located anywhere in the world. We may invest in debt obligations of companies with operating histories that are unprofitable or marginally profitable, that have negative net worth or are involved in bankruptcy or reorganization proceedings, or that are start-up or development stage entities. In addition, we may participate in the acquisition or divestiture of companies or divisions of companies through issuance or receipt of debt obligations. As of December 31, 2008, the debt obligations held in our portfolio consisted of convertible bridge notes and U.S. Treasury securities. The convertible bridge notes generally do not generate income, nor are they held for that purpose.

Our investments in debt obligations may be of varying quality, including non-rated, unsecured, highly speculative debt investments with limited marketability. Investments in lower-rated and non-rated securities, commonly referred to as "junk bonds," are subject to special risks, including a greater risk of loss of principal and non-payment of interest. Generally, lower-rated securities offer a higher return potential than higher-rated securities, but involve greater volatility of price and greater risk of loss of income and principal, including the possibility of default or bankruptcy of the issuers of these securities. Lower-rated securities and comparable non-rated securities will likely have large uncertainties or major risk exposure to adverse conditions and are predominantly speculative with respect to the issuer's capacity to pay interest and repay principal in accordance with the terms of the obligation. The occurrence of adverse conditions and uncertainties to issuers of lower-rated securities would likely reduce the value of lower-rated securities held by us, with a commensurate effect on the value of our shares.

The markets in which lower-rated securities or comparable non-rated securities are traded generally are more limited than those in which higher-rated securities are traded. The existence of limited markets for these securities may restrict our ability to obtain accurate market quotations for the purposes of valuing lower-rated or non-rated securities and calculating net asset value or to sell securities at their fair value. Any economic downturn could adversely affect the ability of issuers' lower-rated securities to repay principal and pay interest thereon. The market values of lower-rated and non-rated securities also tend to be more sensitive to individual corporate developments and changes in economic conditions than higher-rated securities. In addition, lower-rated securities and comparable non-rated securities generally present a higher degree of credit risk. Issuers of lower-rated securities and comparable non-rated securities are often highly leveraged and may not have more traditional methods of financing available to them, so that their ability to service their debt obligations during an economic downturn or during sustained periods of rising interest rates may be impaired. The risk of loss owing to default by these issuers is significantly greater because lower-rated securities and comparable non-rated securities generally are unsecured and frequently are subordinated to the prior payment of senior indebtedness. We may incur additional expenses to the extent that we are required to seek recovery upon a default in the payment of principal or interest on our portfolio holdings.

The market value of investments in debt securities that carry no equity participation usually reflects yields generally available on securities of similar quality and type at the time purchased. When interest rates decline, the market value of a debt portfolio already invested at higher yields can be expected to rise if the securities are protected against early call. Similarly, when interest rates increase, the market value of a debt portfolio already invested at lower yields can be expected to decline. Deterioration in credit quality also generally causes a decline in market value of the security, while an improvement in credit quality generally leads to increased value.

### **Foreign Securities**

We may make investments in securities of issuers whose principal operations are conducted outside the United States, and whose earnings and securities are stated in foreign currency. In order to maintain our status as a business development company, our investments in non-qualifying assets, including the securities of companies organized outside the U.S., would be limited to 30 percent of our assets, because we must invest at least 70 percent of our assets in "qualifying assets," and securities of foreign companies are not "qualifying assets."

Compared to otherwise comparable investments in securities of U.S. issuers, currency exchange risk of securities of foreign issuers is a significant variable. The value of these investments to us will vary with the relation of the currency in which they are denominated to the U.S. dollar, as well as with intrinsic elements of value such as credit risk, interest rates and performance of the issuer. Investments in foreign securities also involve risks relating to economic and political developments, including nationalization, expropriation of assets, currency exchange freezes and local recession. Securities of many foreign issuers are less liquid and more volatile than those of comparable U.S. issuers. Interest and dividend income and capital gains on our foreign securities may be subject to withholding and other taxes that may not be recoverable by us. We may seek to hedge all or part of the currency risk of our investments in foreign securities through the use of futures, options and forward currency purchases or sales.

### **Borrowing and Margin Transactions**

We may from time to time borrow money or obtain credit by any lawful means from banks, lending institutions, other entities or individuals, in negotiated transactions. We may issue, publicly or privately, bonds, debentures or notes, in series or otherwise, with interest rates and other terms and provisions, including conversion rights, on a secured or unsecured basis, for any purpose, up to the maximum amounts and percentages permitted for business development companies under the 1940 Act. The 1940 Act currently prohibits us from borrowing any money or issuing any other senior securities (including preferred stock but excluding temporary borrowings of up to five percent of our assets), if after giving effect to the borrowing or issuance, the value of our total assets less liabilities not constituting senior securities would be less than 200 percent of our senior securities. We may pledge assets to secure any borrowings. We currently have no debt and have no current intention to issue preferred stock.

Although not currently employed in the operation of our business, a primary purpose of our borrowing power should we decide to use it is for leverage, to increase our ability to acquire investments both by acquiring larger positions and by acquiring more positions. Borrowings for leverage accentuate any increase or decrease in the market value of our investments and thus our net asset value. Because any decline in the net asset value of our investments will be borne first by holders of common stock, the effect of leverage in a declining market would be a greater decrease in net asset value applicable to the common stock than if we were not leveraged. Any decrease would likely be reflected in a decline in the market price of our common stock. To the extent the income derived from assets acquired with borrowed funds exceeds the interest and other expenses associated with borrowing, our total income will be greater than if borrowings were not used. Conversely, if the income from assets is not sufficient to cover the borrowing costs, our total income will be less than if borrowings were not used. If our current income is not sufficient to meet our borrowing costs (repayment of principal and interest), we might have to liquidate some or all of our investments when it may be disadvantageous to do so. Our borrowings for the purpose of buying most liquid equity securities will be subject to the margin rules, which require excess liquid collateral marked to market daily. If we are unable to post sufficient collateral, we will be required to sell securities to remain in compliance with the margin rules. These sales might be at disadvantageous times or prices.

### **Repurchase of Shares**

Our shareholders do not have the right to compel us to redeem our shares. We may, however, purchase outstanding shares of our common stock from time to time, subject to approval of our Board of Directors and compliance with applicable corporate and securities laws. The Board of Directors may authorize purchases from time to time when they are deemed to be in the best interests of our shareholders, but could do so only after notification to shareholders. The Board of Directors may or may not decide to undertake any purchases of our common stock.

Our repurchases of our common shares would decrease our total assets and would therefore likely have the effect of increasing our expense ratio. Subject to our investment restrictions, we may borrow money to finance the repurchase of our common stock in the open market pursuant to any tender offer. Interest on any borrowings to finance share repurchase transactions will reduce our net assets. If, because of market fluctuations or other reasons, the value of our assets falls below the required 1940 Act coverage requirements, we may have to reduce our borrowed debt to the extent necessary to comply with the requirement. To achieve a reduction, it is possible that we may be required to sell portfolio securities at inopportune times when it may be disadvantageous to do so. Since 1998, we have repurchased a total of 1,828,740 shares of our common stock at a total cost of \$3,405,531, or \$1.86 per share. On July 23, 2002, because of our strategic decision to invest in nanotechnology and microsystems, our Board of Directors reaffirmed its commitment not to authorize the purchase of additional shares of our common stock.

### **Portfolio Company Turnover**

Changes with respect to portfolio companies will be made as our management considers necessary in seeking to achieve our investment objective. The rate of portfolio turnover will not be treated as a limiting or relevant factor when circumstances exist, which are considered by management to make portfolio changes advisable.

Although we expect that many of our investments will be relatively long term in nature, we may make changes in our particular portfolio holdings whenever it is considered that an investment no longer has substantial growth potential or has reached its anticipated level of performance, or (especially when cash is not otherwise available) that another investment appears to have a relatively greater opportunity for capital appreciation. We may also make general portfolio changes to increase our cash to position us in a defensive posture. We may make portfolio changes without regard to the length of time we have held an investment, or whether a sale results in profit or loss, or whether a purchase results in the reacquisition of an investment which we may have only recently sold. Our investments in privately held companies are illiquid, which limits portfolio turnover.

The portfolio turnover rate may vary greatly during a year as well as from year to year and may also be affected by cash requirements.

## **Competition**

Numerous companies and individuals are engaged in the venture capital business, and such business is intensely competitive. We believe the perpetual nature of our corporate structure enables us to be a better long-term partner for our portfolio companies than if we were organized as a traditional private equity fund, which typically has a limited life. We believe that we have invested in more nanotechnology-enabled companies than any venture capital firm and that we have assembled a team of investment professionals that have scientific and intellectual property expertise that is relevant to investing in nanotechnology. Nevertheless, many of our competitors have significantly greater financial and other resources and managerial capabilities than we do and are therefore, in certain respects, in a better position than we are to obtain access to attractive venture capital investments. There can be no assurance that we will be able to compete against these venture capital businesses for attractive investments, particularly as a lead investor in capital-intensive companies.

## **Regulation**

The Small Business Investment Incentive Act of 1980 added the provisions of the 1940 Act applicable to BDCs. BDCs are a special type of investment company. After a company files its election to be treated as a BDC, it may not withdraw its election without first obtaining the approval of holders of a majority of its outstanding voting securities. The following is a brief description of the 1940 Act provisions applicable to BDCs, qualified in its entirety by reference to the full text of the 1940 Act and the rules issued thereunder by the SEC.

Generally, to be eligible to elect BDC status, a company must primarily engage in the business of furnishing capital and making significant managerial assistance available to companies that do not have ready access to capital through conventional financial channels. Such companies that satisfy certain additional criteria described below are termed "eligible portfolio companies." In general, in order to qualify as a BDC, a company must: (i) be a domestic company; (ii) have registered a class of its securities pursuant to Section 12 of the Securities Exchange Act of 1934; (iii) operate for the purpose of investing in the securities of certain types of portfolio companies, including early stage or emerging companies and businesses suffering or just recovering from financial distress (see following paragraph); (iv) make available significant managerial assistance to such portfolio companies; and (v) file a proper notice of election with the SEC.

An eligible portfolio company generally is a domestic company that is not an investment company or a company excluded from investment company status pursuant to exclusions for certain types of financial companies (such as brokerage firms, banks, insurance companies and investment banking firms) and that: (i) has a market capitalization of less than \$250 million and has a class of equity securities listed on a national securities exchange, (ii) does not have a class of securities listed on a national securities exchange, or (iii) is controlled by the BDC by itself or together with others (control under the 1940 Act is presumed to exist where a person owns at least 25 percent of the outstanding voting securities of the portfolio company) and has a representative on the Board of Directors of such company.

We may be periodically examined by the SEC for compliance with the 1940 Act.

As with other companies regulated by the 1940 Act, a BDC must adhere to certain substantive regulatory requirements. A majority of the directors must be persons who are not interested persons, as that term is defined in the 1940 Act. Additionally, we are required to provide and maintain a bond issued by a reputable fidelity insurance company to protect the BDC. Furthermore, as a BDC, we are prohibited from protecting any director or officer against any liability to us or our shareholders arising from willful malfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person's office.

The 1940 Act provides that we may not make an investment in non-qualifying assets unless at the time at least 70 percent of the value of our total assets (measured as of the date of our most recently filed financial statements) consists of qualifying assets. Qualifying assets include: (i) securities of eligible portfolio companies; (ii) securities of certain companies that were eligible portfolio companies at the time we initially acquired their securities and in which we retain a substantial interest; (iii) securities of certain controlled companies; (iv) securities of certain bankrupt, insolvent or distressed companies; (v) securities received in exchange for or distributed in or with respect to any of the foregoing; and (vi) cash items, U.S. government securities and high quality short-term debt. The SEC has adopted a rule permitting a BDC to invest its cash in certain money market funds. The 1940 Act also places restrictions on the nature of the transactions in which, and the persons from whom, securities can be purchased in some instances in order for the securities to be considered qualifying assets.

We are permitted by the 1940 Act, under specified conditions, to issue multiple classes of debt and a single class of preferred stock if our asset coverage, as defined in the 1940 Act, is at least 200 percent after the issuance of the debt or the preferred stock (i.e., such senior securities may not be in excess of our net assets). Under specific conditions, we are also permitted by the 1940 Act to issue warrants.

Except under certain conditions, we may sell our securities at a price that is below the prevailing net asset value per share only during the 12-month period after (i) a majority of our directors and our disinterested directors have determined that such sale would be in the best interest of us and our stockholders and (ii) the holders of a majority of our outstanding voting securities and the holders of a majority of our voting securities held by persons who are not affiliated persons of ours approve such issuances. A majority of the disinterested directors must determine in good faith that the price of the securities being sold is not less than a price which closely approximates market value of the securities, less any distribution discount or commission.

Certain transactions involving certain closely related persons of the Company, including its directors, officers and employees, may require the prior approval of the SEC. However, the 1940 Act ordinarily does not restrict transactions between us and our portfolio companies.

### **Subchapter M Status**

We elected to be treated as a regulated investment company (a "RIC"), taxable under Subchapter M of the Internal Revenue Code (the "Code"), for federal income tax purposes. In general, a RIC is not taxable on its income or gains to the extent it distributes such income or gains to its shareholders. In order to qualify as a RIC, we must, in general, (1) annually derive at least 90 percent of our gross income from dividends, interest and gains from the sale of securities and similar sources (the "Income Source Rule"); (2) quarterly meet certain investment asset diversification requirements; and (3) annually distribute at least 90 percent of our investment company taxable income as a dividend (the "Income Distribution Rule"). Any taxable investment company income not distributed will be subject to corporate level tax. Any taxable investment company income distributed generally will be taxable to shareholders as dividend income.

In addition to the requirement that we must annually distribute at least 90 percent of our investment company taxable income, we may either distribute or retain our realized net capital gains from investments, but any net capital gains not distributed may be subject to corporate level tax. It is our current intention not to distribute net capital gains. Any net capital gains distributed generally will be taxable to shareholders as long-term capital gains.

In lieu of actually distributing our realized net capital gains, we as a RIC may retain all or part of our net capital gains and elect to be deemed to have made a distribution of the retained portion to our shareholders under the "designated undistributed capital gain" rules of the Code. We currently intend to retain and so designate all of our net capital gains. In this case, the "deemed dividend" generally is taxable to our shareholders as long-term capital gains. Although we pay tax at the corporate rate on the amount deemed to have been distributed, our shareholders receive a tax credit equal to their proportionate share of the tax paid and an increase in the tax basis of their shares by the amount per share retained by us.

To the extent that we declare a deemed dividend, each shareholder will receive an IRS Form 2439 that will reflect each shareholder's receipt of the deemed dividend income and a tax credit equal to each shareholder's proportionate share of the tax paid by us. This tax credit, which is paid at the corporate rate, is often credited at a higher rate than the actual tax due by a shareholder on the deemed dividend income. The "residual" credit can be used by the shareholder to offset other taxes due in that year or to generate a tax refund to the shareholder. Tax exempt investors may file for a refund.

The following simplified examples illustrate the tax treatment under Subchapter M of the Code for us and our individual shareholders with regard to three possible distribution alternatives, assuming a net capital gain of \$1.00 per share, consisting entirely of sales of non-real property assets held for more than 12 months.

**Under Alternative A:** 100 percent of net capital gain declared as a cash dividend and distributed to shareholders:

1. No federal taxation at the Company level.
2. Taxable shareholders receive a \$1.00 per share dividend and pay federal tax at a rate not in excess of 15 percent\* or \$.15 per share, retaining \$.85 per share.
3. Non-taxable shareholders that file a federal tax return receive a \$1.00 per share dividend and pay no federal tax, retaining \$1.00 per share.

**Under Alternative B (Current Tax Structure Employed):** 100 percent of net capital gain retained by the Company and designated as "undistributed capital gain" or deemed dividend:

1. The Company pays a corporate-level federal income tax of 35 percent on the undistributed gain or \$.35 per share and retains 65 percent of the gain or \$.65 per share.
2. Taxable shareholders increase their cost basis in their stock by \$.65 per share. They pay federal capital gains tax at a rate not in excess of 15 percent\* on 100 percent of the undistributed gain of \$1.00 per share or \$.15 per share in tax. Offsetting this tax, shareholders receive a tax credit equal to 35 percent of the undistributed gain or \$.35 per share.
3. Non-taxable shareholders that file a federal tax return receive a tax refund equal to \$.35 per share.

\*Assumes all capital gains qualify for long-term rates of 15 percent.

**Under Alternative C:** 100 percent of net capital gain retained by the Company, with no designated undistributed capital gain or deemed dividend:

1. The Company pays a corporate-level federal income tax of 35 percent on the retained gain or \$.35 per share plus an excise tax of four percent of \$.98 per share, or about \$.04 per share.
2. There is no tax consequence at the shareholder level.

Although we may retain income and gains subject to the limitations described above (including paying corporate level tax on such amounts), we could be subject to an additional four percent excise tax if we fail to distribute 98 percent of our aggregate annual taxable income.

As noted above, in order to qualify as a RIC, we must meet certain investment asset diversification requirements each quarter. Because of the specialized nature of our investment portfolio, in some years we have been able to satisfy the diversification requirements under Subchapter M of the Code primarily as a result of receiving certifications from the SEC under the Code with respect to each taxable year beginning after 1998 that we were "principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available" for such year.

Although we received SEC certifications for 1999-2007, there can be no assurance that we will receive such certification for subsequent years (to the extent we need additional certifications as a result of changes in our portfolio). In 2008, we qualified for RIC treatment even without certification. If we require, but fail to obtain, the SEC certification for a taxable year, we may fail to qualify as a RIC for such year. We will also fail to qualify as a RIC for a taxable year if we do not satisfy the Income Source Rule or Income Distribution Rule for such year. In the event we do not qualify as a RIC for any taxable year, we will be subject to federal tax with respect to all of our taxable income, whether or not distributed. In addition, all our distributions to shareholders in that situation generally will be taxable as ordinary dividends.



Although we generally intend to qualify as a RIC for each taxable year, under certain circumstances we may choose to take action with respect to one or more taxable years to ensure that we would be taxed under Subchapter C of the Code (rather than Subchapter M) for such year or years. We will choose to take such action only if we determine that the result of the action will benefit us and our shareholders.

### **Subsidiaries**

Harris & Harris Enterprises, Inc.<sup>SM</sup> ("Enterprises"), is a 100 percent wholly owned subsidiary of the Company and is consolidated in our financial statements. Enterprises is a partner in Harris Partners I, L.P., and is taxed as a C Corporation. Harris Partners I, L.P.<sup>SM</sup>, is a limited partnership. Harris Partners I, L.P., owned our interest in AlphaSimplex Group, LLC, until AlphaSimplex was sold to Natixis Global Asset Management. We received our share of the proceeds on October 30, 2007. The partners of Harris Partners I, L.P., are Harris & Harris Enterprises, Inc. (sole general partner) and the Company (sole limited partner).

### **Available Information**

Additional information about us, including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, are available on our website at [www.TinyTechVC.com](http://www.TinyTechVC.com). Information on our website is not part of this annual report on Form 10-K.

### **Employees**

We currently employ directly 11 full-time employees.

## **Item 1A. Risk Factors.**

Investing in our common stock involves significant risks relating to our business and investment objective. You should carefully consider the risks and uncertainties described below before you purchase any of our common stock. These risks and uncertainties are not the only ones we face. Unknown additional risks and uncertainties, or ones that we currently consider immaterial, may also impair our business. If any of these risks or uncertainties materialize, our business, financial condition or results of operations could be materially adversely affected. In this event, the trading price of our common stock could decline, and you could lose all or part of your investment.

### **Risks related to the companies in our portfolio.**

#### **The recent financial crisis could increase the non-performance risk for our portfolio companies.**

The global financial markets are in turmoil, and the economies of the U.S. and many other countries are in recession, which may be severe and prolonged. This status results in severely diminished opportunities for liquidity and credit availability, declines in consumer confidence, declines in economic growth, increases in unemployment rates, and uncertainty about overall economic stability, and there can be no assurance against further decline. These conditions adversely affect the availability of capital to meet the funding needs of our portfolio companies as the majority of our portfolio companies, and venture-backed companies in general, have negative cash flows, and thus require follow-on financings to continue operations. A substantial decrease in the availability of this necessary capital would dramatically increase the risk of these companies. We define non-performance as the risk that a portfolio company will be unable to raise additional capital. In these circumstances, the portfolio company could be recapitalized at a valuation significantly lower than the post-money valuation implied by our valuation method, sold at a loss to our investment or shut down.

#### **A continuing lack of initial public offering opportunities and a decrease in merger and acquisition transactions may cause companies to stay in our portfolio longer, leading to lower returns, write-downs and write-offs.**

Beginning in about 2001, many fewer venture capital-backed companies per annum have been able to complete initial public offerings (IPOs) than in the years of the previous decade. Moreover, in 2008, according to the National Venture Capital Association, there were only six venture capital-backed companies that completed IPOs, the fewest annual venture-backed offerings since 1977. There were no venture-backed IPOs in the fourth quarter of 2008. In 2008, according to Dow Jones VentureSource, the venture capital-backed companies that completed IPOs had a median age of about 8.3 years. Also according to Dow Jones VentureSource, the market for mergers and acquisitions ("M&A") during 2008 experienced a drop in the number of transactions by 28.8 percent and in median transaction price by 50 percent.

Now that some of our companies are becoming more mature, a continuing lack of IPO opportunities and decrease in the number and size of M&A transactions for venture capital-backed companies could lead to companies staying longer in our portfolio as private entities that may require additional funding. In the best case, such stagnation would dampen returns, and in the worst case, could lead to write-downs and write-offs as some companies run short of cash and have to accept lower valuations in private financings or are not able to access additional capital at all. A continuing lack of IPO opportunities and the decrease in the number and size of M&A transactions for venture capital-backed companies are also causing some venture capital firms to change their strategies. Accordingly, some venture capital firms are reducing funding of their portfolio companies, making it more difficult for such companies to access capital and to fulfill their potential. In some cases this leads to write-downs and write-offs of such companies by other venture capital firms, such as ourselves, who are co-investors in such companies.

**Investing in small, private companies involves a high degree of risk and is highly speculative.**

We have invested a substantial portion of our assets in privately held development stage or start-up companies, the securities of which are inherently illiquid. These businesses tend to lack management depth, to have limited or no history of operations and to have not attained profitability. Companies commercializing products enabled by nanotechnology or microsystems are especially risky, involving scientific, technological and commercialization risks. Because of the speculative nature of these investments, these securities have a significantly greater risk of loss than traditional investment securities. Some of our venture capital investments are likely to be complete losses or unprofitable, and some will never realize their potential. We have been and will continue to be risk seeking rather than risk averse in our approach to venture capital and other investments. Neither our investments nor an investment in our common stock is intended to constitute a balanced investment program.

**We may invest in companies working with technologies or intellectual property that currently have few or no proven commercial applications.**

Nanotechnology, in particular, is a developing area of technology, of which much of the future commercial value is unknown, difficult to estimate and subject to widely varying interpretations. It is sets of enabling technologies that are applicable to a diverse set of industries. As such, nanotechnology-enabled products must compete against existing products or enable a completely new product in a given industry. There are as of yet relatively few nanotechnology-enabled products commercially available. The timing of additional future commercially available nanotechnology-enabled products and the industries on which nanotechnology will have the most significant impact is highly uncertain.

**Our portfolio companies may not successfully develop, manufacture or market their products.**

The technology of our portfolio companies is new and in many cases unproven. Their potential products require significant and lengthy product development, manufacturing and marketing efforts. To date, many of our portfolio companies have not developed any commercially available products. In addition, our portfolio companies may not be able to manufacture successfully or to market their products in order to achieve commercial success. Further, the products may never gain commercial acceptance. If our portfolio companies are not able to develop, manufacture or market successful nanotechnology-enabled products, they will be unable to generate product revenue or build sustainable or profitable businesses. Adverse conditions in the target markets of our portfolio companies may limit or prevent commercial success regardless of the contribution of nanotechnology to these products.

**Our portfolio companies working with nanotechnology and microsystems may be particularly susceptible to intellectual property litigation.**

Research and commercialization efforts in nanotechnology and microsystems are being undertaken by a wide variety of government, academic and private corporate entities. As additional commercially viable applications of nanotechnology emerge, ownership of intellectual property on which these products are based may be contested. From time to time, our portfolio companies are or have been involved in intellectual property disputes and litigation. Any litigation over the ownership of, or rights to, any of our portfolio companies' technologies or products could have a material adverse effect on those companies' values.

**The value of our portfolio could be adversely affected if the technologies utilized by our portfolio companies are found, or even rumored or feared, to cause health or environmental risks, or if legislation is passed that limits the commercialization of any of these technologies.**

Nanotechnology has received both positive and negative publicity and is the subject increasingly of public discussion and debate. For example, debate regarding the production of materials that could cause harm to the environment or the health of individuals could raise concerns in the public's perception of nanotechnology, not all of which might be rational or scientifically based. Nanotechnology in particular is currently the subject of health and environmental impact research. If health or environmental concerns about nanotechnology or microsystems were to arise, whether or not they had any basis in fact, our portfolio companies might incur additional research, legal and regulatory expenses, and might have difficulty raising capital or marketing their products. Government authorities could, for social or other purposes, prohibit or regulate the use of nanotechnology. Legislation could be passed that could circumscribe the commercialization of any of these technologies.

**Our Nanotech for Cleantech™ portfolio is currently the largest and fastest growing portion of our venture capital portfolio, and, therefore, fluctuations in its value may adversely affect our net asset value per share to a greater degree than other sectors of our portfolio.**

The fastest growing portion of our portfolio is our Nanotech for Cleantech™ portfolio, which consists of companies commercializing nanotechnology-enabled products targeted at cleantech-related markets. There are risks in investing in companies that target cleantech-related markets, including the rapid and sometimes dramatic price fluctuations of commodities, particularly oil and public equities, the reliance on the capital and debt markets to finance large capital outlays and the dependence on government subsidies to be cost-competitive with non-cleantech solutions. For example, the attractiveness of alternative methods for the production of biobutanol and biodiesel can be adversely affected by a decrease in the demand or price of oil. The demand for solar cells is driven primarily by government subsidies and the availability of credit to finance the purchase and installation of the system. Adverse developments in any of these sectors may significantly affect the value of our Nanotech for Cleantech portfolio, and thus our venture capital portfolio as a whole. Additionally, companies with alternative energy (cleantech) platforms are currently in favor with the media and investors. Cleantech companies in general may have a harder time accessing capital in the future if this level of interest subsides.

**Our portfolio companies may generate revenues from the sale of products that are not enabled by nanotechnology.**

We consider a company to be enabled by nanotechnology or microsystems if a product or products, or intellectual property covering a product or products, that we consider to be at the microscale or smaller is material to its business plan. The core business of some of these companies may not be nanotechnology-enabled products, and, therefore, their success or failure may not be dependent upon the nanotechnology aspects of their business. In addition to developing products that we consider nanotechnology, some of these companies may also develop products that we do not consider enabled by nanotechnology. Some of these companies will generate revenues from the sale of non-nanotechnology-enabled products. Additionally, it is possible that a portfolio company may decide to change its business focus after our initial investment and decide to develop and commercialize non-nanotechnology-enabled products.

**Risks related to the illiquidity of our investments.**

**We invest in illiquid securities and may not be able to dispose of them when it is advantageous to do so, or ever.**

Most of our investments are or will be equity or equity-linked securities acquired directly from small companies. These equity securities are generally subject to restrictions on resale or otherwise have no established trading market. The illiquidity of most of our portfolio of equity securities may adversely affect our ability to dispose of these securities at times when it may be advantageous for us to liquidate these investments. We may never be able to dispose of these securities.

**Unfavorable regulatory changes could impair our ability to engage in liquidity events.**

Recent government reforms affecting publicly traded companies, stock markets, investment banks and securities research practices have made it more difficult for privately held companies to complete successful initial public offerings of their equity securities, and such reforms have increased the expense and legal exposure of being a public company. Slowdowns in initial public offerings may also be having an adverse effect on the frequency and prices of acquisitions of privately held companies. A lack of merger and/or acquisition opportunities for privately held companies also may be having an adverse effect on the ability of these companies to raise capital from private sources. Public equity market response to companies offering nanotechnology-enabled products is uncertain. An inability to engage in liquidity events could negatively affect our liquidity, our reinvestment rate in new and follow-on investments and the value of our portfolio.

**Even if some of our portfolio companies complete initial public offerings, the returns on our investments in those companies would be uncertain.**

When companies in which we have invested as private entities complete initial public offerings of their securities, these newly issued securities are by definition unseasoned issues. Unseasoned issues tend to be highly volatile and have uncertain liquidity, which may negatively affect their price. In addition, we are typically subject to lock-up provisions that prohibit us from selling our investments into the public market for specified periods of time after initial public offerings. The market price of securities that we hold may decline substantially before we are able to sell these securities. Most initial public offerings of technology companies in the United States are listed on the Nasdaq Global Market. Government reforms of the Nasdaq Global Market have made market-making by broker-dealers less profitable, which has caused broker-dealers to reduce their market-making activities, thereby making the market for unseasoned stocks less liquid than they might be otherwise.

**Risks related to our Company.**

**Our business may be adversely affected by the recent financial crisis and our ability to access the capital markets.**

The global financial markets are in turmoil, and the economies of the U.S. and many other countries are in recession, which may be severe and prolonged. This status results in severely diminished opportunities for liquidity and credit availability, declines in consumer confidence, declines in economic growth, increases in unemployment rates, and uncertainty about overall economic stability, and there can be no assurance against further decline. We are unable to predict the likely duration and severity of this global financial turmoil, and if the current uncertainty continues or economic conditions further deteriorate, our business and the business of our portfolio companies could be materially and adversely affected.

Our business and results of operations could be impacted adversely by a number of follow-on effects of the financial crisis, including the inability of our portfolio companies to obtain sufficient financing to continue to operate as a going concern, an increase in our funding costs or the limitation on our access to the capital markets. A prolonged period of market illiquidity may have an adverse effect on our business, financial condition, and results of operations. Our nonperforming assets are likely to increase, and the value of our portfolio is likely to decrease during these periods. These events could limit our investment activity, limit our ability to grow and negatively impact our operating results.

The financial crisis and changes in regulations of the financial industry have adversely affected coverage of us by financial analysts. A number of analysts that have covered us in the past are no longer able to continue to do so owing to changes in employment, to restrictions on the size of companies they are allowed to cover and/or their firms have shut down operations. An inability to attract analyst coverage may adversely affect our ability to raise capital from investors, particularly institutional investors. Our inability to access the capital markets on favorable terms, or at all, may adversely affect our future financial performance. The inability to obtain adequate financing capital sources could force us to seek debt financing, self-fund strategic initiatives or even forgo certain opportunities, which in turn could potentially harm our current and future performance.

**Because there is generally no established market in which to value our investments, our Valuation Committee's value determinations may differ materially from the values that a ready market or third party would attribute to these investments.**

There is generally no public market for the private equity securities in which we invest. Pursuant to the requirements of the 1940 Act, we value all of the private equity securities in our portfolio at fair value as determined in good faith by a committee of independent members of our Board of Directors, which we call the Valuation Committee, pursuant to Valuation Procedures established by the Board of Directors. Determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment pursuant to specified valuation principles and processes. We are required by the 1940 Act to value specifically each individual investment on a quarterly basis and record unrealized depreciation for an investment that we believe has become impaired. Conversely, we must record unrealized appreciation if we believe that a security has appreciated in value. Our valuations, although stated as a precise number, are necessarily within a range of values that vary depending on the significance attributed to the various factors being considered.

We use the Black-Scholes-Merton option pricing model to determine the fair value of warrants held in our portfolio. Option pricing models, including the Black-Scholes-Merton model, require the use of subjective input assumptions, including expected volatility, expected life, expected dividend rate, and expected risk-free rate of return. In the Black-Scholes-Merton model, variations in the expected volatility or expected term assumptions have a significant impact on fair value. Because the securities underlying the warrants in our portfolio are not publicly traded, many of the required input assumptions are more difficult to estimate than they would be if a public market for the underlying securities existed.

Without a readily ascertainable market value and because of the inherent uncertainty of valuation, the fair value that we assign to our investments may differ from the values that would have been used had an efficient market existed for the investments, and the difference could be material. Any changes in fair value are recorded in our consolidated statements of operations as a change in the "Net (decrease) increase in unrealized appreciation on investments."

In the venture capital industry, even when a portfolio of early-stage, high-technology venture capital investments proves to be profitable over the portfolio's lifetime, it is common for the portfolio's value to undergo a so-called "J-curve" valuation pattern. This means that when reflected on a graph, the portfolio's valuation would appear in the shape of the letter "J," declining from the initial valuation prior to increasing in valuation. This J-curve valuation pattern results from write-downs and write-offs of portfolio investments that appear to be unsuccessful, prior to write-ups for portfolio investments that prove to be successful. Because early-stage companies typically have negative cash flow and are by their nature inherently fragile, a valuation process can more readily substantiate a loss of value than an increase in value. Even if our venture capital investments prove to be profitable in the long run, such J-curve valuation patterns could have a significant adverse effect on our net asset value per share and the value of our common stock in the interim. Over time, as we continue to make additional nanotechnology investments, this J-curve pattern may be less relevant for our portfolio as a whole, because the individual J-curves for each investment, or series of investments, may overlap with previous investments at different stages of their J-curves.

**Changes in valuations of our privately held, early stage companies tend to be more volatile than changes in prices of publicly traded securities.**

Investments in privately held, early-stage companies are inherently more volatile than investments in more mature businesses. Such immature businesses are inherently fragile and easily affected by both internal and external forces. Our investee companies can lose much or all of their value suddenly in response to an internal or external adverse event. Conversely, these immature businesses can gain suddenly in value in response to an internal or external positive development. Moreover, because our ownership interests in such investments are generally valued only at quarterly intervals by our Valuation Committee, a committee made up of all of the independent members of our Board of Directors, changes in valuations from one valuation point to another tend to be larger than changes in valuations of marketable securities which are revalued in the marketplace much more frequently, in some highly liquid cases, virtually continuously. Information pertinent to our portfolio companies is not always known immediately by us, and, therefore, its availability for use in determining value may not always coincide with the timeframe of our valuations required by the federal securities laws.



**We expect to continue to experience material write-downs of securities of portfolio companies.**

Write-downs of securities of our privately held companies have always been a by-product and risk of our business. We expect to continue to experience material write-downs of securities of privately held portfolio companies. Write-downs of such companies occur at all stages of their development. Such write-downs may increase in dollar terms, frequency and as a percentage of our net asset value as our dollar investment activity in privately held companies continues to increase, and the number of such holdings in our portfolio continues to grow. Because the average size of each of our investments in nanotechnology has increased from year to year and continues to increase, the average size of our write-downs may also increase.

**Because we do not choose investments based on a strategy of diversification, nor do we rebalance the portfolio should one or more investments increase in value substantially relative to the rest of the portfolio, the value of our portfolio is subject to greater volatility than the value of companies with more broadly diversified investments.**

We do not choose investments based on a strategy of diversification. We also do not rebalance the portfolio should one of our portfolio companies increase in value substantially relative to the rest of the portfolio. Therefore, the value of our portfolio may be more vulnerable to events affecting a single sector or industry and, therefore, subject to greater volatility than a company that follows a diversification strategy. Accordingly, an investment in our common stock may present greater risk to you than an investment in a diversified company.

**We are dependent upon key management personnel for future success, and may not be able to retain them.**

We are dependent upon the diligence and skill of our senior management and other key advisers for the selection, structuring, closing and monitoring of our investments. We utilize lawyers, and we utilize outside consultants, including one of our directors, Lori D. Pressman, to assist us in conducting due diligence when evaluating potential investments. There is generally no publicly available information about the companies in which we invest, and we rely significantly on the diligence of our employees and advisers to obtain information in connection with our investment decisions. Our future success, to a significant extent, depends on the continued service and coordination of our senior management team, particularly on Douglas W. Jamison, our Chairman and Chief Executive Officer and a Managing Director, who was designated by our Board of Directors as the successor to Mr. Harris upon his retirement in his positions of Chairman and Chief Executive Officer as of January 1, 2009; on Daniel B. Wolfe, our President, Chief Operating Officer, Chief Financial Officer and a Managing Director; on Alexei A. Andreev and Michael A. Janse, each an Executive Vice President and Managing Director; and on Sandra M. Forman, our General Counsel, Chief Compliance Officer and Director of Human Resources. The departure of any of our executive officers, key employees or advisers could materially adversely affect our ability to implement our business strategy. We do not maintain for our benefit any key-man life insurance on any of our officers or employees.

**We will need to hire additional employees as the size of our portfolio increases.**

We anticipate that it will be necessary for us to add investment professionals with expertise in venture capital and/or nanotechnology and administrative and support staff to accommodate the increasing size of our portfolio. We may need to provide additional scientific, business, accounting, legal or investment training for our hires. There is competition for highly qualified personnel. We may not be successful in our efforts to recruit and retain highly qualified personnel because the expenses that we incur as a heavily regulated, publicly held company preclude our paying as high a percentage of our total expenses in cash compensation for employees as the private partnerships with which we compete. Although we have the advantage of offering equity incentive compensation, unlike those private partnerships, we cannot permit co-investment in our investments by our employees, and we cannot give our employees 20 percent or higher carried interests in our investments as incentive compensation taxable as long-term capital gains.

**The market for venture capital investments, including nanotechnology investments, is highly competitive.**

We face substantial competition in our investing activities from many competitors, including but not limited to: private venture capital funds; investment affiliates of large industrial, technology, service and financial companies; small business investment companies; hedge funds; wealthy individuals; and foreign investors. Our most significant competitors typically have significantly greater financial resources than we do. Greater financial resources are particularly advantageous in securing lead investor roles in venture capital syndicates. Lead investors typically negotiate the terms and conditions of such financings. Many sources of funding compete for a small number of attractive investment opportunities. Hence, we face substantial competition in sourcing good investment opportunities on terms of investment that are commercially attractive.

**In addition to the difficulty of finding attractive investment opportunities, our status as a regulated business development company may hinder our ability to participate in investment opportunities or to protect the value of existing investments.**

We are required to disclose on a quarterly basis the names and business descriptions of our portfolio companies and the type and value of our portfolio securities. Most of our competitors are not subject to these disclosure requirements. Our obligation to disclose this information could hinder our ability to invest in some portfolio companies. Additionally, other current and future regulations may make us less attractive as a potential investor than a competitor not subject to the same regulations.

**Our failure to make follow-on investments in our portfolio companies could impair the value of our portfolio.**

Following an initial investment in a portfolio company, we may make additional investments in that portfolio company as "follow-on" investments, in order to: (1) increase or maintain in whole or in part our ownership percentage; (2) exercise warrants, options or convertible securities that were acquired in the original or subsequent financing; or (3) attempt to preserve or enhance the value of our investment.

We may elect not to make follow-on investments or lack sufficient funds to make such investments. We have the discretion to make any follow-on investments, subject to the availability of capital resources. The failure to make a follow-on investment may, in some circumstances, jeopardize the continued viability of a portfolio company and our initial investment, or may result in a missed opportunity for us to increase our participation in a successful operation, or may cause us to lose some or all preferred rights pursuant to "pay-to-play" provisions that have become common in venture capital transactions. These provisions require proportionate investment in subsequent rounds of financing in order to preserve preferred rights such as anti-dilution protection, liquidation preferences and preemptive rights to invest in future rounds of financing. Even if we have sufficient capital to make a desired follow-on investment, we may elect not to make a follow-on investment because we may not want to increase our concentration of risk, because we prefer other opportunities or because we are inhibited by compliance with business development company requirements or the desire to maintain our tax status.

**Bank borrowing or the issuance of debt securities or preferred stock by us, to fund investments in portfolio companies or to fund our operating expenses, would make our total return to common shareholders more volatile.**

Use of debt or preferred stock as a source of capital entails two primary risks. The first is the risk of leverage, which is the use of debt to increase the pool of capital available for investment purposes. The use of debt leverages our available common equity capital, magnifying the impact on net asset value of changes in the value of our investment portfolio. For example, a business development company that uses 33 percent leverage (that is, \$50 of leverage per \$100 of common equity) will show a 1.5 percent increase or decline in net asset value for each 1 percent increase or decline in the value of its total assets. The second risk is that the cost of debt or preferred stock financing may exceed the return on the assets the proceeds are used to acquire, thereby diminishing rather than enhancing the return to common shareholders. If we issue preferred shares or debt, the common shareholders would bear the cost of this leverage. To the extent that we utilize debt or preferred stock financing for any purpose, these two risks would likely make our total return to common shareholders more volatile. In addition, we might be required to sell investments, in order to meet dividend, interest or principal payments, when it might be disadvantageous for us to do so.

As provided in the 1940 Act and subject to some exceptions, we can issue debt or preferred stock so long as our total assets immediately after the issuance, less some ordinary course liabilities, exceed 200 percent of the sum of the debt and any preferred stock outstanding. The debt or preferred stock may be convertible in accordance with SEC guidelines, which might permit us to obtain leverage at more attractive rates. The requirement under the 1940 Act to pay, in full, dividends on preferred shares or interest on debt before any dividends may be paid on our common stock means that dividends on our common stock from earnings may be reduced or eliminated. An inability to pay dividends on our common stock could conceivably result in our ceasing to qualify as a regulated investment company, or RIC, under the Code, which would in most circumstances be materially adverse to the holders of our common stock. As of the date hereof, we do not have any debt or preferred stock outstanding.

**We are authorized to issue preferred stock, which would convey special rights and privileges to its owners senior to those of common stock shareholders.**

We are currently authorized to issue up to 2,000,000 shares of preferred stock, under terms and conditions determined by our Board of Directors. These shares would have a preference over our common stock with respect to dividends and liquidation. The statutory class voting rights of any preferred shares we would issue could make it more difficult for us to take some actions that might, in the future, be proposed by the Board and/or holders of common stock, such as a merger, exchange of securities, liquidation or alteration of the rights of a class of our securities, if these actions were perceived by the holders of the preferred shares as not in their best interests. The issuance of preferred shares convertible into shares of common stock might also reduce the net income and net asset value per share of our common stock upon conversion.

**Loss of status as a RIC would reduce our net asset value and distributable income.**

We currently intend to qualify as a RIC for 2009 under the Code. As a RIC, we do not have to pay federal income taxes on our income (including realized gains) that is distributed to our shareholders. Accordingly, we are not permitted under accounting rules to establish reserves for taxes on our unrealized capital gains. If we failed to qualify for RIC status in 2009 or beyond, to the extent that we had unrealized gains, we would have to establish reserves for taxes, which would reduce our net asset value, accordingly. In addition, if we, as a RIC, were to decide to make a deemed distribution of net realized capital gains and retain the net realized capital gains, we would have to establish appropriate reserves for taxes that we would have to pay on behalf of shareholders. It is possible that establishing reserves for taxes could have a material adverse effect on the value of our common stock.

**We operate in a heavily regulated environment, and changes to, or non-compliance with, regulations and laws could harm our business.**

We are subject to substantive SEC regulations as a BDC. Securities and tax laws and regulations governing our activities may change in ways adverse to our and our shareholders' interests, and interpretations of these laws and regulations may change with unpredictable consequences. Any change in the laws or regulations that govern our business could have an adverse impact on us or on our operations. Changing laws, regulations and standards relating to corporate governance, valuation and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations, new federal accounting standards and Nasdaq Stock Market rules, are creating additional expense and uncertainty for publicly held companies in general, and for BDCs in particular. These new or changed laws, regulations and standards are subject to varying interpretations in many cases because of their lack of specificity, and as a result, their application in practice may evolve over time, which may well result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices.

We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations and standards have and will continue to result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. In particular, our efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding our required assessment of our internal controls over financial reporting has required the commitment of significant financial and managerial resources.

Moreover, even though BDCs are not mutual funds, they must comply with several of the regulations applicable to mutual funds, such as the requirement for the implementation of a comprehensive compliance program and the appointment of a Chief Compliance Officer. Further, our Board members, Chief Executive Officer and Chief Financial Officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified Board members and executive officers, which could harm our business, and we have significantly increased both our coverage under, and the related expense for, directors' and officers' liability insurance. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies, our reputation may be harmed. Also, as business and financial practices continue to evolve, they may render the regulations under which we operate less appropriate and more burdensome than they were when originally imposed. This increased regulatory burden is causing us to incur significant additional expenses and is time consuming for our management, which could have a material adverse effect on our financial performance.

**Market prices of our common stock will continue to be volatile.**

We expect that the market price of our common stock price will continue to be volatile. The price of the common stock may be higher or lower than the price you pay for your shares, depending on many factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include the following:

- stock market and capital markets conditions;
- internal developments in our Company with respect to our personnel, financial condition and compliance with all applicable regulations;
- announcements regarding any of our portfolio companies;
- announcements regarding developments in the nanotechnology or cleantech-related fields in general;
- environmental and health concerns regarding nanotechnology, whether real or perceptual;
- announcements regarding government funding and initiatives related to the development of nanotechnology or cleantech-related products;
- general economic conditions and trends; and/or
- departures of key personnel.

We will not have control over many of these factors, but expect that our stock price may be influenced by them. As a result, our stock price may be volatile, and you may lose all or part of your investment.

**Quarterly results fluctuate and are not indicative of future quarterly performance.**

Our quarterly operating results fluctuate as a result of a number of factors. These factors include, among others, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we and our portfolio companies encounter competition in our markets and general economic and capital markets conditions. As a result of these factors, results for any one quarter should not be relied upon as being indicative of performance in future quarters.

**To the extent that we do not realize income or choose not to retain after-tax realized capital gains, we will have a greater need for additional capital to fund our investments and operating expenses.**

As a RIC, we must annually distribute at least 90 percent of our investment company taxable income as a dividend and may either distribute or retain our realized net capital gains from investments. As a result, these earnings may not be available to fund investments. If we fail to generate net realized capital gains or to obtain funds from outside sources, it would have a material adverse effect on our financial condition and results of operations as well as our ability to make follow-on and new investments. Because of the structure and objectives of our business, we generally expect to experience net operating losses and rely on proceeds from sales of investments, rather than on investment income, to defray a significant portion of our operating expenses. These sales are unpredictable and may not occur. In addition, as a BDC, we are generally required to maintain a ratio of at least 200 percent of total assets to total borrowings and preferred stock, which may restrict our ability to borrow to fund these requirements. Lack of capital could curtail our investment activities or impair our working capital.

**Investment in foreign securities could result in additional risks.**

We may invest in foreign securities, and we currently have one investment in a foreign security. When we invest in securities of foreign issuers, we may be subject to risks not usually associated with owning securities of U.S. issuers. These risks can include fluctuations in foreign currencies, foreign currency exchange controls, social, political and economic instability, differences in securities regulation and trading, expropriation or nationalization of assets and foreign taxation issues. In addition, changes in government administrations or economic or monetary policies in the United States or abroad could result in appreciation or depreciation of our securities and could favorably or unfavorably affect our operations. It may also be more difficult to obtain and enforce a judgment against a foreign issuer. Any foreign investments made by us must be made in compliance with U.S. and foreign currency restrictions and tax laws restricting the amounts and types of foreign investments.

Although most of our investments are denominated in U.S. dollars, our investments that are denominated in a foreign currency are subject to the risk that the value of a particular currency may change in relation to the U.S. dollar, in which currency we maintain financial statements and valuations. Among the factors that may affect currency values are trade balances, the level of short-term interest rates, differences in relative values of similar assets in different currencies, long-term opportunities for investment and capital appreciation and political developments.

**Investing in our stock is highly speculative and an investor could lose some or all of the amount invested.**

Our investment objective and strategies result in a high degree of risk in our investments and may result in losses in the value of our investment portfolio. Our investments in portfolio companies are highly speculative and, therefore, an investor in our common stock may lose his or her entire investment. The value of our common stock may decline and may be affected by numerous market conditions, which could result in the loss of some or all of the amount invested in our common stock. The securities markets frequently experience extreme price and volume fluctuations that affect market prices for securities of companies in general, and technology and very small capitalization companies in particular. Because of our focus on the technology and very small capitalization sectors, and because we are a very small capitalization company ourselves, our stock price is especially likely to be affected by these market conditions. General economic conditions, and general conditions in nanotechnology and in the semi-conductor and information technology, life sciences, materials science and other high technology industries, including cleantech, may also affect the price of our common stock.

**Our shares might trade at discounts from net asset value or at premiums that are unsustainable over the long term.**

Shares of BDCs like us may, during some periods, trade at prices higher than their net asset value and during other periods, as frequently occurs with closed-end investment companies, trade at prices lower than their net asset value. The possibility that our shares will trade at discounts from net asset value or at premiums that are unsustainable over the long term are risks separate and distinct from the risk that our net asset value per share will decrease. The risk of purchasing shares of a BDC that might trade at a discount or unsustainable premium is more pronounced for investors who wish to sell their shares in a relatively short period of time because, for those investors, realization of a gain or loss on their investments is likely to be more dependent upon changes in premium or discount levels than upon increases or decreases in net asset value per share. Our common stock may not trade at a price higher than or equal to net asset value per share. On December 31, 2008, our stock closed at \$3.95 per share, a discount of \$0.29 to our net asset value per share of \$4.24 as of December 31, 2008.

**The Board of Directors intends to grant stock options to our employees pursuant to the Company's Equity Incentive Plan. When exercised, these options may have a dilutive effect on existing shareholders.**

In accordance with the Company's Equity Incentive Plan, the Company's Board of Directors may grant options from time to time for up to 20 percent of the total shares of stock issued and outstanding. When options are exercised, net asset value per share will decrease if the net asset value per share at the time of exercise is higher than the exercise price. Alternatively, net asset value per share will increase if the net asset value per share at the time of exercise is lower than the exercise price. Therefore, existing shareholders will be diluted if the net asset value per share at the time of exercise is higher than the exercise price of the options. Even though issuance of shares pursuant to exercises of options increases the Company's capital, and regardless of whether such issuance results in increases or decreases in net asset value per share, such issuance results in existing shareholders owning a smaller percentage of the shares outstanding.

**You have no right to require us to repurchase your shares.**

You do not have the right to require us to repurchase your shares of common stock.

**Item 1B. Unresolved Staff Comments.**

None.

**Item 2. Properties.**

The Company maintains its offices at 111 West 57<sup>th</sup> Street, New York, New York 10019, where it leases approximately 3,540 square feet of office space pursuant to lease agreements expiring in 2010. (See "Note 9 of Notes to Consolidated Financial Statements" contained in "Item 8. Consolidated Financial Statements and Supplementary Data.")

On July 1, 2008, we signed a five-year lease for approximately 2,290 square feet of office space at 420 Florence Street, Suite 200, Palo Alto, California 94301, commencing on August 1, 2008, and expiring on August 31, 2013.

**Item 3. Legal Proceedings.**

The Company is not a party to any legal proceedings.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.



## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

#### Market Information

Our common stock is traded on the Nasdaq Global Market under the symbol "TINY." The following table sets forth the range of the high and low sales price of the Company's shares during each quarter of the last two fiscal years, as reported by Nasdaq Global Market. The quarterly stock prices quoted represent interdealer quotations and do not include markups, markdowns or commissions.

<b>2008 Quarter Ending</b>	<b>Low</b>	<b>High</b>
March 31	\$ 5.76	\$ 8.98
June 30	\$ 6.00	\$ 8.73
September 30	\$ 4.97	\$ 8.50
December 31	\$ 3.10	\$ 6.58
<b>2007 Quarter Ending</b>	<b>Low</b>	<b>High</b>
March 31	\$ 11.00	\$ 13.58
June 30	\$ 11.01	\$ 14.32
September 30	\$ 9.51	\$ 11.79
December 31	\$ 8.00	\$ 11.10

#### Shareholders

As of March 12, 2009, there were approximately 149 holders of record of the Company's common stock. As of February 13, 2009, there were approximately 20,066 beneficial owners of the Company's common stock.

#### Dividends

We did not pay a cash dividend or declare a deemed dividend for 2008 or 2007. For more information about deemed dividends, please refer to the discussion under "Subchapter M Status."

## Securities Authorized for Issuance Under Equity Compensation Plans

### EQUITY COMPENSATION PLAN INFORMATION As of December 31, 2008

<b>Plan category</b>	<b>Number of securities to be issued upon exercise of outstanding options, warrants and rights</b>	<b>Weighted-average exercise price of outstanding options, warrants and rights</b>	<b>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in Column (a))</b>
	<b>(a)</b>	<b>(b)</b>	<b>(c)</b>
Equity compensation plans approved by security holders	4,638,213	\$9.30	(1)
Equity compensation plans not approved by security holders	-	-	-
<b>TOTAL</b>	<b>4,638,213</b>	<b>\$9.30</b>	<b>(1)</b>

<sup>(1)</sup> A maximum of twenty percent (20%) of our total shares of our common stock issued and outstanding will be available for awards under the plan, subject to adjustment as described below. Shares issued under the plan may be authorized but unissued shares or treasury shares. If any shares subject to an award granted under the plan are forfeited, cancelled, exchanged or surrendered, or if an award terminates or expires without a distribution of shares, or if shares of stock are surrendered or withheld as payment of the exercise price of an award, those shares will again be available for awards under the plan.

#### Recent Sales of Unregistered Securities

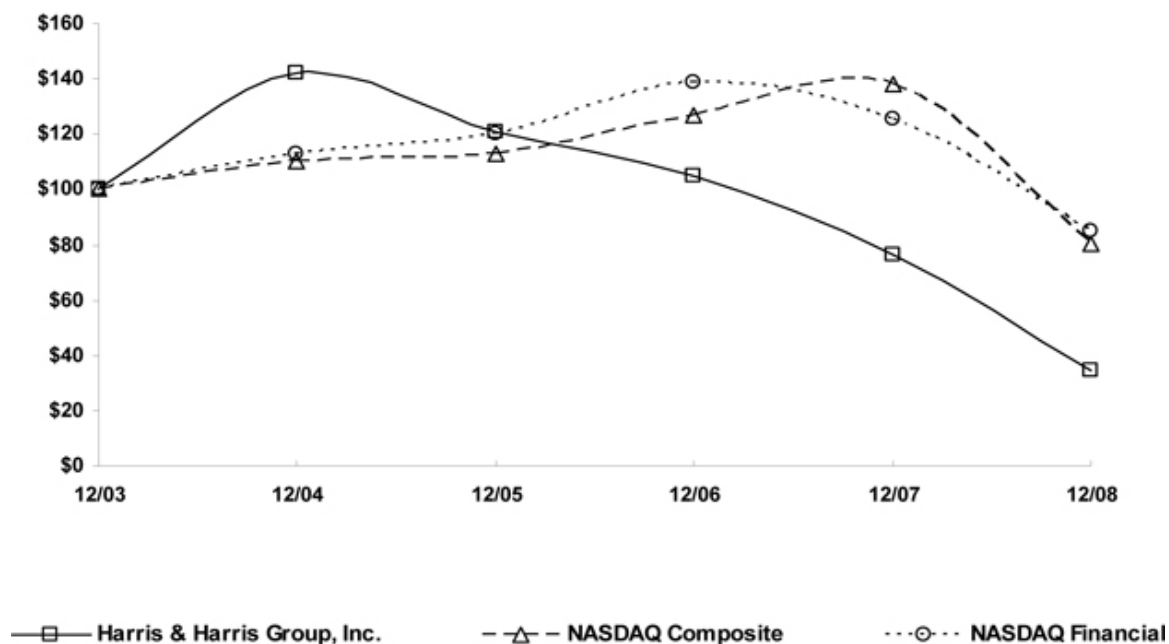
The Company did not sell any equity securities during 2008 that were not registered under the Securities Act of 1933.

#### Performance Graph

The graph below compares the cumulative five-year total return of holders of the Company's common stock with the cumulative total returns of the Nasdaq Composite index and the Nasdaq Financial index. The graph assumes that the value of the investment in the Company's common stock and in each of the indexes (including reinvestment of dividends) was \$100 on December 31, 2003 and tracks it through December 31, 2008.

## COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\*

Among Harris & Harris Group, Inc., The NASDAQ Composite Index  
And The NASDAQ Financial Index



\*\$100 invested on 12/31/03 in stock & index-including reinvestment of dividends.  
Fiscal year ending December 31.

	12/03	12/04	12/05	12/06	12/07	12/08
Harris & Harris Group, Inc.	100.00	142.06	120.56	104.86	76.24	34.26
NASDAQ Composite	100.00	110.08	112.88	126.51	138.13	80.47
NASDAQ Financial	100.00	113.05	120.15	138.66	125.59	85.29

*The stock price performance included in this graph is not necessarily indicative of future stock price performance.*

*Source: Research Data Group, Inc.*

### Stock Transfer Agent

American Stock Transfer & Trust Company, 59 Maiden Lane, New York, New York 10038 (Telephone 800-937-5449, Attention: Mr. Joe Wolf) serves as transfer agent for our common stock. Certificates to be transferred should be mailed directly to the transfer agent, preferably by registered mail.

## Item 6. Selected Financial Data.

The information below was derived from the audited Consolidated Financial Statements included in this report and in previous annual reports filed with the SEC. This information should be read in conjunction with those Consolidated Financial Statements and Supplementary Data and the notes thereto. These historical results are not necessarily indicative of the results to be expected in the future.

### Financial Position as of December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Total assets	\$111,627,601	\$142,893,332	\$118,328,590	\$132,938,120	\$79,361,451
Total liabilities	\$ 2,096,488	\$ 4,529,988	\$ 4,398,287	\$ 14,950,378	\$ 4,616,652
Net assets	\$109,531,113	\$138,363,344	\$113,930,303	\$117,987,742	\$74,744,799
Net asset value per outstanding share	\$ 4.24	\$ 5.93	\$ 5.42	\$ 5.68	\$ 4.33
Cash dividends paid	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
Cash dividends paid per outstanding share	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
Shares outstanding, end of year	25,859,573	23,314,573	21,015,017	20,756,345	17,248,845

### Operating Data for Year Ended December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Total investment income	\$ 1,987,347	\$ 2,705,636	\$ 3,028,761	\$ 1,540,862	\$ 637,562
Total expenses <sup>1</sup>	\$ 12,674,498	\$ 14,533,179	\$ 10,641,696	\$ 7,006,623	\$ 4,046,341
Net operating loss	\$(10,687,151)	\$(11,827,543)	\$(7,612,935)	\$(5,465,761)	\$(3,408,779)
Total tax expense (benefit) <sup>2</sup>	\$ 34,121	\$ 87,975	\$ (227,355)	\$ 8,288,778	\$ 650,617
Net realized (loss) income from investments	\$ (8,323,634)	\$ 30,162	\$ 258,693	\$14,208,789	\$ 858,503
Net (increase) decrease in unrealized depreciation on investments	\$(30,170,712)	\$ 5,080,936	\$ (4,418,870)	\$(2,026,652)	\$ 484,162
Net (decrease) increase in net assets resulting from operations	\$(49,181,497)	\$ (6,716,445)	\$(11,773,112)	\$ 6,716,376	\$(2,066,114)
(Decrease) increase in net assets resulting from operations per average outstanding share	\$ (1.99)	\$ (0.30)	\$ (0.57)	\$ 0.36	\$ (0.13)

<sup>1</sup> Included in total expenses is non-cash, stock-based, compensation expense of \$5,965,769 in 2008; \$8,050,807 in 2007; and \$5,038,956 in 2006. There was no stock-based compensation expense in 2005 or 2004. Also included in total expenses are the following profit-sharing expenses: \$0 in each of 2008 and 2007; \$50,875 in 2006; \$1,796,264 in 2005; and \$311,594 in 2004.

<sup>2</sup> Included in total tax expense are the following taxes paid by the Company on behalf of shareholders: \$0 in each of 2008, 2007 and 2006; \$8,122,367 in 2005; and \$0 in 2004.

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The information contained in this section should be read in conjunction with the Company's 2008 Consolidated Financial Statements and notes thereto.

### **Forward-Looking Statements**

The information contained herein may contain "forward-looking statements" based on our current expectations, assumptions and estimates about us and our industry. These forward-looking statements involve risks and uncertainties. Words such as "believe," "anticipate," "estimate," "expect," "intend," "plan," "will," "may," "might," "could," "continue" and other similar expressions identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of several factors more fully described in "Risk Factors" and elsewhere in this Form 10-K. The forward-looking statements made in this Form 10-K relate only to events as of the date on which the statements are made. We undertake no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

### **Background and Overview**

We incorporated under the laws of the state of New York in August 1981. In 1983, we completed an initial public offering. In 1984, we divested all of our assets except Otisville BioTech, Inc., and became a financial services company with the investment in Otisville as the initial focus of our business activity.

In 1992, we registered as an investment company under the 1940 Act, commencing operations as a closed-end, non-diversified investment company. In 1995, we elected to become a business development company subject to the provisions of Sections 55 through 65 of the 1940 Act.

We have discretion in the investment of our capital. Primarily, we invest in illiquid equity securities. Generally, these investments take the form of preferred stock, are subject to restrictions on resale and have no established trading market. Throughout our corporate history, we have made primarily early stage venture capital investments in a variety of industries. We define venture capital as the money and resources made available to privately held start-up firms and privately held and publicly traded small businesses with exceptional growth potential. These businesses can range in stage from pre-revenue to cash flow positive. These businesses tend to be thinly capitalized, unproven, small companies that lack management depth, have little or no history of operations and are developing unproven technologies. At December 31, 2008, \$56,965,153, or 52.0 percent, of our net assets at fair value consisted of private venture capital investments, net of unrealized depreciation of \$34,124,848. At December 31, 2007, \$78,110,384, or 56.5 percent, of our net assets at fair value consisted of private venture capital investments, net of unrealized depreciation of \$4,567,144.

Since our investment in Otisville in 1983 through December 31, 2008, we have made a total of 84 venture capital investments, including four private placement investments in securities of publicly traded companies. We have exited 50 of these 84 investments, realizing total proceeds of \$143,923,354 on our invested capital of \$60,549,559. As measured from first dollar in to last dollar out, the average and median holding periods for these 50 investments were 3.68 years and 3.20 years, respectively. As measured by the 173 separate rounds of investment within these 50 investments, the average and median holding periods for the 173 separate rounds of investment were 2.86 years and 2.53 years, respectively.

In 1994, we made our first nanotechnology investment. From August 2001 through December 31, 2008, all 42 of our initial investments have been in companies commercializing or integrating products enabled by nanotechnology or microsystems. We use the term "tiny technology" to describe both of these disciplines. From August 2001 through December 31, 2008, we have invested a total (before any subsequent write-ups, write-downs or dispositions) of \$104,414,712 in these companies.

We currently have 33 active tiny technology companies in our portfolio, including one investment made prior to 2001. At December 31, 2008, from first dollar in, the average and median holding periods for these 33 active tiny technology investments were 3.67 years and 3.62 years, respectively.

Our cumulative dollars invested in nanotechnology and microsystems increased from \$489,999 for the year ended December 31, 2001, to \$104,414,712 through December 31, 2008.

The following is a summary of our initial and follow-on investments in nanotechnology over the past five years. We consider a "round led" to be a round where we were the new investor or the leader of a set of new investors in an investee company. Typically, but not always, the lead investor negotiates the price and terms of a deal with the investee company.

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Total Incremental Investments	\$14,837,846	\$16,251,339	\$24,408,187	\$20,595,161	\$17,779,462
No. of New Investments	8	4	6	7	4
No. of Follow-On Investment Rounds	21	13	14	20	25
No. of Rounds Led	2	0	7	3	4
Average Dollar Amount – Initial	\$ 911,625	\$ 1,575,000	\$ 2,383,424	\$ 1,086,441	\$ 683,625
Average Dollar Amount – Follow- On	\$ 359,278	\$ 765,488	\$ 721,974	\$ 649,504	\$ 601,799

We value our private venture capital investments each quarter as determined in good faith by our Valuation Committee, a committee of all our independent directors, within guidelines established by our Board of Directors in accordance with the 1940 Act. (See "Footnote to Consolidated Schedule of Investments" contained in "Item 8. Consolidated Financial Statements and Supplementary Data.")

In the years 2004 through 2008, the Company recorded the following gross write-ups in privately held securities as a percentage of net assets at the beginning of the year ("BOY"), gross write-downs in privately held securities as a percentage of net assets at the beginning of the year, and net write-ups/(write-downs) in privately held securities as a percentage of net assets at the beginning of the year.

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Net Asset Value, BOY	\$40,682,738	\$74,744,799	\$117,987,742	\$113,930,303	\$138,363,344
Gross Write-Downs During Year	\$ (5,711,229)	\$ (3,450,236)	\$ (4,211,323)	\$ (7,810,794)	\$ (39,671,588)
Gross Write-Ups During Year	\$ 6,288,397	\$23,485,176	\$ 279,363	\$ 11,694,618	\$ 820,559
Gross Write-Downs as a Percentage of Net Asset Value, BOY	-14.04%	-4.62%	-3.57%	-6.86%	-28.67%
Gross Write-Ups as a Percentage of Net Asset Value, BOY	15.46%	31.42%	0.24%	10.26%	0.59%
Net Write-Downs/Write-Ups as a Percentage of Net Asset Value, BOY	1.42 %	26.8%	-3.33%	3.40%	-28.08%

During the year ended December 31, 2008, we recorded gross write-downs of \$39,671,588. These write-downs primarily reflect the non-performance risk associated with our portfolio companies in the current business environment. This non-performance risk accounted for approximately 60 percent of the \$39,671,588 in gross write-downs and applied to approximately 50 percent of our portfolio companies. The remaining 40 percent of write-downs reflected adjustments of valuations relating to specific fundamental developments unique to particular portfolio companies. We define non-performance risk as the risk that a portfolio company will be: (a) unable to raise capital, will need to be shut down and will not return our invested capital; or (b) able to raise capital, but at a valuation significantly lower than the implied post-money valuation. Our best estimate of the non-performance risk of our portfolio companies has been quantified and included in the valuation of the companies as of December 31, 2008.

The increase or decrease in the value of our venture capital investments does not affect the day-to-day operations of the Company, as we have no debt and fund our venture capital investments and daily operating expenses from interest earned and proceeds from the sales of our investments in U.S. government and agency obligations, which is where we hold our cash. As of December 31, 2008, we held \$52,983,940 in U.S. government obligations.

Our principal objective is to achieve long-term capital appreciation. Therefore, a significant portion of our investment portfolio provides little or no income in the form of dividends or interest. We earn interest income from fixed-income securities, including U.S. government and agency securities. The amount of interest income we earn varies with the average balance of our fixed-income portfolio and the average yield on this portfolio. Interest income is secondary to capital gains and losses in our results of operations.

### **Current Business Environment**

We continually examine our approach to investing activities based on the market conditions at the time of investment. The slowdown in global economic activities that began with the intensification of the housing and credit crises during the third quarter of 2008 resulted in a global devaluation of assets. For example, between the beginning and end of the fourth quarter of 2008, the Dow Jones Industrial Average dropped 19.1 percent, the S&P 500 dropped 22.5 percent, and the Nasdaq dropped 24.6 percent. From December 31, 2007, to December 31, 2008, the Dow Jones Industrial Average dropped by 33.8 percent, the S&P 500 dropped 38.5 percent and the Nasdaq dropped 40.5 percent. We view this devaluing process as both a concern and an opportunity. We have historically not used leverage or debt financing when making an investment; thus, we continue to finance our new and follow-on investments from our cash reserves, currently invested in U.S. treasury obligations. We have considered how the current conditions will affect how we will fund our own portfolio based on the potential for an increased time to liquidity event, how we will make new investments, what our pace of investment will be and how we will syndicate with others.

Many of our portfolio companies are cash flow negative and, therefore, need additional rounds of financing to continue operations. Articles published in newspapers such as The Wall Street Journal, The New York Times, The Financial Times and other sources present data that supports the conclusion that the availability of capital has been severely affected by this economic downturn. Many venture capital firms, including us, are evaluating their investment portfolios carefully to assess future potential capital needs. In the current business climate, this evaluation may result in a decrease in the number of companies we decide to finance going forward or may increase the number of companies we decide to sell before reaching their full potential. Our ownership in portfolio companies that we decide to stop funding may be subject to punitive action that reduces or eliminates value. This could result in an unprofitable investment or a complete loss of invested funds. If we decide to proceed with a follow-on investment, these rounds of financing may occur at valuations lower than those at which we invested originally.



From conversations with venture capitalists, we believe that this continued collapse in public market asset prices, the growing intensity of the slowdown in global economic activities, and the quick response being taken by venture capitalists to adjust their plans for new and follow-on investments has resulted in another collapse in the venture market. This conclusion is supported by the results of a survey conducted by the National Venture Capital Association that showed "92 percent of venture capitalists are predicting a slowing of venture investment in 2009." Similar to 2008, we expect that our investment pace for new investments will decrease as compared with recent years as we monitor the state of the capital markets. We do not, however, intend to stop making investments and will continue to evaluate investments in companies enabled by nanotechnology and microsystems. Our aim is to preserve our cash and manage our current operating expenses to enable us to make follow-on investments in current portfolio companies and to look for new investment opportunities. In July 2008, the SEC amended a rule expanding the definition of eligible portfolio companies in which BDCs can invest to include publicly traded securities of companies with a market capitalization of less than \$250 million. We believe this action greatly increases our opportunity to invest in public companies involved in nanotechnology. As of December 31, 2008, approximately 51 percent of companies listed on a major U.S. stock exchange had market capitalizations of less than \$250 million. Although we do not currently have any investments in publicly traded securities in our portfolio, we intend to adjust our investment focus, as needed, to comply with and/or take advantage of the new rule, as well as other regulatory, legislative, administrative or judicial actions in this area.

For new and follow-on investments, we generally syndicate with other venture capital firms and corporate investors. We plan to continue this approach, while taking into account that the current economic turmoil has affected the availability of capital to our potential co-investors, particularly firms that manage a small amount of assets. This fact may reduce the number of potential co-investors available to us when forming syndicates. The inability to form a syndicate of investors may decrease the number of investments made by us in both new and current portfolio companies.

### **Results of Operations**

We present the financial results of our operations utilizing accounting principles generally accepted in the United States for investment companies. On this basis, the principal measure of our financial performance during any period is the net increase/(decrease) in our net assets resulting from our operating activities, which is the sum of the following three elements:

Net Operating Income / (Loss) - the difference between our income from interest, dividends, and fees and our operating expenses.

Net Realized Gain / (Loss) on Investments - the difference between the net proceeds of sales of portfolio securities and their stated cost, plus income from interests in limited liability companies.

Net Increase / (Decrease) in Unrealized Appreciation or Depreciation on Investments - the net unrealized change in the value of our investment portfolio.

Owing to the structure and objectives of our business, we generally expect to experience net operating losses and seek to generate increases in our net assets from operations through the long term appreciation of our venture capital investments. We have relied, and continue to rely, on proceeds from sales of investments, rather than on investment income, to defray a significant portion of our operating expenses. Because such sales are unpredictable, we attempt to maintain adequate working capital to provide for fiscal periods when there are no such sales.

### *Years Ended December 31, 2008, 2007, and 2006*

During the years ended December 31, 2008, 2007, and 2006, we had net decreases in net assets resulting from operations of \$49,181,497, \$6,716,445, and \$11,773,112, respectively.

#### Investment Income and Expenses:

During the years ended December 31, 2008, 2007, and 2006, we had net operating losses of \$10,687,151, \$11,827,543, and \$7,612,935, respectively. The variation in these results is primarily owing to the changes in investment income and operating expenses, including non-cash expense of \$5,965,769 in 2008, \$8,050,807 in 2007, and \$5,038,956 in 2006 associated with the granting of stock options. During the years ended December 31, 2008, 2007, and 2006, total investment income was \$1,987,347, \$2,705,636, and \$3,028,761, respectively. During the years ended December 31, 2008, 2007, and 2006, total operating expenses were \$12,674,498, \$14,533,179, and \$10,641,696, respectively.

During 2008, as compared with 2007, investment income decreased from \$2,705,636 to \$1,987,347, reflecting a decrease in our average holdings of U.S. government securities throughout the period and a decrease in interest rates. During the twelve months ended December 31, 2008, our average holdings of such securities were \$55,978,372, as compared with \$62,184,565 during the year ended December 31, 2007.

Operating expenses, including non-cash, stock-based compensation expenses, were \$12,674,498 and \$14,533,179 for the twelve months ended December 31, 2008, and December 31, 2007, respectively. The decrease in operating expenses for the twelve months ended December 31, 2008, as compared to the twelve months ended December 31, 2007, was primarily owing to decreases in salaries, benefits and stock-based compensation expenses and to decreases in administration and operations expense, professional fees and directors' fees and expenses. Salaries, benefits and non-cash, stock-based compensation expense decreased by \$1,344,671, or 11.8 percent, through December 31, 2008, as compared to December 31, 2007, primarily as a result of a decrease in non-cash expense of \$2,085,038 through December 31, 2008, associated with the Harris & Harris Group, Inc. 2006 Equity Incentive Plan (the "Stock Plan"), offset by an increase in salaries and benefits owing to bonus payments and increased health insurance costs. While the non-cash, stock-based, compensation expense for the Stock Plan increased our operating expenses by \$5,965,769, this increase was offset by a corresponding increase to our additional paid-in capital, resulting in no net impact to our net asset value. The non-cash, stock-based, compensation expense and corresponding increase to our additional paid-in capital may increase in future quarters. Administration and operations expense decreased by \$272,628, or 19.0 percent, for the twelve months ended December 31, 2008, as compared with the same period in 2007, primarily as a result of a decrease in our directors' and officers' liability insurance expense, decreases in the cost of the annual report and proxy-related expenses, and decreases in fees associated with the exercise of stock options. Professional fees decreased by \$208,904, or 23.1 percent, primarily as a result of a reduction in the cost of our annual compliance program audit and a reduction in certain legal and accounting fees. Directors' fees and expenses decreased by \$67,677, or 15.6 percent, primarily as a result of fewer meetings held during the year ended December 31, 2008, as compared with the same period through December 31, 2007.

During 2007, as compared with 2006, investment income decreased from \$3,028,761 to \$2,705,636, reflecting a decrease in our average holdings of U.S. government securities throughout the period. During the twelve months ended December 31, 2007, our average holdings of such securities were \$62,184,565, as compared with \$69,506,136 at December 31, 2006.

Operating expenses, including non-cash, stock-based compensation expenses, were \$14,533,179 and \$10,641,696 for the twelve months ended December 31, 2007, and December 31, 2006, respectively. The increase in operating expenses for the twelve months ended December 31, 2007, as compared to the twelve months ended December 31, 2006, was primarily owing to increases in salaries, benefits and stock-based compensation expenses and to increases in administration and operations expense, professional fees and directors' fees and expenses. Salaries, benefits and non-cash, stock-based compensation expense increased by \$3,502,053, or 44.1 percent, through December 31, 2007, as compared to December 31, 2006, primarily as a result of an increase in non-cash expense of \$3,011,851 through December 31, 2007, associated with the Stock Plan. While the non-cash, stock-based, compensation expense for the Stock Plan increased our operating expenses by \$8,050,807, this increase was offset by a corresponding increase to our additional paid-in capital, resulting in no net impact to our net asset value. The non-cash, stock-based, compensation expense and corresponding increase to our additional paid-in capital may increase in future quarters. Salaries and benefits also increased for the twelve months ended December 31, 2007, owing to an increase in our headcount as compared with that of the same period in 2006. At December 31, 2007, we had 13 full-time employees, as compared with 10 full-time employees and one part-time employee at December 31, 2006. Administration and operations expense increased by \$182,573, or 14.6 percent, for the twelve months ended December 31, 2007, as compared with the same period in 2006, owing to an increase in Nasdaq Global Market fees related to the increase in our number of outstanding shares and increased office-related and travel expenses related to the increase in headcount. Professional fees increased by \$165,083, or 22.4 percent, primarily as a result of an increase in legal fees, an increase in audit fees and corporate consulting costs for the audit of our compliance program. Directors' fees and expenses increased by \$94,310, or 27.7 percent, primarily as a result of additional meetings held in the period ended December 31, 2007, as compared with the period ended December 31, 2006, as well as an increase in the monthly retainers paid to committee chairs and to the Lead Independent Director.

During 2006, investment income increased, reflecting an increase in our average holdings of U.S. government securities, as our average holdings increased from \$50,620,881 at December 31, 2005, to \$69,506,136 at December 31, 2006, and as a result of an increase in interest rates during the year. During 2005, investment income increased, reflecting an increase in our income on U.S. government securities, as our holdings increased from \$44,622,722 at December 31, 2004 to \$96,250,864 at December 31, 2005, and as a result of an increase in interest rates during the year.

The increase in operating expenses for the year ended December 31, 2006, was primarily owing to increases in salaries, benefits and stock-based compensation expense, and directors' fees and expenses, offset by decreases in administrative and operations expenses, profit-sharing expense and professional fees. Salaries, benefits and stock-based compensation expense increased by \$5,474,243, or 222.6 percent, for the year ended December 31, 2006, as compared with December 31, 2005, primarily as a result of non-cash expense of \$5,038,956 associated with the Stock Plan adopted during the second quarter of 2006 and secondarily as a result of an increase in the number of full-time employees. The increase in salaries, benefits and stock-based compensation expense reflects expenses associated with ten full-time employees and one part-time employee during the year ended December 31, 2006, as compared with an average of nine full-time employees during the year ended December 31, 2005. Salaries, benefits and stock-based compensation include \$5,038,956 of non-cash expense associated with the Stock Plan, versus no such charge in 2005. Directors' fees and expenses increased by \$31,876, or 10.3 percent, as a result of additional meetings held in 2006 related to the adoption of the Stock Plan. Administrative and operations expense decreased by \$69,274, or 5.3 percent, primarily as a result of a decrease in our directors' and officers' liability insurance expense and decreases in the cost of proxy-related expenses. Profit-sharing expense for the year ended December 31, 2006, was \$50,875, as compared with \$1,796,264 for December 31, 2005, owing to the termination of the profit-sharing plan effective May 4, 2006. We recorded \$50,875 of profit-sharing expense toward the remainder of the 2005 profit-sharing payment in the year ended December 31, 2006, because of updated estimates of our ultimate tax liability for 2005. Professional fees decreased by \$92,234, or 11.1 percent, for the year ended December 31, 2006, as compared with December 31, 2005. Professional fees were lower for the year ended December 31, 2006, as compared with December 31, 2005, primarily as a result of the elimination of consulting costs incurred for a temporary Senior Controller in 2005 and the reduction of some of our Sarbanes-Oxley-related compliance costs incurred in 2005.

#### Realized Gains and Losses from Investments:

During the year ended December 31, 2008, we realized net losses on investments of \$8,323,634. During the years ended December 31, 2007, and 2006, we had net realized income from investments of \$30,162, and \$258,693, respectively. The variation in these results is primarily owing to variations in gross realized gains and losses from investments and income taxes in each of the three years. For the years ended December 31, 2008, 2007, and 2006, we realized (losses) gains from investments, before taxes, of \$(8,289,513), \$118,137, and \$31,338, respectively. Income tax expense (benefit) for the years ended December 31, 2008, 2007, and 2006 was \$34,121, \$87,975, and \$(227,355), respectively.

During the year ended December 31, 2008, we realized net losses of \$8,289,513, consisting primarily of realized losses on our investments in Chlorogen, Inc., of \$1,326,072, on Evolved Nanomaterial Sciences, Inc., of \$2,800,000, on NanoOpto Corporation of \$3,688,581, on Phoenix Molecular Corporation of \$93,487, on Questech Corporation of \$16,253 and on Zia Laser of \$1,478,500, offset by realized gains of \$1,110,821 on the sale of U.S. government securities. During the first quarter of 2008, we received a payment of \$105,714 from the NanoOpto Corporation bridge note.

During the year ended December 31, 2007, we realized net gains of \$118,137, consisting primarily of proceeds received from the sale of our interest in AlphaSimplex Group, LLC, and income from our investment in Exponential Business Development Company. During the year ended December 31, 2007, we recognized tax expense of \$87,975, consisting of \$74,454 of interest and penalties related to our 2005 tax returns and \$13,521 in current year expense.

During the year ended December 31, 2006, we realized net gains of \$31,338, consisting primarily of proceeds received from the liquidation of Optiva, Inc., proceeds received from Exponential Business Development Company, and net losses realized on our investment in AlphaSimplex Group, LLC. During 2005, we deemed the securities we held in Optiva, Inc., worthless and recorded the proceeds received and due to us on the liquidation of our bridge notes, realizing a loss of \$1,619,245. At December 31, 2005, we recorded a \$75,000 receivable for estimated proceeds from the final payment on the Optiva, Inc., bridge notes. During the first quarter of 2006, we received payment of \$95,688 from these bridge notes, resulting in the realized gain of \$20,688 on Optiva, Inc. During the year ended December 31, 2006, we realized tax benefits of \$227,355 for 2005 taxes that had been refunded.

Net Unrealized Appreciation and Depreciation of Portfolio Securities:

During the year ended December 31, 2008, net unrealized depreciation on total investments increased by \$30,170,712.

During the year ended December 31, 2007, net unrealized depreciation on total investments decreased by \$5,080,936.

During the year ended December 31, 2006, net unrealized depreciation on total investments increased by \$4,418,870.

During the year ended December 31, 2008, net unrealized depreciation on our venture capital investments increased by \$29,557,704, or 647.2 percent, from net unrealized depreciation of \$4,567,144 at December 31, 2007, to net unrealized depreciation of \$34,124,848 at December 31, 2008, owing primarily to decreases in the valuations of the following investments held:

<u>Investment</u>	<u>Amount of Write-Down</u>
Adesto Technologies Corporation	\$ 1,100,000
Ancora Pharmaceuticals, Inc.	299,439
BioVex Group, Inc.	2,439,250
BridgeLux, Inc.	3,624,553
Cambrios Technologies Corporation	1,297,012
Cobalt Technologies, Inc.	187,499
Crystal IS, Inc.	1,001,300
CSwitch Corporation	5,177,946
D-Wave Systems, Inc.	22,670
Ensemble Discovery Corporation	1,000,000
Innovalight, Inc.	1,927,946
Kereos, Inc.	159,743
Kovio, Inc.	761,497
Mersana Therapeutics, Inc.	1,019,613
Metabolon, Inc.	2,136,734
Molecular Imprints, Inc.	2,365,417

<u>Investment</u>	<u>Amount of Write-Down</u>
NanoGram Corporation	4,415,417
Nanomix, Inc.	980,418
Neophotonics Corporation	4,024,305
Nextreme Thermal Solutions, Inc.	2,182,133
Polatis, Inc.	276,526
PolyRemedy, Inc.	122,250
Questech Corporation	463,968
Siluria Technologies, Inc.	160,723
SiOnyx, Inc.	1,076,153
Starfire Systems, Inc.	750,000
TetraVitae Bioscience, Inc.	125,000

We also had decreases in unrealized depreciation attributable to the reversal of depreciation owing to net realized losses on Chlorogen, Inc., of \$1,326,072, on Evolved Nanomaterial Sciences, Inc., of \$2,800,000, on NanoOpto Corporation of \$3,688,581, on Questech Corporation of \$16,253 owing to a realized loss on an unexercised warrant that expired on November 19, 2008, and on Zia Laser, Inc., of \$1,478,672. For the twelve months ended December 31, 2008, we had increases in the valuations of our investments in Exponential Business Development Company of \$25 and Solazyme, Inc., of \$820,534. We had a decrease owing to foreign currency translation of \$590,329 on our investment in D-Wave Systems, Inc. Unrealized appreciation on our U.S. government securities portfolio decreased from \$640,660 at December 31, 2007, to \$27,652 at December 31, 2008.

During the year ended December 31, 2007, net unrealized depreciation on our venture capital investments decreased by \$3,883,825, or 46.0 percent, from \$8,450,969 to \$4,567,144, owing primarily to increases in the valuations of our investments in BridgeLux, Inc., of \$3,699,529, Crystal IS, Inc., of \$13,819, CSwitch Corporation, of \$48,935, D-Wave Systems, Inc., of \$202,408, Exponential Business Development Company of \$2,026, Innovalight, Inc., of \$3,218,216, Kovio, Inc., of \$125,000, Mersana Therapeutics, Inc., of \$118,378, NanoGram Corporation of \$2,437,136, NeoPhotonics Corporation of \$2,160, SiOnyx, Inc., of \$899,566, Solazyme, Inc., of \$612,291 and Zia Laser, Inc., of \$6,329, offset by decreases in the valuations of our investments in Ancora Pharmaceuticals, Inc., of \$100,561, Chlorogen, Inc., of \$1,326,073, Evolved Nanomaterial Sciences, Inc., of \$2,800,000, Kereos, Inc., of \$1,340,257, Nanomix, Inc., of \$459,772, NanoOpto Corporation of \$1,369,885, Polatis, Inc., of \$9,534 and Questech Corporation of \$404,712. We also had an increase owing to foreign currency translation of \$307,636 on our investment in D-Wave Systems, Inc. Unrealized depreciation on our U.S. government securities portfolio decreased from \$556,451 at December 31, 2006, to unrealized appreciation of \$640,660 at December 31, 2007.

The net increase in unrealized depreciation on our venture capital investments in 2006 was owing primarily to decreases in the valuations of our investments in Nanomix, Inc., of \$1,710,000, NanoOpto Corporation of \$1,211,259, NeoPhotonics Corporation of \$254,238, Polatis, Inc., of \$145,228, SiOnyx, Inc., of \$679,950 and Zia Laser, Inc., of \$172,500, and to increases in the valuations of our investments in Crystal IS of \$19,735 and Questech Corporation of \$259,628. We also had a decrease, owing to foreign currency translation, of \$34,103 on our investment in D-Wave Systems, Inc. Unrealized depreciation on our U.S. government securities portfolio increased from \$69,541 at December 31, 2005, to \$556,451 at December 31, 2006.

## Financial Condition

### December 31, 2008

At December 31, 2008, our total assets and net assets were \$111,627,601 and \$109,531,113, respectively. Our net asset value ("NAV") per share at that date was \$4.24, and our shares outstanding increased to 25,859,573 at December 31, 2008.

Significant developments in the twelve months ended December 31, 2008, included a decrease in the value of our venture capital investments of \$21,145,231 and a decrease in our holdings in U.S. government obligations of \$7,209,653. The decrease in the value of our venture capital investments from \$78,110,384 at December 31, 2007, to \$56,965,153 at December 31, 2008, resulted primarily from a decrease in the net value of our venture capital investments of \$29,557,704, offset by four new and 25 follow-on investments of \$17,779,462. The decrease in the net value of our venture capital investments is primarily owing to the non-performance risk associated with our portfolio companies in the current economic environment and secondarily to adjustments of valuation to reflect specific fundamental developments unique to particular portfolio companies. The decrease in the value of our U.S. government obligations from \$60,193,593 at December 31, 2007, to \$52,983,940 at December 31, 2008, is primarily owing to the payment of cash basis operating expenses of \$6,397,424 and to new and follow-on venture capital investments totaling \$17,779,462, offset by investment of net proceeds of \$14,383,497 received through the registered direct stock offering.

The following table is a summary of additions to our portfolio of venture capital investments made during the twelve months ended December 31, 2008:

<u>New Investment</u>	<u>Amount</u>
Cobalt Technologies, Inc.	\$ 240,000
Laser Light Engines, Inc.	\$2,000,000
PolyRemedy, Inc.	\$ 244,500
TetraVitae Bioscience, Inc.	\$ 250,000
<b>Follow-on Investment</b>	
Adesto Technologies Corporation	\$1,052,174
Ancora Pharmaceuticals Inc.	\$ 800,000
BioVex Group, Inc.	\$ 200,000
BridgeLux, Inc.	\$1,000,001
Cobalt Technologies, Inc.	\$ 134,999
CFX Battery, Inc.	\$ 526,736
CSwitch Corporation	\$ 986,821

<b>Follow-on Investment</b>	<b>Amount</b>
CSwitch Corporation	\$ 250,000
D-Wave Systems, Inc.	\$ 736,019
D-Wave Systems, Inc.	\$ 487,804
Ensemble Discovery Corporation	\$ 250,286
Kovio, Inc.	\$ 1,500,000
Mersana Therapeutics, Inc.	\$ 200,000
Metabolon, Inc.	\$ 1,000,000
NeoPhotonics Corporation	\$ 200,000
Nextreme Thermal Solutions, Inc.	\$ 377,580
Nextreme Thermal Solutions, Inc.	\$ 200,000
Nextreme Thermal Solutions, Inc.	\$ 200,000
Nextreme Thermal Solutions, Inc.	\$ 800,000
Nextreme Thermal Solutions, Inc.	\$ 1,050,000
Phoenix Molecular Corporation	\$ 25,000
Phoenix Molecular Corporation	\$ 25,000
Siluria Technologies, Inc.	\$ 42,542
Solazyme, Inc.	\$ 2,000,000
Solazyme, Inc.	\$ 1,000,000
<b>Total</b>	<b>\$ 17,779,462</b>

The following tables summarize the values of our portfolios of venture capital investments and U.S. government obligations, as compared with their cost, at December 31, 2008, and December 31, 2007:

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
Venture capital investments, at cost	\$ 91,090,001	\$ 82,677,528
Net unrealized depreciation <sup>(1)</sup>	34,124,848	4,567,144
<b>Venture capital investments, at value</b>	<b>\$ 56,965,153</b>	<b>\$ 78,110,384</b>

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
U.S. government obligations, at cost	\$ 52,956,288	\$ 59,552,933
Net unrealized appreciation <sup>(1)</sup>	27,652	640,660
<b>U.S. government obligations, at value</b>	<b>\$ 52,983,940</b>	<b>\$ 60,193,593</b>

<sup>(1)</sup>At December 31, 2008, and December 31, 2007, the net accumulated unrealized depreciation on investments was \$34,097,196 and \$3,926,484, respectively.



**December 31, 2007**

At December 31, 2007, our total assets and net assets were \$142,893,332 and \$138,363,344, respectively. Our net asset value ("NAV") per share at that date was \$5.93, and our shares outstanding increased to 23,314,573 at December 31, 2007.

During the twelve months ended December 31, 2007, significant developments included an increase in the value of our venture capital investments of \$24,442,553 and an increase in the value of our investment in U.S. government obligations of \$1,537,446. The increase in the value of our venture capital investments, from \$53,667,831 at December 31, 2006, to \$78,110,384 at December 31, 2007, resulted primarily from seven new and 20 follow-on investments and by a net increase of \$3,883,825 in the net value of our venture capital investments. The increase in the value of our U.S. government obligations, from \$58,656,147 at December 31, 2006, to \$60,193,593 at December 31, 2007, is primarily owing to the use of net proceeds of \$12,993,168 received through a registered stock offering and proceeds received from stock option exercises of \$10,105,511, offset by a payment of \$80,236 for federal tax and interest and penalties, profit sharing payments of \$261,661, net operating expenses and by new and follow-on venture capital investments totaling \$20,595,161.

For the year ended December 31, 2007, the Company issued 999,556 shares and received proceeds of \$10,105,511 as a result of employee stock option exercises.

The following table is a summary of additions to our portfolio of venture capital investments made during the twelve months ended December 31, 2007:

<b>New Investments</b>	<b>Cost</b>
Adesto Technologies Corporation	\$ 1,147,826
Ancora Pharmaceuticals, Inc.	\$ 800,000
BioVex Group, Inc.	\$ 2,500,000
Ensemble Discovery Corporation	\$ 2,000,000
Lifco, Inc.	\$ 946,528
Phoenix Molecular Corporation	\$ 50,010
Siluria Technologies, Inc.	\$ 160,723
<b>Follow-on Investments</b>	
BridgeLux, Inc.	\$ 350,877
BridgeLux, Inc.	\$ 233,918
BridgeLux, Inc.	\$ 916,928
Cambrios Technologies Corporation	\$ 1,300,000
Chlorogen, Inc.	\$ 7,042
CSwitch Corporation	\$ 32,624
CSwitch Corporation	\$ 529,852
Innovalight, Inc.	\$ 1,993,568

<u>Follow-on Investments</u>	<u>Cost</u>
Kereos, Inc.	\$ 540,000
Kovio, Inc.	\$ 1,000,000
NanoGram Corporation	\$ 851,393
Mersana Therapeutics, Inc.	\$ 500,000
Nanomix, Inc.	\$ 680,240
NanoOpto Corporation	\$ 268,654
Nextreme Thermal Solutions, Inc.	\$ 750,000
Polatis, Inc.	\$ 17,942
Polatis, Inc.	\$ 13,454
Polatis, Inc.	\$ 58,582
SiOnyx, Inc.	\$ 2,445,000
Solazyme, Inc.	\$ 500,000
Total	<u>\$ 20,595,161</u>

## Cash Flow

### *Year Ended December 31, 2008*

Net cash used in operating activities for the year ended December 31, 2008, was \$4,155,439, primarily owing to the payment of operating expenses.

Cash used in investing activities for the year ended December 31, 2008, was \$9,865,758, primarily reflecting a net decrease in our investment in U.S. government securities of \$7,798,836 and investments in private placements of \$17,779,462, less proceeds from the sale of venture capital investments of \$136,837.

Cash provided by financing activities for the year ended December 31, 2008, was \$14,383,497, resulting from the issuance of 2,545,000 new shares of our common stock on June 20, 2008, in a registered direct stock offering.

### *Year Ended December 31, 2007*

Net cash used in operating activities for the year ended December 31, 2007, was \$4,142,572, primarily owing to the payment of operating expenses.

Cash used in investing activities for the year ended December 31, 2007, was \$20,697,886, primarily reflecting a net increase in our investment in U.S. government obligations of \$235,754 and investments in private placements of \$20,595,161, less proceeds from the sale of venture capital investments of \$174,669.

Cash provided by financing activities for the year ended December 31, 2007, was \$23,098,679, reflecting the issuance of shares in connection with the Stock Plan and the net proceeds from the issuance of 1,300,000 new shares of our common stock on June 25, 2007, in a registered direct follow-on offering.

***Year Ended December 31, 2006***

Net cash used in operating activities for the year ended December 31, 2006, was \$14,955,302, primarily owing both to the payment of various federal, state and local taxes, including the tax paid on behalf of shareholders for the deemed dividend, and to the payment of operating expenses.

Cash provided by investing activities for the year ended December 31, 2006, was \$13,198,611, primarily reflecting net proceeds from the sale of U.S. government obligations of \$37,593,589, less investments in private placements of \$24,408,187.

Cash provided by financing activities for the year ended December 31, 2006, was \$2,615,190, reflecting the issuance of shares in connection with the Stock Plan.

**Liquidity and Capital Resources**

Our liquidity and capital resources are generated and generally available through our cash holdings, interest earned on our investments on U.S. government securities, cash flows from the sales of U.S. government securities, proceeds from periodic follow-on equity offerings and realized capital gains retained for reinvestment.

We fund our day-to-day operations using interest earned and proceeds from the sales of our investments in U.S. government securities. The increase or decrease in the valuations of our private portfolio companies does not impact our daily liquidity. At December 31, 2008, and December 31, 2007, we had no investments in money market mutual funds. We have no debt outstanding, and, therefore, are not subject to credit agency downgrades.

The crisis in the global credit markets during the past year, and more specifically subsequent to September 30, 2008, has adversely affected all industry sectors. We believe that the market disruption may continue to adversely affect financial services companies with respect to the valuation of their investment portfolios, tighter lending standards and reduced access to capital. In addition, the economies of the U.S. and many other countries are in recession, which may be severe and prolonged. These conditions may lead to a further decline in earnings and/or decline in valuation of our portfolio companies. Although we cannot predict future market conditions, we believe that our current cash and U.S. government security holdings and our ability to adjust our investment pace will provide us with adequate liquidity to execute our current business strategy.

Except for a rights offering, we are also generally not able to issue and sell our common stock at a price below our net asset value per share, exclusive of any distributing commission or discount, without shareholder approval. As of December 31, 2008, our net asset value per share was \$4.24 per share and our closing market price was \$3.95 per share. We do not have shareholder approval to issue or sell shares below our net asset value per share.

#### ***December 31, 2008***

At December 31, 2008, and December 31, 2007, our total net primary liquidity was \$53,701,819 and \$61,183,136, respectively.

Our net primary sources of liquidity, which consist of cash, U.S. government obligations and receivables, are adequate to cover our gross cash operating expenses. Our gross cash operating expenses for 2008 and 2007 totaled \$6,397,424 and \$6,263,510, respectively.

The decrease in our primary liquidity from December 31, 2007, to December 31, 2008, is primarily owing to the use of funds for investments and payment of net operating expenses, partially offset by the proceeds received through the registered direct stock offering.

On June 25, 2007, we completed the sale of 1,300,000 shares of our common stock from the shelf registration statement for gross proceeds of \$14,027,000; net proceeds of this offering, after placement agent fees and offering costs of \$1,033,832, were \$12,993,168. We used the net proceeds of this offering to make new investments in nanotechnology, as well as for follow-on investments in our existing venture capital investments and for working capital. Through December 31, 2008, we have used all of the net proceeds from this offering for these purposes.

On June 20, 2008, we completed the sale of 2,545,000 shares of our common stock, for total gross proceeds of \$15,651,750; net proceeds of this offering, after placement agent fees and offering costs of \$1,268,253, were \$14,383,497. We intend to use, and have been using, the net proceeds of this offering to make new investments in nanotechnology, as well as for follow-on investments in our existing venture capital investments and for working capital. Through December 31, 2008, we have used \$11,723,553 of the net proceeds from this offering for these purposes.

On April 17, 2003, we signed a seven-year sublease for office space at 111 West 57<sup>th</sup> Street in New York City. On December 17, 2004, we signed a sublease for additional office space at our current location. The subleases expire on April 29, 2010. Total rent expense for our office space in New York City was \$186,698 in 2008, \$178,167 in 2007, and \$174,625 in 2006. The minimum sublease payments in 2009 will be \$197,700 and \$65,969 thereafter for the remaining term.

On July 1, 2008, we signed a five-year lease for office space at 420 Florence Street, Suite 200, Palo Alto, California, commencing on August 1, 2008, and expiring on August 31, 2013. Total rent expense for our office space in Palo Alto was \$51,525 in 2008. Future minimum lease payments in each of the following years are: 2009 - \$125,206; 2010 - \$128,962; 2011 - \$132,831; 2012 - \$136,816 and 2013 - \$93,135.

### ***December 31, 2007***

At December 31, 2007, and December 31, 2006, our total net primary liquidity was \$61,183,136 and \$61,323,306, respectively.

Our gross cash operating expenses for 2007 and 2006 totaled \$6,263,510 and \$5,285,448, respectively.

The increase in our primary liquidity from December 31, 2006, to December 31, 2007, is primarily owing to the proceeds received through a registered direct stock offering from a shelf registration statement and proceeds received from stock option exercises, offset by the use of funds for investments and payment of net operating expenses.

### **Critical Accounting Policies**

The Company's significant accounting policies are described in Note 2 to the Consolidated Financial Statements and in the Footnote to the Consolidated Schedule of Investments. Critical accounting policies are those that are both important to the presentation of our financial condition and results of operations and those that require management's most difficult, complex or subjective judgments. The Company considers the following accounting policies and related estimates to be critical:

#### Valuation of Portfolio Investments

The most significant estimate inherent in the preparation of our consolidated financial statements is the valuation of investments and the related amounts of unrealized appreciation and depreciation of investments recorded. As a BDC, we invest in primarily illiquid securities that generally have no established trading market.

Investments are stated at "value" as defined in the 1940 Act and in the applicable regulations of the SEC. Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which a market quotation is readily available and (ii) the fair value as determined in good faith by, or under the direction of, the Board of Directors for all other assets. (See "Valuation Procedures" in the "Footnote to Consolidated Schedule of Investments.") At December 31, 2008, our financial statements include private venture capital investments valued at \$56,965,153, the fair values of which were determined in good faith by, or under the direction of, the Board of Directors. At December 31, 2008, approximately 51.0 percent of our total assets represent investments in portfolio companies valued at fair value by the Board of Directors.

Determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment, although our valuation policy is intended to provide a consistent basis for determining fair value of the portfolio investments. Factors that may be considered include, but are not limited to, readily available public market quotations; the cost of the Company's investment; transactions in the portfolio company's securities or unconditional firm offers by responsible parties; the financial condition and operating results of the company; the long-term potential of the business and technology of the company; the values of similar securities issued by companies in similar businesses; multiples to revenues, net income or EBITDA that similar securities issued by companies in similar businesses receive; the proportion of the company's securities we own and the nature of any rights to require the company to register restricted securities under the applicable securities laws; the achievement of milestones; and the rights and preferences of the class of securities we own as compared with other classes of securities the portfolio has issued.

The ongoing financial markets turmoil and severe recession have made it extremely difficult for many companies to raise capital. Moreover, the cost of capital has increased substantially. Historically, difficult venture capital environments have resulted in weak companies not receiving financing and being subsequently closed down with a loss of investment to venture investors, and/or strong companies receiving financing but at significantly lower valuations than the preceding venture rounds, leading to very deep dilution for those who do not participate in the new rounds of investment. This economic and financing environment has caused an increase in the non-performance risk for venture-backed companies. We define non-performance risk as the risk that a portfolio company will be: (a) unable to raise capital, will need to be shut down and will not return our invested capital; or (b) able to raise capital, but at a valuation significantly lower than the implied post-money valuation. Our best estimate of the non-performance risk of our portfolio companies has been quantified and included in the valuation of the companies at December 31, 2008.

All investments recorded at fair value are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," ("SFAS No. 157") and directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets, are as follows:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2: Quoted prices in active markets for similar assets or liabilities, or quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.
- Level 3: Unobservable inputs for the asset or liability.

At December 31, 2008, all of our private portfolio investments were classified as Level 3 in the hierarchy, indicating a high level of judgment required in their valuation.

The values assigned to our assets are based on available information and do not necessarily represent amounts that might ultimately be realized, as these amounts depend on future circumstances and cannot be reasonably determined until the individual investments are actually liquidated or become readily marketable. Upon sale of investments, the values that are ultimately realized may be different from what is presently estimated. This difference could be material.

### Stock-Based Compensation

Determining the appropriate fair-value model and calculating the fair value of share-based awards at the date of grant requires judgment. We use the Black-Scholes-Merton option pricing model to estimate the fair value of employee stock options, consistent with the provisions of Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment," ("SFAS No. 123(R)"). Management uses the Black-Scholes-Merton option pricing model because of the lack of the historical option data that is required for use in other, more complex models. Other models may yield fair values that are significantly different from those calculated by the Black-Scholes-Merton option pricing model.

Option pricing models, including the Black-Scholes-Merton model, require the use of subjective input assumptions, including expected volatility, expected life, expected dividend rate, and expected risk-free rate of return. In the Black-Scholes-Merton model, variations in the expected volatility or expected term assumptions have a significant impact on fair value. As the volatility or expected term assumptions increase, the fair value of the stock option increases. In the Black-Scholes-Merton model, the expected dividend rate and expected risk-free rate of return are not as significant to the calculation of fair value. A higher assumed dividend rate yields a lower fair value, whereas higher assumed interest rates yield higher fair values for stock options.

We use the simplified calculation of expected life described in the SEC's Staff Accounting Bulletin 107 because of the lack of historical information about option exercise patterns. Future exercise behavior could be materially different than that which is assumed by the model.

Expected volatility is based on the historical fluctuations in the Company's stock. The Company's stock has historically been volatile, which increases the fair value of the underlying share-based awards.

SFAS No. 123(R) requires us to develop an estimate of the number of share-based awards that will be forfeited owing to employee turnover. Quarterly changes in the estimated forfeiture rate can have a significant effect on reported share-based compensation, as the effect of adjusting the rate for all expense amortization after the grant date is recognized in the period the forfeiture estimate is changed. If the actual forfeiture rate proves to be higher than the estimated forfeiture rate, then an adjustment will be made to increase the estimated forfeiture rate, which would result in a decrease to the expense recognized in the financial statements. If the actual forfeiture rate proves to be lower than the estimated forfeiture rate, then an adjustment will be made to decrease the estimated forfeiture rate, which would result in an increase to the expense recognized in the financial statements. Such adjustments would affect our operating expenses and additional paid-in capital, but would have no effect on our net asset value.

### Pension and Post-Retirement Benefit Plan Assumptions

The Company provides a Retiree Medical Benefit Plan for employees who meet certain eligibility requirements. Several statistical and other factors that attempt to anticipate future events are used in calculating the expense and liability values related to our post-retirement benefit plans. These factors include assumptions we make about the discount rate, the rate of increase in healthcare costs, and mortality, among others.

The discount rate reflects the current rate at which the post-retirement benefit liabilities could be effectively settled considering the timing of expected payments for plan participants. In estimating this rate, we consider rates of return on high quality fixed-income investments included in published bond indexes. We consider the Citigroup Pension Liability Index in the determination of the appropriate discount rate assumptions. The weighted average rate we utilized to measure our post retirement medical benefit obligation as of December 31, 2008, and to calculate our 2009 expense was 5.71 percent, which is a decrease from the 6.55 percent rate used in determining the 2008 expense. We used a discount rate of 5.75 percent to calculate our pension obligation.

#### **Recent Developments — Portfolio Companies**

On February 4, 2009, we made a \$408,573 follow-on investment in a privately held tiny technology portfolio company.

On February 13, 2009, we made a \$200,000 follow-on investment in a privately held tiny technology portfolio company.

On March 11, 2009, we made a \$3,492 follow-on investment in a privately held tiny technology portfolio company.

On December 31, 2008, we valued the shares of one of our privately held tiny technology portfolio companies at \$2.5188 per share. On February 27, 2009, that company raised additional funding from a third party, independent financial investor at \$5.0376 per share. This transaction could be a material input to our determination of the value of our shares of this portfolio company at March 31, 2009. A valuation calculated based on this input alone could increase the value of this portfolio company at March 31, 2009, ranging from \$0 to approximately \$5,400,000, or \$0 to approximately \$0.21 per share, from the value at December 31, 2008. This input will be one of many used by our Valuation Committee, which is made up of all of our independent directors, to set the value of this portfolio company at March 31, 2009.

#### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

Our business activities contain elements of risk. We consider the principal types of market risk to be valuation risk and the risk associated with fluctuations in interest rates. Although we are risk-seeking rather than risk-averse in our investments, we consider the management of risk to be essential to our business.



Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which market quotations are readily available and (ii) fair value as determined in good faith by, or under the direction of, the Board of Directors for all other assets. (See the "Valuation Procedures" in the "Footnote to Consolidated Schedule of Investments" contained in "Item 8. Consolidated Financial Statements and Supplementary Data.")

Neither our investments nor an investment in us is intended to constitute a balanced investment program.

We have invested a substantial portion of our assets in private development stage or start-up companies. These private businesses tend to be based on new technology and to be thinly capitalized, unproven, small companies that lack management depth and have not attained profitability or have no history of operations. Because of the speculative nature and the lack of a public market for these investments, there is significantly greater risk of loss than is the case with traditional investment securities. We expect that some of our venture capital investments will be a complete loss or will be unprofitable and that some will appear to be likely to become successful but never realize their potential. Even when our private equity investments complete initial public offerings (IPOs), we are normally subject to lock-up agreements for a period of time, and thereafter, the market for the unseasoned publicly traded securities may be relatively illiquid.

Because there is typically no public market for our interests in the small privately held companies in which we invest, the valuation of the equity interests in that portion of our portfolio is determined in good faith by our Valuation Committee, comprised of the independent members of our Board of Directors, in accordance with our Valuation Procedures. In the absence of a readily ascertainable market value, the determined value of our portfolio of equity interests may differ significantly from the values that would be placed on the portfolio if a ready market for the equity interests existed. Any changes in valuation are recorded in our consolidated statements of operations as "Net increase (decrease) in unrealized appreciation on investments." Changes in valuation of any of our investments in privately held companies from one period to another may be volatile.

Investments in privately held, early-stage companies are inherently more volatile than investments in more mature businesses. Such immature businesses are inherently fragile and easily affected by both internal and external forces. Our investee companies can lose much or all of their value suddenly in response to an internal or external adverse event. Conversely, these immature businesses can gain suddenly in value in response to an internal or external positive development. During the twelve months ended December 31, 2008, we recorded gross write-downs of \$39,671,588. These write-downs are primarily owing to the non-performance risk associated with our portfolio companies in the current economic environment and secondarily to adjustments of valuation to reflect specific fundamental developments unique to particular portfolio companies.

We generally also invest in both short and long-term U.S. government and agency securities. To the extent that we invest in short and long-term U.S. government and agency securities, changes in interest rates result in changes in the value of these obligations which result in an increase or decrease of our net asset value. The level of interest rate risk exposure at any given point in time depends on the market environment, the expectations of future price and market movements, and the quantity and duration of long-term U.S. government and agency securities held by the Company, and it will vary from period to period. If the average interest rate on U.S. government securities with three-month maturities which corresponds to the maturities of the Company's holdings at December 31, 2008, were to increase by 25, 75 and 150 basis points, the average value of these securities held by us at December 31, 2008, would decrease by approximately \$132,463, \$397,388 and \$794,775, respectively, and our net asset value would decrease correspondingly.

Most of our investments are denominated in U.S. dollars. We currently have one investment denominated in Canadian dollars. We are exposed to foreign currency risk related to potential changes in foreign currency exchange rates. The potential loss in fair value on this investment resulting from a 10 percent adverse change in quoted foreign currency exchange rates is \$265,758 at December 31, 2008.

In addition, in the future, we may from time to time opt to borrow money to make investments. Our net investment income will be dependent upon the difference between the rate at which we borrow funds and the rate at which we invest such funds. As a result, there can be no assurance that a significant change in market interest rates and the current credit crisis will not have a material adverse effect on our net investment income in the event we choose to borrow funds for investing purposes.

**Item 8. Consolidated Financial Statements and Supplementary Data.**

**HARRIS & HARRIS GROUP, INC.  
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES**

The following reports and consolidated financial schedules of Harris & Harris Group, Inc. are filed herewith and included in response to Item 8.

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Schedules other than those listed above have been omitted because they are not applicable or the required information is presented in the consolidated financial statements and/or related notes.

### **Management's Report on Internal Control Over Financial Reporting**

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness of internal control over financial reporting to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2008. In making its assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on the results of this assessment, management (including our Chief Executive Officer and Chief Financial Officer) has concluded that, as of December 31, 2008, the Company's internal control over financial reporting was effective.

The effectiveness of the Company's internal control over financial reporting has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears on page 58 of this Annual Report on Form 10-K.

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of Harris & Harris Group, Inc.:

In our opinion, the accompanying consolidated statements of assets and liabilities, including the consolidated schedules of investments, and the related consolidated statements of operations, changes in net assets, cash flows, and the financial highlights present fairly, in all material respects, the financial position of Harris & Harris Group, Inc. and its subsidiaries at December 31, 2008 and December 31, 2007, and the results of their operations, changes in net assets, cash flows, and the financial highlights for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing on page 57 of the 2008 Annual Report to Shareholders. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As more fully disclosed in Note 2 of the Notes to the Consolidated Financial Statements, the financial statements include investments valued at \$56,965,153 (52.1% of net assets ) at December 31, 2008, the fair values of which have been estimated by the Board of Directors in the absence of readily ascertainable market values. These estimated values may differ significantly from the values that would have been used had a ready market for the investments existed, and the differences could be material.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

New York, New York  
March 13, 2009

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES**

	<u>December</u> <u>31, 2008</u>	<u>December</u> <u>31, 2007</u>
<b>ASSETS</b>		
Investments, in portfolio securities at value:		
Unaffiliated companies (cost: \$24,208,281 and \$21,435,392, respectively)	\$ 12,086,503	\$ 21,103,836
Non-controlled affiliated companies (cost: \$60,796,720 and \$54,306,393, respectively)	39,650,187	52,651,189
Controlled affiliated companies (cost: \$6,085,000 and \$6,935,743, respectively)	<u>5,228,463</u>	<u>4,355,359</u>
Total, investments in private portfolio companies at value (cost: \$91,090,001 and \$82,677,528, respectively)	\$ 56,965,153	\$ 78,110,384
Investments, in U.S. Treasury obligations at value (cost: \$52,956,288 and \$59,552,933, respectively)		
	52,983,940	60,193,593
Cash and cash equivalents	692,309	330,009
Restricted funds (Note 7)	191,955	2,667,020
Receivable from portfolio company	0	524
Interest receivable	56	647,337
Prepaid expenses	484,567	488,667
Other assets	<u>309,621</u>	<u>455,798</u>
<b>Total assets</b>	<u>\$111,627,601</u>	<u>\$142,893,332</u>
<b>LIABILITIES &amp; NET ASSETS</b>		
Accounts payable and accrued liabilities (Note 7)	\$ 2,088,348	\$ 4,515,463
Deferred rent	<u>8,140</u>	<u>14,525</u>
<b>Total liabilities</b>	<u>2,096,488</u>	<u>4,529,988</u>
<b>Net assets</b>	<u>\$109,531,113</u>	<u>\$138,363,344</u>
<b>Net assets are comprised of:</b>		
Preferred stock, \$0.10 par value, 2,000,000 shares authorized; none issued	\$ 0	\$ 0
Common stock, \$0.01 par value, 45,000,000 shares authorized at		
12/31/08 and 12/31/07; 27,688,313 issued at 12/31/08 and 25,143,313 issued at 12/31/07	276,884	251,434
Additional paid in capital (Note 10)	181,251,507	160,927,691
Accumulated net operating and realized loss	(34,494,551)	(15,483,766)
Accumulated unrealized depreciation of investments	(34,097,196)	(3,926,484)
Treasury stock, at cost (1,828,740 shares at 12/31/08 and 12/31/07)	<u>(3,405,531)</u>	<u>(3,405,531)</u>
<b>Net assets</b>	<u>\$109,531,113</u>	<u>\$138,363,344</u>
<b>Shares outstanding</b>	<u>25,859,573</u>	<u>23,314,573</u>
<b>Net asset value per outstanding share</b>	<u>\$ 4.24</u>	<u>\$ 5.93</u>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006
<b>Investment income:</b>			
Interest from:			
Fixed-income securities	\$ 1,971,178	\$ 2,705,597	\$ 2,991,261
Miscellaneous income	16,169	39	37,500
<b>Total investment income</b>	<u>1,987,347</u>	<u>2,705,636</u>	<u>3,028,761</u>
<b>Expenses:</b>			
Salaries, benefits and stock-based compensation (Note 5)	10,090,658	11,435,329	7,933,276
Administration and operations	1,160,025	1,432,653	1,250,080
Profit-sharing provision	0	0	50,875
Professional fees	694,007	902,911	737,828
Rent	276,023	235,998	239,846
Directors' fees and expenses	367,383	435,060	340,750
Depreciation	54,795	63,113	64,916
Custodian fees	31,607	28,115	24,125
<b>Total expenses</b>	<u>12,674,498</u>	<u>14,533,179</u>	<u>10,641,696</u>
<b>Net operating loss</b>	<u>(10,687,151)</u>	<u>(11,827,543)</u>	<u>(7,612,935)</u>
<b>Net realized (loss) gain from investments:</b>			
Realized gain (loss) from:			
Unaffiliated companies	3,588	119,082	32,484
Non-controlled affiliated companies	(6,509,404)	0	0
Controlled affiliated companies	(2,893,487)	0	0
U.S. Treasury obligations/other	1,109,790	(945)	(1,146)
<b>Realized (loss) gain from investments</b>	<u>(8,289,513)</u>	<u>118,137</u>	<u>31,338</u>
Income tax expense (benefit) (Note 8)	34,121	87,975	(223,355)
<b>Net realized (loss) gain from investments</b>	<u>(8,323,634)</u>	<u>30,162</u>	<u>258,693</u>
<b>Net (increase) decrease in unrealized depreciation on investments:</b>			
Change as a result of investment sales	8,292,072	0	0
Change on investments held	(38,462,784)	5,080,936	(4,418,870)
<b>Net (increase) decrease in unrealized depreciation on investments</b>	<u>(30,170,712)</u>	<u>5,080,936</u>	<u>(4,418,870)</u>
<b>Net decrease in net assets resulting from operations:</b>			
<b>Total</b>	<u>\$ (49,181,497)</u>	<u>\$ (6,716,445)</u>	<u>\$ (11,773,112)</u>
<b>Per average basic and diluted outstanding share</b>	<u>\$ (1.99)</u>	<u>\$ (0.30)</u>	<u>\$ (0.57)</u>
<b>Average outstanding shares</b>	<u>24,670,516</u>	<u>22,393,030</u>	<u>20,759,547</u>

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



**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<u>Year Ended</u> <u>December 31, 2008</u>	<u>Year Ended</u> <u>December 31, 2007</u>	<u>Year Ended</u> <u>December 31, 2006</u>
<b>Cash flows used in operating activities:</b>			
Net decrease in net assets resulting from operations	\$ (49,181,497)	\$ (6,716,445)	\$ (11,773,112)
Adjustments to reconcile net decrease in net assets resulting from operations to net cash used in operating activities:			
Net realized and unrealized loss (gain) on investments	38,460,225	(5,199,073)	4,420,619
Depreciation of fixed assets, amortization of premium or discount on U.S. government securities, and bridge note interest	(179,809)	(60,009)	(426,168)
Stock-based compensation expense	5,965,769	8,050,807	5,038,956
Changes in assets and liabilities:			
Restricted funds	2,475,065	(517,235)	(419,351)
Receivable from portfolio company	524	(524)	75,000
Interest receivable	621,856	(21,965)	(376,808)
Prepaid expenses	4,100	(477,722)	(7,951)
Other receivables	0	819,905	(819,905)
Other assets	111,828	(152,012)	(176,325)
Accounts payable and accrued liabilities	(2,427,115)	400,163	1,002,643
Accrued profit sharing	0	(261,661)	(1,846,197)
Deferred rent	(6,385)	(6,801)	(9,677)
Current income tax liability	0	0	(9,637,026)
Net cash used in operating activities	<u>(4,155,439)</u>	<u>(4,142,572)</u>	<u>(14,955,302)</u>
<b>Cash flows from investing activities:</b>			
Purchase of U.S. government securities	(133,032,933)	(60,744,292)	(70,030,872)
Sale of U.S. government securities	140,831,769	60,508,538	107,624,461
Investment in private placements and notes	(17,779,462)	(20,595,161)	(24,408,187)
Proceeds from sale of private placements and notes	136,837	174,669	28,295
Purchase of fixed assets	<u>(21,969)</u>	<u>(41,640)</u>	<u>(15,086)</u>
Net cash (used in) provided by investing activities	<u>(9,865,758)</u>	<u>(20,697,886)</u>	<u>13,198,611</u>
<b>Cash flows from financing activities:</b>			
Gross proceeds from public offering (Note 10)	15,651,750	14,027,000	0
Gross expenses for public offering (Note 10)	(1,268,253)	(1,033,832)	0
Proceeds from stock option exercises (Note 5)	0	10,105,511	2,615,190
Net cash provided by financing activities	<u>14,383,497</u>	<u>23,098,679</u>	<u>2,615,190</u>
<b>Net (decrease) increase in cash and cash equivalents:</b>			
Cash and cash equivalents at beginning of the year	330,009	2,071,788	1,213,289
Cash and cash equivalents at end of the year	<u>692,309</u>	<u>330,009</u>	<u>2,071,788</u>
Net increase (decrease) in cash and cash equivalents	<u>\$ 362,300</u>	<u>\$ (1,741,779)</u>	<u>\$ 858,499</u>
<b>Supplemental disclosures of cash flow information:</b>			
Income taxes paid	\$ 45,765	\$ 80,236	\$ 9,425,922

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

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS</b>
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	<u>Year Ended December 31, 2008</u>	<u>Year Ended December 31, 2007</u>	<u>Year Ended December 31, 2006</u>
<b>Changes in net assets from operations:</b>			
Net operating loss	\$ (10,687,151)	\$ (11,827,543)	\$ (7,612,935)
Net realized (loss) gain on investments	(8,323,634)	30,162	258,693
Net decrease in unrealized depreciation on investments as a result of sales	8,292,072	0	0
Net (increase) decrease in unrealized depreciation on investments held	<u>(38,462,784)</u>	<u>5,080,936</u>	<u>(4,418,870)</u>
<b>Net decrease in net assets resulting from operations</b>	<u>(49,181,497)</u>	<u>(6,716,445)</u>	<u>(11,773,112)</u>
<b>Changes in net assets from capital stock transactions:</b>			
Issuance of common stock upon the exercise of stock options	0	9,996	2,587
Issuance of common stock on offering	25,450	13,000	0
Additional paid in capital on common stock issued	14,358,047	23,075,683	2,612,603
Stock-based compensation expense	<u>5,965,769</u>	<u>8,050,807</u>	<u>5,038,956</u>
<b>Net increase in net assets resulting from capital stock transactions</b>	<u>20,349,266</u>	<u>31,149,486</u>	<u>7,654,146</u>
<b>Changes in net assets from adoption of SFAS No. 158</b>	<u>0</u>	<u>0</u>	<u>61,527</u>
<b>Net (decrease) increase in net assets</b>	<u>(28,832,231)</u>	<u>24,433,041</u>	<u>(4,057,439)</u>
<b>Net Assets:</b>			
Beginning of the year	<u>138,363,344</u>	<u>113,930,303</u>	<u>117,987,742</u>
End of the year	<u>\$ 109,531,113</u>	<u>\$ 138,363,344</u>	<u>\$ 113,930,303</u>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Unaffiliated Companies (2)(3) – 11.0% of net assets at value</b>			
<b>Private Placement Portfolio (Illiquid) – 11.0% of net assets at value</b>			
BioVex Group, Inc. (4)(5)(6)(7)(8) — Developing novel biologics for treatment of cancer and infectious disease			
Series E Convertible Preferred Stock	(M)	2,799,552	\$ 60,750
Unsecured Convertible Bridge Note (including interest)	(M)	\$ 200,000	<u>203,222</u>
			<u>263,972</u>
Cobalt Technologies, Inc. (4)(5)(6)(9)(10) – Developing biobutanol through biomass fermentation			
Series C Convertible Preferred Stock	(M)	176,056	<u>187,500</u>
Exponential Business Development Company (4)(5) — Venture capital partnership focused on early stage companies			
Limited Partnership Interest	(M)	1	<u>2,219</u>
Kereos, Inc. (4)(5)(6) — Developing emulsion-based imaging agents and targeted therapeutics to image and treat cancer and cardiovascular disease			
Common Stock	(M)	545,456	<u>0</u>
Molecular Imprints, Inc. (4)(5) — Manufacturing nanoimprint lithography capital equipment			
Series B Convertible Preferred Stock	(M)	1,333,333	1,083,333
Series C Convertible Preferred Stock	(M)	1,250,000	1,015,625
Warrants at \$2.00 expiring 12/31/11	(I)	125,000	<u>35,625</u>
			<u>2,134,583</u>
Nanosys, Inc. (4)(5) — Developing zero and one-dimensional inorganic nanometer-scale materials and devices			
Series C Convertible Preferred Stock	(M)	803,428	2,370,113
Series D Convertible Preferred Stock	(M)	1,016,950	<u>3,000,003</u>
			<u>5,370,116</u>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Unaffiliated Companies (2)(3) – 11.0% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 11.0% of net assets at value (cont.)</b>			
Nantero, Inc. (4)(5)(6) — Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes			
Series A Convertible Preferred Stock	(M)	345,070	\$ 1,046,908
Series B Convertible Preferred Stock	(M)	207,051	628,172
Series C Convertible Preferred Stock	(M)	188,315	571,329
			<u>2,246,409</u>
NeoPhotonics Corporation (4)(5) — Developing and manufacturing optical devices and components			
Common Stock	(M)	716,195	181,262
Series 1 Convertible Preferred Stock	(M)	1,831,256	463,472
Series 2 Convertible Preferred Stock	(M)	741,898	187,767
Series 3 Convertible Preferred Stock	(M)	2,750,000	695,995
Series X Convertible Preferred Stock	(M)	2,000	101,236
Warrants at \$0.15 expiring 01/26/10	(I)	16,364	2,373
Warrants at \$0.15 expiring 12/05/10	(I)	14,063	2,349
			<u>1,634,454</u>
Polatis, Inc. (4)(5)(6)(11) — Developing MEMS-based optical networking components			
Series A-1 Convertible Preferred Stock	(M)	16,775	0
Series A-2 Convertible Preferred Stock	(M)	71,611	0
Series A-4 Convertible Preferred Stock	(M)	4,774	0
Series A-5 Convertible Preferred Stock	(M)	16,438	0
			<u>0</u>
PolyRemedy, Inc. (4)(5)(6)(9) — Developing a robotic manufacturing platform for wound treatment patches			
Series B-1 Convertible Preferred Stock	(M)	287,647	122,250
Starfire Systems, Inc. (4)(5) — Producing ceramic-forming polymers			
Common Stock	(M)	375,000	0
Series A-1 Convertible Preferred Stock	(M)	600,000	0
			<u>0</u>

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

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008</b>
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	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Unaffiliated Companies (2)(3) – 11.0% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 11.0% of net assets at value (cont.)</b>			
TetraVitae Bioscience, Inc. (4)(5)(6)(9)(12) — Developing alternative fuels through biomass fermentation			
Series B Convertible Preferred Stock	(M)	118,804	<u>\$ 125,000</u>
<b>Total Unaffiliated Private Placement Portfolio (cost: \$24,208,281)</b>			<b><u>\$ 12,086,503</u></b>
<b>Total Investments in Unaffiliated Companies (cost: \$24,208,281)</b>			<b><u>\$ 12,086,503</u></b>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Non-Controlled Affiliated Companies (2)(13) – 36.2% of net assets at value</b>			
<b>Private Placement Portfolio (Illiquid) – 36.2% of net assets at value</b>			
Adesto Technologies Corporation (4)(5)(6) — Developing semiconductor-related products enabled at the nanoscale			
Series A Convertible Preferred Stock	(M)	6,547,619	\$ <u>1,100,000</u>
Ancora Pharmaceuticals, Inc. (4)(5)(6) — Developing synthetic carbohydrates for pharmaceutical applications			
Series B Convertible Preferred Stock	(M)	1,663,808	<u>1,200,000</u>
BridgeLux, Inc. (4)(5)(14) — Manufacturing high-power light emitting diodes			
Series B Convertible Preferred Stock	(M)	1,861,504	1,396,128
Series C Convertible Preferred Stock	(M)	2,130,699	1,598,025
Series D Convertible Preferred Stock	(M)	666,667	500,000
Warrants at \$0.7136 expiring 12/31/14	(I)	98,340	60,774
Warrants at \$0.7136 expiring 12/31/14	(I)	65,560	40,516
			<u>3,595,443</u>
Cambrios Technologies Corporation (4)(5)(6) — Developing nanowire-enabled electronic materials for the display industry			
Series B Convertible Preferred Stock	(M)	1,294,025	647,013
Series C Convertible Preferred Stock	(M)	1,300,000	650,000
			<u>1,297,013</u>
CFX Battery, Inc. (4)(5)(6)(15) — Developing batteries using nanostructured materials			
Series A Convertible Preferred Stock	(M)	1,880,651	<u>1,473,264</u>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Non-Controlled Affiliated Companies (2)(13) – 36.2% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 36.2% of net assets at value (cont.)</b>			
Crystal IS, Inc. (4)(5) — Developing single-crystal aluminum nitride substrates for optoelectronic devices			
Series A Convertible Preferred Stock	(M)	391,571	\$ 76,357
Series A-1 Convertible Preferred Stock	(M)	1,300,376	253,574
Warrants at \$0.78 expiring 05/05/13	(I)	15,231	1,584
Warrants at \$0.78 expiring 05/12/13	(I)	2,350	244
Warrants at \$0.78 expiring 08/08/13	(I)	4,396	479
			<u>332,238</u>
CSwitch Corporation (4)(5)(6)(16) — Developing next-generation, system-on-a-chip solutions for communications-based platforms			
Series A-1 Convertible Preferred Stock	(M)	6,863,118	0
Unsecured Convertible Bridge Note (including interest)	(M)	\$ 1,766,673	118,624
			<u>118,624</u>
D-Wave Systems, Inc. (4)(5)(6)(17) — Developing high-performance quantum computing systems			
Series B Convertible Preferred Stock	(M)	1,144,869	1,038,238
Series C Convertible Preferred Stock	(M)	450,450	408,496
Series D Convertible Preferred Stock	(M)	1,533,395	1,390,578
			<u>2,837,312</u>
Ensemble Discovery Corporation (4)(5)(6)(18) — Developing DNA Programmed Chemistry for the discovery of new classes of therapeutics and bioassays			
Series B Convertible Preferred Stock	(M)	1,449,275	1,000,000
Unsecured Convertible Bridge Note (including interest)	(M)	\$ 250,286	256,375
			<u>1,256,375</u>
Innovalight, Inc. (4)(5)(6) — Developing solar power products enabled by silicon-based nanomaterials			
Series B Convertible Preferred Stock	(M)	16,666,666	4,288,662
Series C Convertible Preferred Stock	(M)	5,810,577	1,495,176
			<u>5,783,838</u>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Non-Controlled Affiliated Companies (2)(13) – 36.2% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 36.2% of net assets at value (cont.)</b>			
Kovio, Inc. (4)(5)(6) — Developing semiconductor products using printed electronics and thin-film technologies			
Series C Convertible Preferred Stock	(M)	2,500,000	\$ 2,561,354
Series D Convertible Preferred Stock	(M)	800,000	819,633
Series E Convertible Preferred Stock	(M)	1,200,000	1,229,450
Warrants at \$1.25 expiring 12/31/12	(I)	355,880	253,066
			<u>4,863,503</u>
Mersana Therapeutics, Inc. (4)(5)(6)(19) — Developing advanced polymers for drug delivery			
Series A Convertible Preferred Stock	(M)	68,451	68,451
Series B Convertible Preferred Stock	(M)	866,500	866,500
Warrants at \$2.00 expiring 10/21/10	(I)	91,625	33,718
Unsecured Convertible Bridge Note (including interest)	(M)	\$ 200,000	208,110
			<u>1,176,779</u>
Metabolon, Inc. (4)(5) — Discovering biomarkers through the use of metabolomics			
Series B Convertible Preferred Stock	(M)	2,173,913	882,768
Series B-1 Convertible Preferred Stock	(M)	869,565	353,107
Warrants at \$1.15 expiring 3/25/15	(I)	434,783	127,391
			<u>1,363,266</u>
NanoGram Corporation (4)(5) — Developing solar power products enabled by silicon-based nanomaterials			
Series I Convertible Preferred Stock	(M)	63,210	31,131
Series II Convertible Preferred Stock	(M)	1,250,904	616,070
Series III Convertible Preferred Stock	(M)	1,242,144	611,756
Series IV Convertible Preferred Stock	(M)	432,179	212,848
			<u>1,471,805</u>
Nanomix, Inc. (4)(5) — Producing nanoelectronic sensors that integrate carbon nanotube electronics with silicon microstructures			
Series C Convertible Preferred Stock	(M)	977,917	23,622
Series D Convertible Preferred Stock	(M)	6,802,397	6,428
			<u>30,050</u>

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



**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Non-Controlled Affiliated Companies (2)(13) – 36.2% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 36.2% of net assets At value (cont.)</b>			
Nextreme Thermal Solutions, Inc. (4)(5) — Developing thin-film thermoelectric devices for cooling and energy conversion			
Series A Convertible Preferred Stock	(M)	17,500	\$ 875,000
Series B Convertible Preferred Stock	(M)	4,870,244	1,327,629
			<u>2,202,629</u>
Questech Corporation (4)(5) — Manufacturing and marketing proprietary metal and stone decorative tiles			
Common Stock	(M)	655,454	128,266
Warrants at \$1.50 expiring 11/19/09	(I)	5,000	20
			<u>128,286</u>
Siluria Technologies, Inc. (4)(5)(6) — Developing next-generation nanomaterials			
Series S-2 Convertible Preferred Stock	(M)	482,218	0
Unsecured Bridge Note (including interest)	(M)	\$ 42,542	42,731
			<u>42,731</u>
Solazyme, Inc. (4)(5)(6) — Developing algal biodiesel, industrial chemicals and special ingredients based on synthetic biology			
Series A Convertible Preferred Stock	(M)	988,204	2,489,088
Series B Convertible Preferred Stock	(M)	495,246	1,247,426
Series C Convertible Preferred Stock	(M)	651,309	1,640,517
			<u>5,377,031</u>
Xradia, Inc. (4)(5) — Designing, manufacturing and selling ultra-high resolution 3D x-ray microscopes and fluorescence imaging systems			
Series D Convertible Preferred Stock	(M)	3,121,099	4,000,000
<b>Total Non-Controlled Private Placement Portfolio (cost: \$60,796,720)</b>			<b><u>\$ 39,650,187</u></b>
<b>Total Investments in Non-Controlled Affiliated Companies (cost: \$60,796,720)</b>			<b><u>\$ 39,650,187</u></b>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Controlled Affiliated Companies (2)(20) – 4.8% of net assets at value</b>			
<b>Private Placement Portfolio (Illiquid) – 4.8% of net assets at value</b>			
Laser Light Engines, Inc. (4)(5)(6)(9) — Manufacturing solid-state light sources for digital cinema and large-venue projection displays			
Series A Convertible Preferred Stock	(M)	7,499,062	\$ 2,000,000
SiOnyx, Inc. (4)(5)(6) — Developing silicon-based optoelectronic products enabled by its proprietary "Black Silicon"			
Series A Convertible Preferred Stock	(M)	233,499	101,765
Series A-1 Convertible Preferred Stock	(M)	2,966,667	1,292,948
Series A-2 Convertible Preferred Stock	(M)	4,207,537	1,833,750
			<u>3,228,463</u>
<b>Total Controlled Private Placement Portfolio (cost: \$6,085,000)</b>			<b>\$ 5,228,463</b>
<b>Total Investments in Controlled Affiliated Companies (cost: \$6,085,000)</b>			<b>\$ 5,228,463</b>
<b>Total Private Placement Portfolio (cost: \$91,090,001)</b>			<b>\$ 56,965,153</b>

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

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008</b>
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	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>U.S. Government Securities (21) – 48.4% of net assets at value</b>			
U.S. Treasury Bill — due date 01/29/09	(M)	\$ 52,985,000	\$ 52,983,940
<b>Total Investments in U.S. Government Securities (cost: \$52,956,288)</b>			<b><u>\$ 52,983,940</u></b>
<b>Total Investments (cost: \$144,046,289)</b>			<b><u>\$109,949,093</u></b>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008**

Notes to Consolidated Schedule of Investments

- (1) See Footnote to Consolidated Schedule of Investments on page 87 for a description of the Valuation Procedures.
- (2) Investments in unaffiliated companies consist of investments in which we own less than five percent of the voting shares of the portfolio company. Investments in non-controlled affiliated companies consist of investments in which we own five percent or more, but less than 25 percent, of the voting shares of the portfolio company, or where we hold one or more seats on the portfolio company's Board of Directors but do not control the company. Investments in controlled affiliated companies consist of investments in which we own 25 percent or more of the voting shares of the portfolio company or otherwise control the company.
- (3) The aggregate cost for federal income tax purposes of investments in unaffiliated companies is \$24,208,281. The gross unrealized appreciation based on the tax cost for these securities is \$1,732,194. The gross unrealized depreciation based on the tax cost for these securities is \$13,853,972.
- (4) Legal restrictions on sale of investment.
- (5) Represents a non-income producing security. Equity investments that have not paid dividends within the last 12 months are considered to be non-income producing.
- (6) These investments are development stage companies. A development stage company is defined as a company that is devoting substantially all of its efforts to establishing a new business, and either it has not yet commenced its planned principal operations, or it has commenced such operations but has not realized significant revenue from them.
- (7) With our purchase of Series E Convertible Preferred Stock of BioVex, we received a warrant to purchase a number of shares of common stock of BioVex as determined by dividing 624,999.99 by the price per share at which the common stock is offered and sold to the public in connection with the initial public offering. The ability to exercise this warrant is therefore contingent on BioVex completing successfully an initial public offering before the expiration date of the warrant on September 27, 2012. The exercise price of this warrant shall be 110 percent of the initial public offering price.

The accompanying notes are an integral part of this consolidated schedule.

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008**

- (8) With our investment in a convertible bridge note issued by BioVex Group, Inc., we received a warrant to purchase a number of shares of the class of stock sold in the next financing of BioVex equal to \$60,000 divided by the price per share of the class of stock sold in the next financing of BioVex. The ability to exercise this warrant is, therefore, contingent on BioVex completing successfully a subsequent round of financing. This warrant shall expire and no longer be exercisable on November 13, 2015. The cost basis of this warrant is \$200.
- (9) Initial investment was made during 2008.
- (10) Cobalt Technologies, Inc., does business as Cobalt Biofuels.
- (11) Continuum Photonics, Inc., merged with Polatis, Ltd., to form Polatis, Inc.
- (12) With our purchase of the Series B Convertible Preferred Stock of TetraVitae Bioscience, Inc., we received the right to purchase, at a price of \$2.63038528 per share, a number of shares in the Series C financing equal to the number of shares of Series B Preferred Stock purchased. The ability to exercise this right is contingent on TetraVitae Bioscience completing successfully a subsequent round of financing.
- (13) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is \$60,796,720. The gross unrealized appreciation based on the tax cost for these securities is \$2,798,072. The gross unrealized depreciation based on the tax cost for these securities is \$23,944,605.
- (14) BridgeLux, Inc., was previously named eLite Optoelectronics, Inc.
- (15) On February 28, 2008, Lifco, Inc., merged with CFX Battery, Inc. The surviving entity is CFX Battery, Inc.
- (16) With our investments in secured convertible bridge notes issued by CSwitch, we received three warrants to purchase a number of shares of the class of stock sold in the next financing of CSwitch equal to \$529,322, \$985,835 and \$249,750, respectively, the principal of the notes, divided by the lowest price per share of the class of stock sold in the next financing of CSwitch. The ability to exercise these warrants is, therefore, contingent on CSwitch completing successfully a subsequent round of financing. The warrants will expire five years from the date of the close of the next round of financing. The cost basis of these warrants is \$529, \$986 and \$250, respectively.

The accompanying notes are an integral part of this consolidated schedule.

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008**

- (17) D-Wave Systems, Inc., is located and is doing business primarily in Canada. We invested in D-Wave Systems, Inc., through D-Wave USA, a Delaware company. Our investment is denominated in Canadian dollars and is subject to foreign currency translation. See "Note 2. Summary of Significant Accounting Policies."
- (18) With our investment in a convertible bridge note issued by Ensemble Discovery, we received a warrant to purchase a number of shares of the class of stock sold in the next financing of Ensemble Discovery equal to \$125,105.40 divided by the price per share of the class of stock sold in the next financing of Ensemble Discovery. The ability to exercise this warrant is, therefore, contingent on Ensemble Discovery completing successfully a subsequent round of financing. This warrant shall expire and no longer be exercisable on September 10, 2015. The cost basis of this warrant is \$75.20.
- (19) Mersana Therapeutics, Inc., was previously named Nanopharma Corp.
- (20) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is \$6,085,000. The gross unrealized appreciation based on the tax cost for these securities is \$0. The gross unrealized depreciation based on the tax cost for these securities is \$856,537.
- (21) The aggregate cost for federal income tax purposes of our U.S. government securities is \$52,956,288. The gross unrealized appreciation on the tax cost for these securities is \$27,652. The gross unrealized depreciation on the tax cost of these securities is \$0.

The accompanying notes are an integral part of this consolidated schedule.

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Unaffiliated Companies (2)(3) – 15.25% of net assets at value</b>			
<b>Private Placement Portfolio (Illiquid) – 15.25% of net assets at value</b>			
BioVex Group, Inc. (4)(5)(6)(7)(8) – Developing novel biologics for treatment of cancer and infectious disease			
Series E Convertible Preferred Stock	(B)	2,799,552	\$ <u>2,500,000</u>
Exponential Business Development Company (4)(5) — Venture capital partnership focused on early stage companies			
Limited Partnership Interest	(B)	1	<u>2,026</u>
Molecular Imprints, Inc. (4)(5) — Manufacturing nanoimprint lithography capital equipment			
Series B Convertible Preferred Stock	(B)	1,333,333	2,000,000
Series C Convertible Preferred Stock	(B)	1,250,000	2,389,250
Warrants at \$2.00 expiring 12/31/11	(B)	125,000	<u>110,750</u>
			<u>4,500,000</u>
Nanosys, Inc. (4)(5)(7) — Developing zero and one-dimensional inorganic nanometer-scale materials and devices			
Series C Convertible Preferred Stock	(B)	803,428	2,370,113
Series D Convertible Preferred Stock	(B)	1,016,950	<u>3,000,003</u>
			<u>5,370,116</u>
Nantero, Inc. (4)(5)(7) — Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes			
Series A Convertible Preferred Stock	(B)	345,070	1,046,908
Series B Convertible Preferred Stock	(B)	207,051	628,172
Series C Convertible Preferred Stock	(B)	188,315	<u>571,329</u>
			<u>2,246,409</u>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Unaffiliated Companies (2)(3) – 15.25% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 15.25% of net assets at value (cont.)</b>			
NeoPhotonics Corporation (4)(5) — Developing and manufacturing optical devices and components			
Common Stock	(B)	716,195	\$ 133,141
Series 1 Convertible Preferred Stock	(B)	1,831,256	1,831,256
Series 2 Convertible Preferred Stock	(B)	741,898	741,898
Series 3 Convertible Preferred Stock	(B)	2,750,000	2,750,000
Warrants at \$0.15 expiring 01/26/10	(B)	16,364	1,325
Warrants at \$0.15 expiring 12/05/10	(B)	14,063	1,139
			<u>5,458,759</u>
Polatis, Inc. (4)(5)(7)(9) — Developing MEMS-based optical networking components			
Series A-1 Convertible Preferred Stock	(B)	16,775	0
Series A-2 Convertible Preferred Stock	(B)	71,611	132,653
Series A-4 Convertible Preferred Stock	(B)	4,774	8,768
Series A-5 Convertible Preferred Stock	(B)	16,438	135,105
			<u>276,526</u>
Starfire Systems, Inc. (4)(5)(7) — Producing ceramic-forming polymers			
Common Stock	(B)	375,000	150,000
Series A-1 Convertible Preferred Stock	(B)	600,000	600,000
			<u>750,000</u>
<b>Total Unaffiliated Private Placement Portfolio (cost: \$21,435,392)</b>			<b><u>\$ 21,103,836</u></b>
<b>Total Investments in Unaffiliated Companies (cost: \$21,435,392)</b>			<b><u>\$ 21,103,836</u></b>

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



**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Non-Controlled Affiliated Companies (2)(10) – 38.06% of net assets at value</b>			
<b>Private Placement Portfolio (Illiquid) – 38.06% of net assets at value</b>			
Adesto Technologies Corporation (4)(5)(6)(7) — Developing semiconductor-related products enabled at the nanoscale			
Series A Convertible Preferred Stock	(B)	3,416,149	\$ 1,147,826
Ancora Pharmaceuticals Inc. (4)(5)(6)(7) – Developing synthetic carbohydrates for pharmaceutical markets and for internal drug development programs			
Series B Convertible Preferred Stock	(B)	909,091	639,062
Warrants at \$1.06 expiring 05/01/08	(B)	754,717	60,377
			<u>699,439</u>
BridgeLux, Inc. (4)(5)(11) — Manufacturing high-power light emitting diodes			
Series B Convertible Preferred Stock	(B)	1,861,504	2,792,256
Series C Convertible Preferred Stock	(B)	2,130,699	3,196,050
Warrants at \$0.7136 expiring 02/02/2017	(B)	98,340	138,856
Warrants at \$0.7136 expiring 04/26/2017	(B)	65,560	92,833
			<u>6,219,995</u>
Cambrios Technologies Corporation (4)(5)(7) — Developing nanowire-enabled electronic materials for the display industry			
Series B Convertible Preferred Stock	(B)	1,294,025	1,294,025
Series C Convertible Preferred Stock	(B)	1,300,000	1,300,000
			<u>2,594,025</u>
Chlorogen, Inc. (4)(5)(12) — Developed patented chloroplast technology to produce plant-made proteins			
Series A Convertible Preferred Stock	(B)	4,478,038	0
Series B Convertible Preferred Stock	(B)	2,077,930	0
Secured Convertible Bridge Note (including interest)	(B)	\$ 176,811	0
			<u>0</u>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Non-Controlled Affiliated Companies (2)(10) – 38.06% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 38.06% of net assets at value (cont.)</b>			
Crystal IS, Inc. (4)(5)(7) — Developing single-crystal aluminum nitride substrates for optoelectronic devices			
Series A Convertible Preferred Stock	(B)	391,571	\$ 305,425
Series A-1 Convertible Preferred Stock	(B)	1,300,376	1,014,294
Warrants at \$0.78 expiring 05/05/2013	(B)	15,231	9,550
Warrants at \$0.78 expiring 05/12/2013	(B)	2,350	1,473
Warrants at \$0.78 expiring 08/08/2013	(B)	4,396	2,796
			<u>1,333,538</u>
CSwitch Corporation. (4)(5)(7)(13) — Developing next-generation, system-on-a-chip solutions for communications-based platforms			
Series A-1 Convertible Preferred Stock	(B)	6,863,118	3,431,559
Secured Convertible Bridge Note (including interest)	(B)	\$ 529,852	541,581
			<u>3,973,140</u>
D-Wave Systems, Inc. (4)(5)(7)(14) — Developing high-performance quantum computing systems			
Series B Convertible Preferred Stock	(B)	2,000,000	2,226,488
Ensemble Discovery Corporation (4)(5)(6)(7) – Developing DNA Programmed Chemistry for the discovery of new classes of therapeutics and bioassays			
Series B Convertible Preferred Stock	(B)	1,449,275	2,000,000
Innovalight, Inc. (4)(5)(7) – Developing renewable energy products enabled by silicon-based nanomaterials			
Series B Convertible Preferred Stock	(B)	16,666,666	5,718,216
Series C Convertible Preferred Stock	(B)	5,810,577	1,993,568
			<u>7,711,784</u>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Non-Controlled Affiliated Companies (2)(10) – 38.06% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 38.06% of net assets at value (cont.)</b>			
Kereos, Inc. (4)(5)(7) — Developing emulsion-based imaging agents and targeted therapeutics to image and treat cancer and cardiovascular disease			
Series B Convertible Preferred Stock	(B)	545,456	\$ <u>159,743</u>
Kovio, Inc. (4)(5)(7) — Developing semiconductor products using printed electronics and thin-film technologies			
Series C Convertible Preferred Stock	(B)	2,500,000	3,125,000
Series D Convertible Preferred Stock	(B)	800,000	<u>1,000,000</u>
			<u>4,125,000</u>
Lifco, Inc. (4)(5)(6)(7)(15) — Developing energy solutions using nanostructured materials			
Series A Convertible Preferred Stock	(B)	1,208,262	<u>946,528</u>
Mersana Therapeutics, Inc. (4)(5)(7)(16) — Developing advanced polymers for drug delivery			
Series A Convertible Preferred Stock	(B)	68,451	136,902
Series B Convertible Preferred Stock	(B)	866,500	1,733,000
Warrants at \$2.00 expiring 10/21/10	(B)	91,625	<u>118,380</u>
			<u>1,988,282</u>
Metabolon, Inc. (4)(5)(7) – Discovering biomarkers through the use of metabolomics			
Series B Convertible Preferred Stock	(B)	2,173,913	<u>2,500,000</u>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Non-Controlled Affiliated Companies (2)(10) – 38.06% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 38.06% of net assets at value (cont.)</b>			
NanoGram Corporation (4)(5)(7) — Developing a broad suite of intellectual property utilizing nanoscale materials			
Series I Convertible Preferred Stock	(B)	63,210	\$ 124,524
Series II Convertible Preferred Stock	(B)	1,250,904	2,464,281
Series III Convertible Preferred Stock	(B)	1,242,144	2,447,024
Series IV Convertible Preferred Stock	(B)	432,179	851,393
			<u>5,887,222</u>
Nanomix, Inc. (4)(5)(7) — Producing nanoelectronic sensors that integrate carbon nanotube electronics with silicon microstructures			
Series C Convertible Preferred Stock	(B)	977,917	330,228
Series D Convertible Preferred Stock	(B)	6,802,397	680,240
			<u>1,010,468</u>
NanoOpto Corporation (4)(5)(17) — Manufactured discrete and integrated optical communications sub-components on a chip by utilizing nano manufacturing and nano coating technology			
Series A-1 Convertible Preferred Stock	(B)	267,857	0
Series B Convertible Preferred Stock	(B)	3,819,935	0
Series C Convertible Preferred Stock	(B)	1,932,789	0
Series D Convertible Preferred Stock	(B)	1,397,218	0
Warrants at \$0.4359 expiring 03/15/10	(B)	193,279	0
Secured Convertible Bridge Note (including interest)	(B)	\$ 268,654	105,714
			<u>105,714</u>
Nextreme Thermal Solutions, Inc. (4)(5)(7) — Developing thin-film thermoelectric devices for cooling and energy conversion			
Series A Convertible Preferred Stock	(B)	1,750,000	<u>1,750,000</u>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Non-Controlled Affiliated Companies (2)(10) – 38.06% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 38.06% of net assets at value (cont.)</b>			
Questech Corporation (4)(5) — Manufacturing and marketing proprietary metal and stone decorative tiles			
Common Stock	(B)	655,454	\$ 589,259
Warrants at \$1.50 expiring 11/19/08	(B)	5,000	1,085
Warrants at \$1.50 expiring 11/19/09	(B)	5,000	1,910
			<u>592,254</u>
Siluria Technologies, Inc. (4)(5)(6)(7) – Developing new-generation nanomaterials			
Series S-2 Convertible Preferred Stock	(B)	482,218	160,723
Solazyme, Inc. (4)(5)(7) — Developing energy-harvesting machinery of photosynthetic microbes to produce industrial and pharmaceutical molecules			
Series A Convertible Preferred Stock	(B)	988,204	997,691
Series B Convertible Preferred Stock	(B)	495,246	500,000
			<u>1,497,691</u>
Xradia, Inc. (4)(5) – Designing, manufacturing and selling ultra high resolution 3D x-ray microscopes and fluorescence imaging systems			
Series D Convertible Preferred Stock	(B)	3,121,099	4,000,000
Zia Laser, Inc. (4)(5)(18) — Developed quantum dot semiconductor lasers			
Series C Convertible Preferred Stock	(B)	1,500,000	21,329
<b>Total Non-Controlled Private Placement Portfolio (cost: \$54,306,393)</b>			<b><u>\$ 52,651,189</u></b>
<b>Total Investments in Non-Controlled Affiliated Companies (cost: \$54,306,393)</b>			<b><u>\$ 52,651,189</u></b>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007**

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
<b>Investments in Controlled Affiliated Companies (2)(19) – 3.15% of net assets at value</b>			
<b>Private Placement Portfolio (Illiquid) – 3.15% of net assets at value</b>			
Evolved Nanomaterial Sciences, Inc. (4)(5)(20) — Developed nanoscale-enhanced approaches for the resolution of chiral molecules			
Series A Convertible Preferred Stock	(B)	5,870,021	\$ <u>0</u>
Phoenix Molecular Corporation (4)(5)(6)(7) – Developing technology to enable the separation of difficult-to-separate materials.			
Common Stock	(B)	1,000	10
Unsecured Convertible Bridge Note (including interest)	(B)	\$ 50,000	<u>50,733</u>
			<u>50,743</u>
SiOnyx, Inc. (4)(5)(7) — Developing silicon-based optoelectronic products enabled by its proprietary "Black Silicon"			
Series A Convertible Preferred Stock	(B)	233,499	135,686
Series A-1 Convertible Preferred Stock	(B)	2,966,667	1,723,930
Series A-2 Convertible Preferred Stock	(B)	4,207,537	<u>2,445,000</u>
			<u>4,304,616</u>
<b>Total Controlled Private Placement Portfolio (cost: \$6,935,743)</b>			<b>\$ <u>4,355,359</u></b>
<b>Total Investments in Controlled Affiliated Companies (cost: \$6,935,743)</b>			<b>\$ <u>4,355,359</u></b>
<b>Total Private Placement Portfolio (cost: \$82,677,528)</b>			<b>\$ <u>78,110,384</u></b>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007**

**U.S. Government and Agency Securities – 43.50% of net assets at value**

U.S. Treasury Bill — due date 02/21/08	(J)	\$ 2,750,000	\$ 2,738,725
U.S. Treasury Notes — due date 02/15/08, coupon 3.375%	(H)	15,005,000	15,006,200
U.S. Treasury Notes — due date 05/15/08, coupon 3.75%	(H)	9,000,000	9,010,530
U.S. Treasury Notes — due date 09/15/08, coupon 3.125%	(H)	5,000,000	4,991,800
U.S. Treasury Notes — due date 01/15/09, coupon 3.25%	(H)	3,000,000	3,005,160
U.S. Treasury Notes — due date 02/15/09, coupon 4.50%	(H)	5,100,000	5,176,908
U.S. Treasury Notes — due date 04/15/09, coupon 3.125%	(H)	3,000,000	3,001,410
U.S. Treasury Notes — due date 07/15/09, coupon 3.625%	(H)	3,000,000	3,023,910
U.S. Treasury Notes — due date 10/15/09, coupon 3.375%	(H)	3,000,000	3,018,510
U.S. Treasury Notes — due date 01/15/10, coupon 3.625%	(H)	3,000,000	3,034,680
U.S. Treasury Notes — due date 04/15/10, coupon 4.00%	(H)	3,000,000	3,060,930
U.S. Treasury Notes — due date 07/15/10, coupon 3.875%	(H)	3,000,000	3,060,930
U.S. Treasury Notes — due date 10/15/10, coupon 4.25%	(H)	2,000,000	2,063,900

**Total Investments in U.S. Government and Agency Securities (cost: \$59,552,933)** **\$ 60,193,593**

**Total Investments (cost: \$142,230,461)** **\$138,303,977**

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007**

Notes to Consolidated Schedule of Investments

- (1) See Footnote to Consolidated Schedule of Investments on page 78 of our December 31, 2007, Annual Report on Form 10-K for a description of the Valuation Procedures at December 31, 2007.
- (2) Investments in unaffiliated companies consist of investments in which we own less than five percent of the voting shares of the portfolio company. Investments in non-controlled affiliated companies consist of investments in which we own five percent or more, but less than 25 percent, of the voting shares of the portfolio company, or where we hold one or more seats on the portfolio company's Board of Directors but do not control the company. Investments in controlled affiliated companies consist of investments in which we own 25 percent or more of the voting shares of the portfolio company or otherwise control the company.
- (3) The aggregate cost for federal income tax purposes of investments in unaffiliated companies is \$21,435,392. The gross unrealized appreciation based on the tax cost for these securities is \$1,732,194. The gross unrealized depreciation based on the tax cost for these securities is \$2,063,750.
- (4) Legal restrictions on sale of investment.
- (5) Represents a non-income producing security. Equity investments that have not paid dividends within the last 12 months are considered to be non-income producing.
- (6) Initial investment was made during 2007.
- (7) These investments are development stage companies. A development stage company is defined as a company that is devoting substantially all of its efforts to establishing a new business, and either it has not yet commenced its planned principal operations, or it has commenced such operations but has not realized significant revenue from them.
- (8) With our purchase of Series E Convertible Preferred Stock of BioVex, we received a warrant to purchase a number of shares of common stock of BioVex as determined by dividing 624,999.99 by the price per share at which the common stock is offered and sold to the public in connection with the initial public offering. The ability to exercise this warrant is therefore contingent on BioVex completing successfully an initial public offering before the expiration date of the warrant of September 27, 2012. The exercise price of this warrant shall be 110 percent of the initial public offering price.
- (9) Continuum Photonics, Inc., merged with Polatis, Ltd., to form Polatis, Inc.

The accompanying notes are an integral part of this consolidated schedule.



**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007**

- (10) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is \$54,306,393. The gross unrealized appreciation based on the tax cost for these securities is \$10,915,201. The gross unrealized depreciation based on the tax cost for these securities is \$12,570,405.
- (11) BridgeLux, Inc., was previously named eLite Optoelectronics, Inc.
- (12) On November 30, 2007, Chlorogen filed a Certificate of Dissolution with the state of Delaware.
- (13) With our investment in a secured convertible bridge note issued by CSwitch, we received a warrant to purchase a number of shares of the class of stock sold in the next financing of CSwitch equal to \$529,322.36, the principal of the note, divided by the lowest price per share of the class of stock sold in the next financing of CSwitch. The ability to exercise this warrant is therefore contingent on CSwitch completing successfully a subsequent round of financing. The warrant will expire five years from the date of the close of the next round of financing. The cost basis of this warrant is \$529.32.
- (14) D-Wave Systems, Inc., is located and is doing business primarily in Canada. We invested in D-Wave Systems, Inc., through D-Wave USA, a Delaware company. Our investment is denominated in Canadian dollars and is subject to foreign currency translation. See "Note 2. Summary of Significant Accounting Policies."
- (15) On February 28, 2008, Lifco, Inc., merged with CFX Battery, Inc., to form CFX Battery, Inc.
- (16) Mersana Therapeutics, Inc., was previously named Nanopharma Corp.
- (17) On July 19, 2007, NanoOpto Corporation sold its assets to API Nanotronics, Inc.
- (18) On November 30, 2006, the assets of Zia Laser, Inc., were acquired by Innolume, Inc.
- (19) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is \$6,935,743. The gross unrealized appreciation based on the tax cost for these securities is \$219,616. The gross unrealized depreciation based on the tax cost for these securities is \$2,800,000.
- (20) On September 30, 2007, Evolved Nanomaterial Sciences, Inc., filed for Chapter 7 bankruptcy.

The accompanying notes are an integral part of this consolidated schedule.

## **VALUATION PROCEDURES**

### **I. Determination of Net Asset Value**

The 1940 Act requires periodic valuation of each investment in the portfolio of the Company to determine its net asset value. Under the 1940 Act, unrestricted securities with readily available market quotations are to be valued at the current market value; all other assets must be valued at "fair value" as determined in good faith by or under the direction of the Board of Directors.

The Board of Directors is responsible for (1) determining overall valuation guidelines and (2) ensuring that the investments of the Company are valued within the prescribed guidelines.

The Valuation Committee, comprised of all of the independent Board members, is responsible for reviewing and approving the valuation of the Company's assets within the guidelines established by the Board of Directors. The Valuation Committee receives information and recommendations from management.

The values assigned to these investments are based on available information and do not necessarily represent amounts that might ultimately be realized, as such amounts depend on future circumstances and cannot reasonably be determined until the individual investments are actually liquidated or become readily marketable.

### **II. Approaches to Determining Fair Value**

Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," ("SFAS No. 157") defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price).

The main approaches to measuring fair value utilized are the market approach and the income approach.

- Market Approach (M): The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. For example, the market approach often uses market multiples derived from a set of comparables. Multiples might lie in ranges with a different multiple for each comparable. The selection of where within the range each appropriate multiple falls requires judgment considering factors specific to the measurement (qualitative and quantitative).

- Income Approach (I): The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present value amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. Those valuation techniques include present value techniques; option-pricing models, such as the Black-Scholes-Merton formula (a closed-form model) and a binomial model (a lattice model), which incorporate present value techniques; and the multi-period excess earnings method, which is used to measure the fair value of certain assets.

SFAS No. 157 classifies the inputs used to measure fair value by these approaches into the following hierarchy:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2: Quoted prices in active markets for similar assets or liabilities, or quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.
- Level 3: Unobservable inputs for the asset or liability.

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

### **III. Investment Categories**

The Company's investments can be classified into five broad categories for valuation purposes:

- Equity-related securities;
- Long-term fixed-income securities;
- Short-term fixed-income securities;
- Investments in intellectual property, patents, research and development in technology or product development; and
- All other securities.

The Company applies the methods for determining fair value discussed above to the valuation of investments in each of these five broad categories as follows:

#### **A. EQUITY-RELATED SECURITIES**

Equity-related securities, including warrants, are fair valued using the market or income approaches. The following factors may be considered when the market approach is used to fair value these types of securities:

- Readily available public market quotations;
- The cost of the Company's investment;
- Transactions in a company's securities or unconditional firm offers by responsible parties as a factor in determining valuation;
- The financial condition and operating results of the company;
- The company's progress towards milestones.
- The long-term potential of the business and technology of the company;
- The values of similar securities issued by companies in similar businesses;
- Multiples to revenue, net income or EBITDA that similar securities issued by companies in similar businesses receive;
- The proportion of the company's securities we own and the nature of any rights to require the company to register restricted securities under applicable securities laws; and
- The rights and preferences of the class of securities we own as compared to other classes of securities the portfolio company has issued.

When the income approach is used to value warrants, the Company uses the Black-Scholes-Merton formula.

## **B. LONG-TERM FIXED-INCOME SECURITIES**

**1. Readily Marketable: Long-term fixed-income securities** for which market quotations are readily available are valued using the most recent bid quotations when available.

**2. Not Readily Marketable: Long-term fixed-income securities** for which market quotations are not readily available are fair valued using the market approach. The factors that may be considered when valuing these types of securities by the market approach include:

- Credit quality;
- Interest rate analysis;
- Quotations from broker-dealers;
- Prices from independent pricing services that the Board believes are reasonably reliable; and
- Reasonable price discovery procedures and data from other sources.

**C. SHORT-TERM FIXED-INCOME SECURITIES**

Short-term fixed-income securities are valued using the market approach in the same manner as long-term fixed-income securities until the remaining maturity is 60 days or less, after which time such securities may be valued at amortized cost if there is no concern over payment at maturity.

**D. INVESTMENTS IN INTELLECTUAL PROPERTY, PATENTS, RESEARCH AND DEVELOPMENT IN TECHNOLOGY OR PRODUCT DEVELOPMENT**

Such investments are fair valued using the market approach. The Company may consider factors specific to these types of investments when using the market approach including:

- The cost of the Company's investment;
- Investments in the same or substantially similar intellectual property or patents or research and development in technology or product development or offers by responsible third parties;
- The results of research and development;
- Product development and milestone progress;
- Commercial prospects;
- Term of patent;
- Projected markets; and
- Other subjective factors.

**E. ALL OTHER SECURITIES**

All other securities are reported at fair value as determined in good faith by the Valuation Committee using the approaches for determining valuation as described above.

For all other securities, the reported values shall reflect the Valuation Committee's judgment of fair values as of the valuation date using the outlined basic approaches of valuation discussed in Section III. They do not necessarily represent an amount of money that would be realized if we had to sell such assets in an immediate liquidation. Thus, valuations as of any particular date are not necessarily indicative of amounts that we may ultimately realize as a result of future sales or other dispositions of investments we hold.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### **NOTE 1. THE COMPANY**

Harris & Harris Group, Inc. (the "Company," "us," "our" and "we"), is a venture capital company operating as a business development company ("BDC") under the Investment Company Act of 1940 ("1940 Act"). We operate as an internally managed company whereby our officers and employees, under the general supervision of our Board of Directors, conduct our operations.

We elected to become a BDC on July 26, 1995, after receiving the necessary shareholder approvals. From September 30, 1992, until the election of BDC status, we operated as a closed-end, non-diversified investment company under the 1940 Act. Upon commencement of operations as an investment company, we revalued all of our assets and liabilities in accordance with the 1940 Act. Prior to September 30, 1992, we were registered and filed under the reporting requirements of the Securities Exchange Act of 1934 (the "1934 Act") as an operating company and, while an operating company, operated directly and through subsidiaries.

Harris & Harris Enterprises, Inc.<sup>SM</sup>, is a 100 percent wholly owned subsidiary of the Company. Harris & Harris Enterprises, Inc., is a partner in Harris Partners I, L.P.<sup>SM</sup>, and is taxed under Subchapter C of the Code (a "C Corporation"). Harris Partners I, L.P. is a limited partnership and is used to hold certain interests in portfolio companies. The partners of Harris Partners I, L.P., are Harris & Harris Enterprises, Inc., (sole general partner) and Harris & Harris Group, Inc., (sole limited partner). Harris & Harris Enterprises, Inc., pays taxes on any non-passive investment income generated by Harris Partners I, L.P. For the year ended December 31, 2008, there was no non-passive investment income generated by Harris Partners I, L.P. The Company consolidates the results of its subsidiaries for financial reporting purposes.

### **NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The following is a summary of significant accounting policies followed in the preparation of the consolidated financial statements:

Principles of Consolidation. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and include the accounts of the Company and its wholly owned subsidiary. All significant inter-company accounts and transactions have been eliminated in consolidation.

Use of Estimates. The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ from these estimates, and the differences could be material. The most significant estimates relate to the fair valuations of certain of our investments.

Cash and Cash Equivalents. Cash and cash equivalents includes demand deposits. Cash and cash equivalents are carried at cost which approximates value.

Portfolio Investment Valuations. Investments are stated at "value" as defined in the 1940 Act and in the applicable regulations of the SEC. Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which a market quotation is readily available and (ii) the fair value as determined in good faith by, or under the direction of, the Board of Directors for all other assets. (See "Valuation Procedures" in the "Footnote to Consolidated Schedule of Investments.") At December 31, 2008, our financial statements include private venture capital investments valued at \$56,965,153, the fair values of which were determined in good faith by, or under the direction, of the Board of Directors. Upon sale of investments, the values that are ultimately realized may be different from what is presently estimated. The difference could be material.

The Company adopted SFAS No. 157 on a prospective basis on January 1, 2008. SFAS No. 157 requires the Company to assume that the portfolio investment is to be sold in the principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market.

On October 10, 2008, FASB Staff Position 157-3, "Determining the Fair Value of a Financial Asset When the Market for that Asset is Not Active," ("FSP 157-3") was issued. FSP 157-3 reiterated that an entity should utilize its own assumptions, information and techniques to estimate fair value when relevant observable inputs are not available, including the use of risk-adjusted discount factors for non-performance risk or liquidity risk.

Foreign Currency Translation. The accounting records of the Company are maintained in U.S. dollars. All assets and liabilities denominated in foreign currencies are translated into U.S. dollars based on the rate of exchange of such currencies against U.S. dollars on the date of valuation. For the twelve months ended December 31, 2008, included in the net decrease in unrealized depreciation on investments was a \$626,593 loss resulting from foreign currency translation.

Securities Transactions. Securities transactions are accounted for on the date the transaction for the purchase or sale of the securities is entered into by the Company (i.e., trade date).

Interest Income Recognition. Interest income, adjusted for amortization of premium and accretion of discount, is recorded on accrual basis. When securities are determined to be non-income producing, the Company ceases accruing interest and writes off any previously accrued interest.

Realized Gain or Loss and Unrealized Appreciation or Depreciation of Portfolio Investments. Realized gain or loss is recognized when an investment is disposed of and is computed as the difference between the Company's cost basis in the investment at the disposition date and the net proceeds received from such disposition. Realized gains and losses on investment transactions are determined by specific identification. Unrealized appreciation or depreciation is computed as the difference between the fair value of the investment and the cost basis of such investment.

Stock-Based Compensation. The Company has a stock-based employee compensation plan. The Company accounts for the plan in accordance with the provisions of SFAS No. 123(R). See "Note 5. Stock-Based Compensation" for further discussion.

Income Taxes. As we intend to qualify as a RIC under Subchapter M of the Internal Revenue Code, the Company does not provide for income taxes. Our taxes are accounted for in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," and FIN 48, "Accounting for Uncertainty in Income Taxes." The Company recognizes interest and penalties in income tax expense.

We pay federal, state and local income taxes on behalf of our wholly owned subsidiary, Harris & Harris Enterprises, Inc., which is a C corporation. See "Note 8. Income Taxes."

Restricted Funds. The Company maintains a rabbi trust for the purposes of accumulating funds to satisfy the obligations incurred by us for the Supplemental Executive Retirement Plan ("SERP") under the employment agreement with Charles E. Harris. The final payment from this rabbi trust will be made on July 31, 2009, after which the rabbi trust will be closed.

Property and Equipment. Property and equipment are included in "Other Assets" and are carried at \$119,180 and \$153,528 at December 31, 2008, and 2007, respectively, representing cost, less accumulated depreciation. Depreciation is provided using the straight-line method over the estimated useful lives of the premises and equipment. We estimate the useful lives to be five to ten years for furniture and fixtures, three years for computer equipment, and five to seven years for leasehold improvements.

Concentration of Credit Risk. The Company places its cash and cash equivalents with financial institutions and, at times, cash held in checking accounts may exceed the Federal Deposit Insurance Corporation insured limit.

### **NOTE 3. BUSINESS RISKS AND UNCERTAINTIES**

We have invested a substantial portion of our assets in private development stage or start-up companies. These private businesses tend to be based on new technology and to be thinly capitalized, unproven, small companies that lack management depth and have not attained profitability or have no history of operations. Because of the speculative nature and the lack of a public market for these investments, there is greater risk of loss than is the case with traditional investment securities.



Because there is typically no public market for our interests in the small privately held companies in which we invest, the valuation of the equity and bridge note interests in that portion of our portfolio is determined in good faith by our Valuation Committee, comprised of the independent members of our Board of Directors, in accordance with our Valuation Procedures and is subject to significant estimates and judgments. In the absence of a readily ascertainable market value, the determined value of our portfolio of equity interests may differ significantly from the values that would be placed on the portfolio if a ready market for the equity interests existed. Any changes in valuation are recorded in our consolidated statements of operations as "Net increase (decrease) in unrealized appreciation on investments." Changes in valuation of any of our investments in privately held companies from one period to another may be volatile.

**NOTE 4. INVESTMENTS**

At December 31, 2008, our financial assets were categorized as follows in the fair value hierarchy for SFAS No. 157 purposes:

<u>Description</u>	<u>December 31, 2008</u>	<u>Fair Value Measurement at Reporting Date Using:</u>		
		<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
U.S. Government Securities	\$ 52,983,940	\$ 52,983,940	\$ 0	\$ 0
Portfolio Companies	\$ 56,965,153	\$ 0	\$ 0	\$ 56,965,153
<b>Total</b>	<b>\$ 109,949,093</b>	<b>\$ 52,983,940</b>	<b>\$ 0</b>	<b>\$ 56,965,153</b>

The following chart shows the components of change in the financial assets categorized as Level 3, for the year ended December 31, 2008.

**Fair Value Measurements Using Significant  
Unobservable Inputs (Level 3)**

**Portfolio Companies**

Beginning Balance, January 1, 2008	\$	78,110,384
Total realized losses included in changes in net assets		(9,402,893)
Total unrealized losses included in changes in net assets		(29,557,705)
Purchases and interest on bridge notes		17,949,104
Disposals		(133,737)
Ending Balance, December 31, 2008	\$	56,965,153
The amount of total losses for the period included in changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	\$	(38,851,029)

**NOTE 5. STOCK-BASED COMPENSATION**

On March 23, 2006, the Board of Directors of the Company voted to terminate the Employee Profit-Sharing Plan and to establish the Harris & Harris Group, Inc. 2006 Equity Incentive Plan (the "Stock Plan"), subject to shareholder approval. This proposal was approved at the May 4, 2006, Annual Meeting of Shareholders. The Stock Plan provides for the grant of equity-based awards of stock options to our officers, employees and directors (subject to receipt of an exemptive order described below) and restricted stock (subject to receipt of an exemptive order described below) to our officers and employees who are selected by our Compensation Committee for participation in the plan and subject to compliance with the 1940 Act.

On July 11, 2006, the Company filed an application with the SEC regarding certain provisions of the Stock Plan, and the Company has responded to comments from the SEC on the application. In the event that the SEC provides the exemptive relief requested by the application, and we receive stockholder approval for such provisions, the Compensation Committee may, in the future, authorize awards of stock options under an amended Stock Plan to non-employee directors of the Company and authorize grants of restricted stock to officers and employees.

A maximum of 20 percent of our total shares of our common stock issued and outstanding are available for awards under the Stock Plan. Under the Stock Plan, no more than 25 percent of the shares of stock reserved for the grant of the awards under the Stock Plan may be restricted stock awards at any time during the term of the Stock Plan. If any shares of restricted stock are awarded, such awards will reduce on a percentage basis the total number of shares of stock for which options may be awarded. If the Company does not receive exemptive relief from the SEC to issue restricted stock, all shares granted under the Stock Plan must be subject to stock options. No more than 1,000,000 shares of our common stock may be made subject to awards under the Stock Plan to any individual in any year.

During the years ended December 31, 2008, 2007, and 2006, the Compensation Committee of the Board of Directors of the Company approved individual stock option awards for certain officers and employees of the Company. Both non-qualified stock options ("NQSOs") and incentive stock options ("ISOs"), subject to the limitations of Section 422 of the Internal Revenue Code, were awarded under the Stock Plan. The terms and conditions of the stock options granted were determined by the Compensation Committee and set forth in award agreements between the Company and each award recipient.

The option grants during the years ended December 31, 2008, 2007, and 2006 were as follows:

<u>Grant Date</u>	<u>No. of Options Granted</u>	<u>Option Type</u>	<u>Vesting Period</u>	<u>Exercise Price</u>
August 13, 2008	1,163,724	NQSO	12/08 to 08/12	\$ 6.92
March 19, 2008	348,032	NQSO	03/09 to 03/12	\$ 6.18
June 27, 2007	1,700,609	NQSO	12/07 to 06/14	\$ 11.11
June 26, 2006	3,958,283	NQSO & ISO	12/06 to 06/14	\$ 10.11

The exercise price for the August 2008, March 2008, and June 2007 option grants was the closing volume weighted average price of our shares of common stock on the date of grant. The full Board of Directors ratified and approved the June 2006 grants on August 3, 2006, on which date the Company's common stock price fluctuated between \$9.76 and \$10.00. Upon exercise, the shares would be issued from our previously authorized but unissued shares.

The Company accounts for the Stock Plan in accordance with the provisions of SFAS No. 123(R), which requires that we determine the fair value of all share-based payments to employees, including the fair value of grants of employee stock options, and record these amounts as an expense in the Statement of Operations over the vesting period with a corresponding increase to our additional paid-in capital. For the years ended December 31, 2008, 2007, and 2006, the increase to our operating expenses was offset by the increase to our additional paid-in capital, resulting in no net impact to our net asset value. Additionally, the Company does not record the tax benefits associated with the expensing of stock options, because the Company currently intends to qualify as a RIC under Subchapter M of the Code.

An option's expected term is the estimated period between the grant date and the exercise date of the option. As the expected term period increases, the fair value of the option and the non-cash compensation cost will also increase. The expected term assumption is generally calculated using historical stock option exercise data. The Company does not have historical exercise data to develop such an assumption. In cases where companies do not have historical data and where the options meet certain criteria, SEC Staff Accounting Bulletin 107 ("SAB 107") provides the use of a simplified expected term calculation. Accordingly, the Company calculated the expected terms using the SAB 107 simplified method.

Expected volatility is the measure of how the stock's price is expected to fluctuate over a period of time. An increase in the expected volatility assumption yields a higher fair value of the stock option. Expected volatility factors for the stock options were based on the historical fluctuations in the Company's stock price over a period commensurate with the expected term of the option, adjusted for stock splits and dividends.

The expected dividend yield assumption is traditionally calculated based on a company's historical dividend yield. An increase to the expected dividend yield results in a decrease in the fair value of option and resulting compensation cost. Although the Company has declared deemed dividends in previous years, most recently in 2005, the amounts and timing of any future dividends cannot be reasonably estimated. Therefore, for purposes of calculating fair value, the Company has assumed an expected dividend yield of zero percent.

The risk-free interest rate assumptions are based on the annual yield on the measurement date of a zero-coupon U.S. Treasury bond the maturity of which equals the option's expected term. Higher assumed interest rates yield higher fair values.

The amount of non-cash, stock-based compensation expense recognized in the Consolidated Statements of Operations is based on the fair value of the awards the Company expects to vest, recognized over the vesting period on a straight-line basis for each award, and adjusted for actual options vested and pre-vesting forfeitures. The forfeiture rate is estimated at the time of grant and revised, if necessary, in subsequent periods if the actual forfeiture rate differs from the estimated rate and is accounted for in the current period and prospectively.

The fair value of each stock option award is estimated on the date of grant using the Black-Scholes-Merton option pricing model as permitted by SFAS No. 123(R). The stock options granted on June 26, 2006, were awarded in five different grant types, each with different contractual terms. The assumptions used in the calculation of fair value of the stock options granted on June 26, 2006, using the Black-Scholes-Merton model for each contract term were as follows:

<b>Type of Award</b>	<b>Term</b>	<b>Number of Options Granted</b>	<b>Expected Term in Yrs</b>	<b>Expected Volatility Factor</b>	<b>Expected Dividend Yield</b>	<b>Risk-free Interest Rates</b>	<b>Weighted Average Fair Value Per Share</b>
Non-qualified stock options	1 Year	1,001,017	0.75	37.4%	0%	5.16%	\$ 1.48
Non-qualified stock options	2 Years	815,000	1.625	45.2%	0%	5.12%	\$ 2.63
Non-qualified stock options	3 Years	659,460	2.42	55.7%	0%	5.09%	\$ 3.81
Non-qualified stock options	10 Years	690,000	5.75	75.6%	0%	5.08%	\$ 6.94
Incentive stock options	10 Years	792,806	7.03	75.6%	0%	5.08%	\$ 7.46
<b>Total</b>		<b>3,958,283</b>					<b>\$ 4.25</b>

The stock options granted on June 27, 2007, were awarded in four different grant types, each with different contractual terms. The assumptions used in the calculation of fair value of the stock options granted on June 27, 2007, using the Black-Scholes-Merton model for each contract term were as follows:

<b>Type of Award</b>	<b>Contractual Term</b>	<b>Number of Options Granted</b>	<b>Expected Term in Yrs</b>	<b>Expected Volatility Factor</b>	<b>Expected Dividend Yield</b>	<b>Risk-free Interest Rates</b>	<b>Fair Value Per Share</b>
Non-qualified stock options	1.5 Years	380,000	1	42.6%	0%	4.93%	\$2.11
Non-qualified stock options	2.5 Years	600,540	2	40.1%	0%	4.91%	\$2.92
Non-qualified stock options	3.5 Years	338,403	3	44.7%	0%	4.93%	\$3.94
Non-qualified stock options	9 Years	381,666	Ranging from 4.75-6.28	Ranging from 57.8% to 59.9%	0%	Ranging from 4.97% to 5.01%	Ranging from \$5.92 to \$6.85
Total		<u>1,700,609</u>					

The assumptions used in the calculation of fair value of the stock options granted on March 19, 2008, using the Black-Scholes-Merton model for the contract term was as follows:

<b>Type of Award</b>	<b>Term</b>	<b>Number of Options Granted</b>	<b>Expected Term in Yrs</b>	<b>Expected Volatility Factor</b>	<b>Expected Dividend Yield</b>	<b>Risk-free Interest Rates</b>	<b>Weighted Average Fair Value Per Share</b>
Non-qualified stock options	9.78 Years	348,032	6.14	57.1%	0%	2.62%	\$3.45
Total		<u>348,032</u>					\$3.45

The assumptions used in the calculation of fair value of the stock options granted on August 13, 2008, using the Black-Scholes-Merton model for the contract term was as follows:

<u>Type of Award</u>	<u>Term</u>	<u>Number of Options Granted</u>	<u>Expected Term in Yrs</u>	<u>Expected Volatility Factor</u>	<u>Expected Dividend Yield</u>	<u>Risk-free Interest Rates</u>	<u>Weighted Average Fair Value Per Share</u>
Non-qualified stock options	9.38 Years	976,685	5.94	55.1%	0%	3.40%	\$3.79
Non-qualified stock options	9.38 Years	187,039	4.88	50.6%	0%	3.24%	\$3.25
<b>Total</b>		<b><u>1,163,724</u></b>					

For the years ended December 31, 2008, December 31, 2007, and December 31, 2006, the Company recognized \$5,965,769, \$8,050,807 and \$5,038,956 of compensation expense in the Consolidated Statements of Operations, respectively. As of December 31, 2008, there was approximately \$7,575,244 of unrecognized compensation cost related to unvested stock option awards. This cost is expected to be recognized over a weighted-average period of approximately 2.1 years.

For the year ended December 31, 2008, no stock options were exercised. For the year ended December 31, 2007, a total of 999,556 options were exercised for total proceeds to the Company of \$10,105,511. For the year ended December 31, 2006, a total of 258,672 shares were exercised for total proceeds to the Company of \$2,615,190.

The grant date fair value of options vested during the years ended December 31, 2008, December 31, 2007, and December 31, 2006, was \$6,779,996, \$6,851,874, and \$3,781,681, respectively.

For the years ended December 31, 2008, December 31, 2007, and December 31, 2006, the calculation of the net decrease in net assets resulting from operations per share excludes the stock options because such options were anti-dilutive. The options may be dilutive in future periods in which there is a net increase in net assets resulting from operations, in the event that there is a significant increase in the average stock price in the stock market or significant decreases in the amount of unrecognized compensation cost.

A summary of the changes in outstanding stock options for the year ended December 31, 2008, is as follows:

	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Grant Date Fair Value</u>	<u>Weighted Average Remaining Contractual Term (Yrs)</u>	<u>Aggregate Intrinsic Value</u>
Options Outstanding at December 31, 2007	3,967,744	\$ 10.54	\$ 4.77		
Granted	1,511,756	\$ 6.75	\$ 3.64	8.99	
Exercised	0	\$ 0	\$ 0		
Forfeited or Expired	<u>841,287</u>	\$ 10.58	\$ 2.43		
Options Outstanding at December 31, 2008	<u>4,638,213</u>	\$ 9.30	\$ 4.83	6.03	\$ 0
Options Exercisable at December 31, 2008	<u>2,467,587</u>	\$ 10.24	\$ 5.03	4.68	\$ 0
Options Exercisable and Expected to be Exercisable at December 31, 2008	<u>4,567,402</u>	\$ 9.28	\$ 4.79	6.00	\$ 0

The aggregate intrinsic value in the table above with respect to options outstanding, exercisable and expected to be exercisable, is calculated as the difference between the Company's closing stock price of \$3.95 on the last trading day of 2008 and the exercise price, multiplied by the number of in-the-money options. This calculation represents the total pre-tax intrinsic value that would have been received by the option holders had all options been fully vested and all option holders exercised their awards on December 31, 2008.

At December 31, 2007, there were 2,250,619 unvested options with a weighted average grant date fair value of \$5.02. At December 31, 2008, there were 2,170,626 unvested options with a weighted average grant date fair value of \$4.60.

For the twelve months ended December 31, 2007, the aggregate intrinsic value of the 999,556 options exercised was \$1,700,552. For the twelve months ended December 31, 2006, the aggregate intrinsic value for the 258,672 options exercised was \$512,171. No options were exercised during 2008.

Unless earlier terminated by our Board of Directors, the Stock Plan will expire on May 4, 2016. The expiration of the Stock Plan will not by itself adversely affect the rights of plan participants under awards that are outstanding at the time the Stock Plan expires. Our Board of Directors may terminate, modify or suspend the plan at any time, provided that no modification of the plan will be effective unless and until any required shareholder approval has been obtained. The Compensation Committee may terminate, modify or amend any outstanding award under the Stock Plan at any time, provided that in such event, the award holder may exercise any vested options prior to such termination of the Stock Plan or award.

**NOTE 6. DISTRIBUTABLE EARNINGS**

As of December 31, 2008, December 31, 2007, and December 31, 2006, there were no distributable earnings. The difference between the book basis and tax basis components of distributable earnings is primarily nondeductible deferred compensation and net operating losses.

The Company did not declare dividends for the years ended December 31, 2008, 2007 or 2006.

**NOTE 7. EMPLOYEE BENEFITS**

**Employment Agreement with Charles E. Harris**

Pursuant to his employment agreement, as most recently amended as of August 2, 2007 (the "Employment Agreement"), during the period of employment, Charles E. Harris received compensation in the form of base salary, with automatic yearly adjustments to reflect inflation, which amounted to a minimum required base salary of \$246,651 for 2006. Mr. Harris's base salary for 2006 was increased to \$300,000 (thereby also increasing his SERP benefit as described below). Mr. Harris's base salary for 2007 and 2008 was increased to \$306,187 and \$314,623, respectively, based on cost-of-living adjustments.

Under his employment agreement, Mr. Harris was entitled to participate in all compensation and employee benefit plans or programs, and to receive all benefits, perquisites, and emoluments for which salaried employees are eligible. Under the Employment Agreement, we furnished Mr. Harris with certain perquisites, which included a company car, health-club membership, membership in certain social or country clubs, a reimbursement for an annual physical examination and up to a \$5,000 annual reimbursement, adjusted for inflation, over the period of the agreement, for personal financial or tax advice.

The Employment Agreement also provided Mr. Harris with life insurance for the benefit of his designated beneficiary in the amount of at least \$2,000,000; provided reimbursement for uninsured medical expenses, not to exceed \$10,000 per annum, adjusted for inflation, over the period of the agreement; provided Mr. Harris and his spouse with long-term care insurance; and provided Mr. Harris with disability insurance providing for continuation of 100 percent of his base salary for a specified period. These benefits were for the term of the Employment Agreement. The Employment Agreement provided that the term of Mr. Harris's employment could not be extended beyond December 31, 2008, unless a committee of the Board consisting of non-interested Directors extended the date by one year pursuant to the Executive Mandatory Retirement Benefit Plan, and Mr. Harris agreed to serve beyond December 31, 2008. Mr. Harris retired on December 31, 2008.

Mr. Harris's Employment Agreement also provided for a supplemental executive retirement plan (the "SERP") and a severance compensation agreement for his benefit as discussed below.



Other than Mr. Harris, our Chairman and Chief Executive Officer through December 31, 2008, none of our executive officers has a change in control agreement. None of our executive officers is entitled to any special payments solely upon a change in control.

### **SERP**

The Employment Agreement provided that we adopt a supplemental executive retirement plan (the "SERP") for the benefit of Mr. Harris. Under the SERP, each month, we deposited one-twelfth of Mr. Harris's annual salary to a special account maintained on our books for the benefit of Mr. Harris, provided that Mr. Harris was employed by us on the last business day of that month. The amounts credited to the SERP Account were deemed invested or reinvested in such investments as were requested by Mr. Harris and agreed to by the Company. The SERP Account was credited and debited to reflect the deemed investment returns, losses and expenses attributed to such deemed investments and reinvestments in accordance with the terms of the SERP. Mr. Harris's benefit under the SERP equaled the balance in the SERP Account and such benefit was 100 percent vested (i.e., not forfeitable).

We established a rabbi trust for the purpose of accumulating funds to satisfy the obligations incurred by us under the SERP, which amounted to \$188,454 and \$2,667,020 at December 31, 2008, and 2007, respectively, and is included in accounts payable and accrued liabilities. The restricted funds for the SERP Account totaled \$188,454 and \$2,667,020 at December 31, 2008, and 2007, respectively. Mr. Harris's rights to benefits pursuant to this SERP are no greater than those of a general creditor of us.

Mr. Harris received a distribution from his SERP Account totaling \$2,889,717 during 2008. The balance at December 31, 2008, of \$188,454, plus any interest or earnings credited to the account through July 31, 2009, will be paid on July 31, 2009.

If Mr. Harris dies before the entire benefit under the SERP Account is paid to him, the amount remaining in the SERP Account will be distributed to his beneficiary in a lump-sum payment on the 90<sup>th</sup> day after the date of his death.

### **401(k) Plan**

We adopted a 401(k) Plan covering substantially all of our employees. Matching contributions to the plan are at the discretion of the Compensation Committee. For the year ended December 31, 2008, the Compensation Committee approved a 100 percent match which amounted to \$180,500. The 401(k) Company match for the years ended December 31, 2007, and 2006 was \$176,873 and \$155,000, respectively.

### **Medical Benefit Retirement Plan**

On June 30, 1994, we adopted a plan to provide medical and dental insurance for retirees, their spouses and dependents who, at the time of their retirement, have ten years of service with us and have attained 50 years of age or have attained 45 years of age and have 15 years of service with us. On February 10, 1997, we amended this plan to include employees who have seven full years of service and have attained 58 years of age. On November 3, 2005, we amended this plan to reverse the 1997 amendment for future retirees and to remove dependents other than spouses from the plan. The coverage is secondary to any government or subsequent employer provided health insurance plans. The annual premium cost to us with respect to the entitled retiree shall not exceed \$12,000, subject to an index for inflation. On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was signed into law. The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. The Act, which went into effect January 1, 2006, provides a 28 percent subsidy for post-65 prescription drug benefits. Our liability assumes our plan is actuarially equivalent under the Act.

The stock options of retirees who qualify for the Medical Benefit Retirement Plan will remain exercisable (to the extent exercisable at the time of the optionee's termination) post retirement, if such retiree executes a post-termination non-solicitation agreement in a form reasonably acceptable to the Company, until the expiration of its term.

The plan is unfunded and has no assets. The following disclosures about changes in the benefit obligation under our plan to provide medical and dental insurance for retirees are as of the measurement date of December 31:

	<u>2008</u>	<u>2007</u>
Accumulated Postretirement Benefit Obligation at Beginning of Year	\$ 628,745	\$ 696,827
Service Cost	86,497	102,676
Interest Cost	39,972	33,935
Actuarial (Gain)/Loss	109,312	(196,248)
Benefits Paid	<u>(10,847)</u>	<u>(8,445)</u>
<b>Accumulated Postretirement Benefit Obligation at End of Year</b>	<b><u>\$ 853,679</u></b>	<b><u>\$ 628,745</u></b>

In accounting for the plan, the assumption made for the discount rate was 5.71 percent and 6.55 percent for the years ended December 31, 2008, and 2007, respectively. The assumed health care cost trend rates in 2008 were nine percent grading to six percent over three years for medical and five percent per year for dental. The assumed health care cost trend rates in 2007 were 9 percent grading to 6 percent over three years for medical and 5 percent per year for dental. The effect on disclosure information of a one percentage point change in the assumed health care cost trend rate for each future year is shown below.

	<u>1% Decrease in Rates</u>	<u>Assumed Rates</u>	<u>1% Increase in Rates</u>
Aggregated Service and Interest Cost	\$ 98,688	\$ 126,469	\$ 164,286
Accumulated Postretirement Benefit Obligation	\$ 700,499	\$ 853,679	\$ 1,056,068

The net periodic postretirement benefit cost for the year is determined as the sum of service cost for the year, interest on the accumulated postretirement benefit obligation and amortization of the transition obligation (asset) less previously accrued expenses over the average remaining service period of employees expected to receive plan benefits. The following is the net periodic postretirement benefit cost for the years ended December 31, 2008, 2007, and 2006:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Service Cost	\$ 86,497	\$ 102,676	\$ 79,381
Interest Cost on Accumulated Postretirement Benefit Obligation	39,972	33,935	33,786
Amortization of Transition Obligation	0	0	0
Amortization of Net (Gain)/Loss	(11,215)	(6,234)	0
<b>Net Periodic Post Retirement Benefit Cost</b>	<b>\$ 115,254</b>	<b>\$ 130,377</b>	<b>\$ 113,167</b>

The Company estimates the following benefits to be paid in each of the following years:

2009	\$ 23,639
2010	\$ 25,584
2011	\$ 20,213
2012	\$ 21,663
2013	\$ 23,175
2014 through 2017	\$ 146,044

On December 31, 2006, the Company adopted the recognition and disclosure provisions of Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," ("SFAS No. 158"). SFAS No. 158 required the Company to recognize the funded status of its retirement benefit plans in the December 31, 2006 statement of assets and liabilities with a corresponding adjustment to net assets. The adjustment to net assets at adoption of \$61,527 represents the net unrecognized actuarial gains of \$95,145 applicable to the healthcare benefit plan net of \$33,618 of unrecognized actuarial losses applicable to the Executive Mandatory Retirement Benefit Plan. Such amounts previously were reflected as a net increase of the plan's funded status in the Company's statement of assets and liabilities pursuant to the provisions of Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," and No. 87, "Employers' Accounting for Pensions." These amounts will be subsequently recognized as net periodic benefit cost pursuant to the Company's historical accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic benefit cost in the same periods will be recognized as a component of net assets. Those amounts are recognized as a component of net periodic benefit cost on the same basis as the amounts recognized at adoption of SFAS No. 158.

For the year ended December 31, 2008, net unrecognized actuarial losses, which resulted from the decrease in the discount rate referred to above, decreased by \$120,527, which represents \$109,312 of actuarial losses arising during the year, net of an \$11,215 reclassification adjustment which increased the net periodic benefit cost for the year.

For the year ended December 31, 2007, net unrecognized actuarial gains, which resulted from the increase in the discount rate, increased by \$190,014, which represents \$196,248 of actuarial gains arising during the year, net of a \$6,234 reclassification adjustment which reduced the net periodic benefit cost for the year.

**Executive Mandatory Retirement Benefit Plan**

On March 20, 2003, in order to begin planning for eventual management succession, the Board of Directors voted to establish the Executive Mandatory Retirement Benefit Plan for individuals who are employed by us in a bona fide executive or high policy-making position. The plan was amended and restated effective January 1, 2005, to comply with certain provisions of the Internal Revenue Code. There are currently four individuals that qualify under the plan: Charles E. Harris, the Chairman and Chief Executive Officer through December 31, 2008, Douglas W. Jamison, the Chairman and Chief Executive Officer, Daniel B. Wolfe, the President, Chief Operating Officer and Chief Financial Officer, and Mel P. Melsheimer, the former President, Chief Operating Officer and Chief Financial Officer. Under this plan, mandatory retirement takes place effective December 31 of the year in which the eligible individuals attain the age of 65. On an annual basis beginning in the year in which the designated individual attains the age of 65, a committee of the Board consisting of non-interested directors may determine for our benefit to postpone the mandatory retirement date for that individual for one additional year.

Under applicable law prohibiting discrimination in employment on the basis of age, we can impose a mandatory retirement age of 65 for our executives or employees in high policy-making positions only if each employee subject to the mandatory retirement age is entitled to an immediate retirement benefit at retirement age of at least \$44,000 per year. The benefits payable at retirement to Mr. Harris and Mr. Melsheimer under our existing 401(k) plan do not equal this threshold. The plan was established to provide the difference between the benefit required under the age discrimination laws and that provided under our existing plans. For individuals retiring after 2007, the benefit under the plan is paid to the qualifying individual in the form of a lump sum, and is paid six months and one day after the individual's separation from service with the Company, pursuant to certain exceptions.

At December 31, 2008, and 2007, we had accrued \$380,737 and \$382,932, respectively, for benefits under this plan. At December 31, 2008, \$229,294 was accrued for Mr. Melsheimer and \$151,443 was accrued for Mr. Harris. Currently, there is no accrual for Mr. Jamison or Mr. Wolfe. This benefit will be unfunded, and the expense as it relates to Mr. Melsheimer and Mr. Harris was amortized over the fiscal periods through the years ended December 31, 2004, and 2008, respectively. On December 31, 2004, Mr. Melsheimer retired pursuant to the Executive Mandatory Retirement Benefit Plan. His annual benefit under the plan is \$22,915. On December 31, 2008, Mr. Harris retired pursuant to the Executive Mandatory Retirement Benefit Plan. Mr. Harris's projected mandatory benefit will be approximately \$151,443 and will be paid as a lump sum six months and one day after his retirement.

#### **NOTE 8. INCOME TAXES**

We filed for the 1999 tax year to elect treatment as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986 (the "Code") and qualified for the same treatment for the years 2000 through 2007. However, there can be no assurance that we will qualify as a RIC for 2008 or subsequent years.

In the case of a RIC which furnishes capital to development corporations, there is an exception to the rule relating to the diversification of investments required to qualify for RIC treatment. This exception is available only to registered investment companies that the SEC determines to be principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available ("SEC Certification"). We have received SEC Certification since 1999, including for 2007, but it is possible that we may not receive SEC Certification in future years.

In addition, under certain circumstances, even if we qualified for Subchapter M treatment for a given year, we might take action in a subsequent year to ensure that we would be taxed in that subsequent year as a C Corporation, rather than as a RIC. As a RIC, we must, among other things, distribute at least 90 percent of our investment company taxable income and may either distribute or retain our realized net capital gains on investments.

Provided that a proper election is made, a corporation taxable under Subchapter C of the Code or a C Corporation that elects to qualify as a RIC continues to be taxable as a C Corporation on any gains realized within 10 years of its qualification as a RIC (the "Inclusion Period") from sales of assets that were held by the corporation on the effective date of the RIC election ("C Corporation Assets"), to the extent of any gain built into the assets on such date ("Built-In Gain"). If the corporation fails to make a proper election, it is taxable on its Built-In Gain as of the effective date of its RIC election. We had Built-In Gains at the time of our qualification as a RIC and made the election to be taxed on any Built-In Gain realized during the Inclusion Period.

For federal tax purposes, the Company's 2005 through 2008 tax years remain open for examination by the tax authorities under the normal three year statute of limitations. Generally, for state tax purposes, the Company's 2004 through 2008 tax years remain open for examination by the tax authorities under a four year statute of limitations.

During 2008, we paid \$17,592 in federal, state and local income taxes. At December 31, 2008, we had \$0 accrued for federal, state and local taxes payable by the Company.

We pay federal, state and local taxes on behalf of our wholly owned subsidiary, Harris & Harris Enterprises, Inc., which is taxed as a C Corporation. For the years ended December 31, 2008, 2007, and 2006, our income tax expense for Harris & Harris Enterprises, Inc., was \$16,528, \$3,231, and \$9,475, respectively.

Tax expense included in the Consolidated Statement of Operations consists of the following:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current	\$ 34,121	\$ 87,975	\$ (227,355)
Total income tax (benefit) expense	<u>\$ 34,121</u>	<u>\$ 87,975</u>	<u>\$ (227,355)</u>

For the years ended December 31, 2008, 2007, and 2006, we paid \$706, \$74,454, and \$0, respectively, in interest and penalties. At December 31, 2008, we had capital loss carryforwards of \$8,292,068, which expire in 2016.

Continued qualification as a RIC requires us to satisfy certain investment asset diversification requirements in future years. Our ability to satisfy those requirements may not be controllable by us. There can be no assurance that we will qualify as a RIC in subsequent years.

#### **NOTE 9. COMMITMENTS & CONTINGENCIES**

On April 17, 2003, we signed a seven-year sublease for office space at 111 West 57<sup>th</sup> Street in New York City. On December 17, 2004, we signed a sublease for additional office space at our current location. The subleases expire on April 29, 2010. Total rent expense for our office space in New York City was \$186,698 in 2008, \$178,167 in 2007 and \$174,625 in 2006. Future minimum sublease payments in each of the following years are: 2009 — \$197,700; and thereafter, for the remaining term — \$65,969.

On July 1, 2008, we signed a five-year lease for office space at 420 Florence Street, Suite 200, Palo Alto, California, commencing on August 1, 2008, and expiring on August 31, 2013. Total rent expense for our office space in Palo Alto was \$51,525 in 2008. Future minimum lease payments in each of the following years are: 2009 - \$125,206; 2010 - \$128,962; 2011 - \$132,831; 2012 - \$136,816 and 2013 - \$93,135.

In the ordinary course of business, we indemnify our officers and directors, subject to certain regulatory limitations, for loss or liability related to their service on behalf of the Company, including serving on the Boards of Directors or as officers of portfolio companies. At December 31, 2008, and 2007, we believe our estimated exposure is minimal, and accordingly we have no liability recorded.

**NOTE 10. CAPITAL TRANSACTIONS**

On November 29, 2006, we filed a shelf registration statement with the SEC on Form N-2 to register 4,000,000 shares of our common stock, which was declared effective by the SEC on May 11, 2007. The common stock could be sold at prices and on terms to be set forth in one or more supplements to the prospectus from time to time.

On June 25, 2007, we completed the sale of 1,300,000 shares of our common stock for gross proceeds of \$14,027,000; net proceeds of this offering, after placement agent fees and offering costs of \$1,033,832, were \$12,993,168.

On June 20, 2008, we completed the sale of 2,545,000 shares of our common stock for gross proceeds of \$15,651,750; net proceeds of this offering, after placement agent fees and offering costs of \$1,268,253, were \$14,383,497.

**NOTE 11. CHANGE IN NET ASSETS PER SHARE**

The following table sets forth the computation of basic and diluted per share net increases in net assets resulting from operations for the twelve months ended December 31, 2008, 2007, and 2006.

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Numerator for decrease in net assets per share	\$(49,181,497)	\$ (6,716,445)	\$(11,773,112)
Denominator for basic and diluted weighted average shares	24,670,516	22,393,030	20,759,547
Basic and diluted net decrease in net assets per share resulting from operations	(1.99)	\$ (0.30)	\$ (0.57)

**NOTE 12. SUBSEQUENT EVENTS**

On February 4, 2009, we made a \$408,573 follow-on investment in a privately held tiny technology portfolio company.

On February 13, 2009, we made a \$200,000 follow-on investment in a privately held tiny technology portfolio company.

On March 11, 2009, we made a \$3,492 follow-on investment in a privately held tiny technology portfolio company.

On December 31, 2008, we valued the shares of one of our privately held tiny technology portfolio companies at \$2.5188 per share. On February 27, 2009, that company raised additional funding from a third party, independent financial investor at \$5.0376 per share. This transaction could be a material input to our determination of the value of our shares of this portfolio company at March 31, 2009. A valuation calculated based on this input alone could increase the value of this portfolio company at March 31, 2009, ranging from \$0 to approximately \$5,400,000, or \$0 to approximately \$0.21 per share, from the value at December 31, 2008. This input will be one of many used by our Valuation Committee, which is made up of all of our independent directors, to set the value of this portfolio company at March 31, 2009.

**NOTE 13. SELECTED QUARTERLY DATA (UNAUDITED)**

	<b>2008</b>			
	<b><u>1<sup>st</sup> Quarter</u></b>	<b><u>2<sup>nd</sup> Quarter</u></b>	<b><u>3<sup>rd</sup> Quarter</u></b>	<b><u>4<sup>th</sup> Quarter</u></b>
Total investment income	\$ 576,302	\$ 467,625	\$ 587,918	\$ 355,502
Net operating loss	\$ (2,480,618)	\$ (2,638,283)	\$ (2,196,739)	\$ (3,371,511)
Net (decrease) increase in net assets resulting from operations	\$ (3,289,035)	\$ 1,354,709	\$(34,032,747)	\$(13,214,424)
Net (decrease) increase in net assets resulting from operations per average outstanding share	\$ (0.14)	\$ 0.06	\$ (1.32)	\$ (0.51)

	<b>2007</b>			
	<b><u>1<sup>st</sup> Quarter</u></b>	<b><u>2<sup>nd</sup> Quarter</u></b>	<b><u>3<sup>rd</sup> Quarter</u></b>	<b><u>4<sup>th</sup> Quarter</u></b>
Total investment income	\$ 652,498	\$ 637,701	\$ 743,414	\$ 672,023
Net operating loss	\$(2,667,118)	\$(2,891,667)	\$(3,117,595)	\$(3,151,163)
Net (decrease) increase in net assets resulting from operations	\$(6,390,160)	\$(4,093,644)	\$ 604,237	\$ 3,163,122
Net (decrease) increase in net assets resulting from operations per average outstanding share	\$ (0.30)	\$ (0.19)	\$ 0.03	\$ 0.16



**HARRIS & HARRIS GROUP, INC.**  
**FINANCIAL HIGHLIGHTS**

	<u>Year Ended December 31, 2008</u>	<u>Year Ended December 31, 2007</u>	<u>Year Ended December 31, 2006</u>
<b>Per Share Operating Performance</b>			
Net asset value per share, beginning of year	\$ 5.93	\$ 5.42	\$ 5.68
Net operating (loss)*	(0.43)	(0.53)	(0.37)
Net realized (loss) income on investments*	(0.34)	0.00	0.01
Net decrease in unrealized depreciation as a result of sales*	0.34	0.00	0.00
Net (increase) decrease in unrealized depreciation on investments held*(1)	(1.49)	0.23	(0.21)
Total from investment operations*	<u>(1.92)</u>	<u>(0.30)</u>	<u>(0.57)</u>
Net increase as a result of stock-based compensation expense*	0.24	0.36	0.24
Net increase as a result of proceeds from exercise of options	0.00	0.19	0.07
Net (decrease) increase as a result of stock offering, net of offering expenses	(0.01)	0.26	0.00
Total increase from capital stock transactions	<u>0.23</u>	<u>0.81</u>	<u>0.31</u>
Net asset value per share, end of year	<u>\$ 4.24</u>	<u>\$ 5.93</u>	<u>\$ 5.42</u>
Stock price per share, end of year	\$ 3.95	\$ 8.79	\$ 12.09
Total return based on stock price	(55.06)%	(27.3)%	(13.0)%
<b>Supplemental Data:</b>			
Net assets, end of year	\$ 109,531,113	\$ 138,363,344	\$ 113,930,303
Ratio of expenses to average net assets	9.6%	11.6%	9.2%
Ratio of net operating loss to average net assets	(8.1)%	(9.5)%	(6.6)%
Cash dividends paid per share	\$ 0.00	\$ 0.00	\$ 0.00
Taxes payable on behalf of shareholders on the deemed dividend per share	\$ 0.00	\$ 0.00	\$ 0.00
Number of shares outstanding, end of year	25,859,573	23,314,573	21,015,017

\*Based on average shares outstanding.

(1) Net unrealized gains (losses) includes rounding adjustments to reconcile change in net asset value per share. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a description of unrealized losses on investments.

The accompanying notes are an integral part of this schedule.

## **Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.**

None.

### **Item 9A. Controls and Procedures.**

#### Disclosure Controls and Procedures

As of the end of the period covered by this report, the Company's management, under the supervision and with the participation of our chief executive officer and chief financial officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as required by Rules 13a-15 of the Securities Exchange Act of 1934 (the "1934 Act")). Disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the 1934 Act is recorded, processed, summarized and reported, within time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the issuer's management, as appropriate, to allow timely decisions regarding required disclosures. As of December 31, 2008, based upon this evaluation of our disclosure controls and procedures, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective.

#### Internal Control Over Financial Reporting

Management's Report on Internal Control Over Financial Reporting and the Report of Independent Registered Public Accounting Firm, on the Company's internal control over financial reporting, is included in Item 8 of this Annual Report on Form 10-K.

#### Changes in Internal Control Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fourth quarter of 2008 to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### **Item 9B. Other Information.**

None.

## PART III

### **Item 10. Directors and Executive Officers of the Registrant.**

The information set forth under the captions "Nominees," "Executive Officers," "Section 16(a) Beneficial Ownership Reporting Compliance" and "Audit Committee" in our Proxy Statement for the Annual Meeting of Shareholders to be held May 5, 2009, to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934 (the "2009 Proxy Statement"), is herein incorporated by reference.

We have adopted a Code of Conduct for Directors and Employees, which also applies to our Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer, Treasurer and Controller and is posted on our website at [http://www.tinytechvc.com/shareholder\\_information/Code\\_of\\_Conduct.html](http://www.tinytechvc.com/shareholder_information/Code_of_Conduct.html).

The Board of Directors has determined that Dugald A. Fletcher, James E. Roberts and Richard P. Shanley are all "Audit Committee Financial Experts" serving on our Audit Committee. Messrs. Fletcher, Roberts and Shanley are independent as defined under Section 2(a) (19) of the Investment Company Act of 1940 and under the rules of the Nasdaq Stock Market.

### **Item 11. Executive Compensation.**

The information set forth under the captions "Executive Compensation," "Compensation Committee Interlocks and Insider Participation" and "Compensation Committee Report on Executive Compensation" in the 2009 Proxy Statement is herein incorporated by reference.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information set forth under the caption "How Many Shares Do the Company's Principal Shareholders, Directors and Executive Officers Own?" in the 2009 Proxy Statement is herein incorporated by reference. The "Equity Compensation Plan Information" chart is set forth herein under Item 5.

### **Item 13. Certain Relationships and Related Transactions, and Director Independence.**

The information set forth under the captions "Board Committees," "Nominees" and "Related Party Transactions" in the 2009 Proxy Statement is herein incorporated by reference.

### **Item 14. Principal Accountant Fees and Services.**

The information set forth under the captions "Audit Committee's Pre-Approval Policies" and "Fees Paid to PwC for 2008 and 2007" in the 2009 Proxy Statement is herein incorporated by reference.

## PART IV

### Item 15. Exhibits and Financial Statements Schedules.

- (a) The following documents are filed as a part of this report:
- (1) Listed below are the financial statements which are filed as part of this report:
- Consolidated Statements of Assets and Liabilities as of December 31, 2008, and 2007;
  - Consolidated Statements of Operations for the years ended December 31, 2008, 2007, and 2006;
  - Consolidated Statements of Cash Flows for the years ended December 31, 2008, 2007, and 2006;
  - Consolidated Statements of Changes in Net Assets for the years ended December 31, 2008, 2007, and 2006;
  - Consolidated Schedule of Investments as of December 31, 2008;
  - Consolidated Schedule of Investments as of December 31, 2007;
  - Footnote to Consolidated Schedule of Investments;
  - Notes to Consolidated Financial Statements; and
  - Financial Highlights for the years ended December 31, 2008, 2007, and 2006.
- (2) No financial statement schedules are required to be filed herewith because (i) such schedules are not required or (ii) the information has been presented in the above financial statements.
- (3) The following exhibits are filed with this report or are incorporated herein by reference to a prior filing, in accordance with Rule 12b-32 under the Securities Exchange Act of 1934.
- 3.1(a) Restated Certificate of Incorporation of Harris & Harris Group, Inc., dated September 23, 2005, incorporated by reference as Exhibit 99 to Form 8-K (File No. 814-00176) filed on September 27, 2005.
- 3.1(b) Certificate of Amendment of the Certificate of Incorporation of Harris & Harris Group, Inc., dated May 19, 2006, incorporated by reference as Exhibit 3.1 to the Company's Form 10-Q (File No. 814-00176) filed on August 9, 2006.
- 3.2\* Restated By-laws.
- 4\* Form of Specimen Certificate of Common Stock.
- 10.1\* Harris & Harris Group, Inc. Form of Custody Agreement with The Bank of New York Mellon.

- 10.2\* Form of Indemnification Agreement which has been established with all directors and executive officers of the Company.
- 10.3 Deferred Compensation Agreement, incorporated by reference as Exhibit 10.5 to the Company's Form 10-K for the year ended December 31, 2004 (File No. 814-00176) filed on March 16, 2005.
- 10.4 Amendment No. 4 to Deferred Compensation Agreement, incorporated by reference as Exhibit 10 to the Company's Form 10-Q (File No. 814-00176) filed on August 9, 2006.
- 10.5 Amendment No. 2 to Deferred Compensation Agreement, incorporated by reference as Exhibit 10.1 to the Company's Form 8-K (File No. 814-00176) filed on October 15, 2004.
- 10.6\* Amendment No. 1 to Deferred Compensation Agreement.
- 10.7 Trust Under Harris & Harris Group, Inc., Deferred Compensation Agreement, incorporated by reference as Exhibit I(12) to the Company's Registration Statement on Form N-2 (File No. 333-138996) filed on November 29, 2006.
- 10.8 Harris & Harris Group, Inc. Amended and Restated Employee Profit-Sharing Plan, incorporated by reference as Exhibit 10.8 to the Company's Form 10-K for the year ended December 31, 2007 (File No. 814-00176) filed on March 13, 2008.
- 10.9 Harris & Harris Group, Inc. 2006 Equity Incentive Plan, incorporated by reference as Appendix B to the Company's Proxy Statement for the 2006 Annual Meeting of Shareholders filed on April 3, 2006.
- 10.10 Form of Incentive Stock Option Agreement incorporated by reference as Exhibit 10.1 to the Company's Form 8-K (File No. 814-00176) filed on June 26, 2006.
- 10.11\* Form of Non-Qualified Stock Option Agreement.
- 10.12 Amended and Restated Employment Agreement between Harris & Harris Group, Inc. and Charles E. Harris, dated August 2, 2007, incorporated by reference as Exhibit 10.1 to the Company's Form 8-K (File No. 814-00176) filed on August 3, 2007.
- 10.13 Amended and Restated Severance Compensation Agreement, dated August 2, 2007, incorporated by reference as Exhibit 10.2 to the Company's Form 8-K (File No. 814-00176) filed on August 3, 2007.
- 10.14 Amended and Restated Supplemental Executive Retirement Plan, dated August 2, 2007, incorporated by reference as Exhibit 10.3 to the Company's Form 8-K (File No. 814-00176) filed on August 3, 2007.
- 10.15 Amended and Restated Harris & Harris Group, Inc. Executive Mandatory Retirement Benefit Plan, dated August 2, 2007, incorporated by reference as Exhibit 10.4 to the Company's Form 8-K (File No. 814-00176) filed on August 3, 2007.

- 10.16 Agreement of Sub-Sublease, dated April 18, 2003, by and between Prominent USA, Inc. and Harris & Harris Group, Inc., incorporated by reference as Exhibit 10.17 to the Company's Form 10-K for the year ended December 31, 2007 (File No. 814-00176) filed on March 13, 2008.
- 10.17 Amendment to Agreement of Sub-Sublease, dated May 9, 2003, by and between Prominent USA, Inc., and Harris & Harris Group, Inc., incorporated by reference as Exhibit 10.18 to the Company's Form 10-K for the year ended December 31, 2007 (File No. 814-00176) filed on March 13, 2008.
- 10.18 Assignment and Assumption, Modification and Extension of Sublease Agreement, dated December 17, 2004, by and among the Economist Newspaper Group, Inc., National Academy of Television Arts & Sciences, and Harris & Harris Group, Inc., incorporated by reference as Exhibit 10.19 to the Company's Form 10-K for the year ended December 31, 2007 (File No. 814-00176) filed on March 13, 2008.
- 10.19 Lease dated July 1, 2008 by and between Jack Rominger, Tommie Plemons and Dale Denson as Lessor and Harris & Harris Group, Inc., a New York corporation, as Lessee, incorporated by reference as Exhibit 10.1 to the Company's Form 10-Q (File No. 814-00176) filed on November 7, 2008.
- 10.20 Nonsolicitation and Noncompetition Agreement between the Company and Charles E. Harris, dated July 31, 2008, incorporated by reference as Exhibit 10 to the Company's Form 8-K (File No. 814-00176) filed on August 1, 2008.
- 14.1 Code of Conduct for Directors and Employees of Harris & Harris Group, Inc. incorporated by reference as Exhibit 14 to the Company's Form 8-K (File No. 814-00176) filed on October 5, 2004.
- 14.2 Code of Ethics Pursuant to Rule 17j-1, incorporated by reference as Exhibit 14 to the Company's Form 8-K (File No. 814-00176) filed on August 1, 2008.
- 31.01\* Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.02\* Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.01\* Certification of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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\*Filed herewith

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HARRIS & HARRIS GROUP, INC.

Date: March 13, 2009

By: /s/ Douglas W. Jamison

Douglas W. Jamison  
Chairman of the Board and  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

<u>Signatures</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Douglas W. Jamison</u> Douglas W. Jamison	Chairman of the Board and Chief Executive Officer	March 13, 2009
<u>/s/ Daniel B. Wolfe</u> Daniel B. Wolfe	Chief Financial Officer	March 13, 2009
<u>/s/ Patricia N. Egan</u> Patricia N. Egan	Chief Accounting Officer and Senior Controller	March 13, 2009
<u>/s/ W. Dillaway Ayres, Jr.</u> W. Dillaway Ayres, Jr.	Director	March 13, 2009
<u>/s/ C. Wayne Bardin</u> C. Wayne Bardin	Director	March 13, 2009

<u>/s/ Phillip A. Bauman</u> Phillip A. Bauman	Director	March 13, 2009
<u>/s/ G. Morgan Browne</u> G. Morgan Browne	Director	March 13, 2009
<u>/s/ Dugald A. Fletcher</u> Dugald A. Fletcher	Director	March 13, 2009
<u>/s/ Lori D. Pressman</u> Lori D. Pressman	Director	March 13, 2009
<u>/s/ Charles E. Ramsey</u> Charles E. Ramsey	Director	March 13, 2009
<u>/s/ James E. Roberts</u> James E. Roberts	Director	March 13, 2009
<u>/s/ Richard P. Shanley</u> Richard P. Shanley	Director	March 13, 2009



## EXHIBIT INDEX

The following exhibits are filed with this report in accordance with Rule 12b-32 under the Securities Exchange Act of 1934.

<b>Exhibit No.</b>	<b>Description</b>
3.2	Restated By-laws.
4	Form of Specimen Certificate of Common Stock.
10.1	Harris & Harris Group, Inc. Form of Custody Agreement with The Bank of New York Mellon.
10.2	Form of Indemnification Agreement which has been established with all directors and executive officers of the Company.
10.6	Amendment No. 1 to Deferred Compensation Agreement.
10.11	Form of Non-Qualified Stock Option Agreement.
31.01	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.01	Certification of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

BY-LAWS  
OF  
HARRIS & HARRIS GROUP, INC.

ARTICLE I  
OFFICES

SECTION 1. PRINCIPAL OFFICE. The principal office of the corporation shall be located in the City, County and State of New York.

SECTION 2. OTHER OFFICES. The corporation may have other offices and places of business, within or without the State of New York, as shall be determined by the directors.

ARTICLE II  
SHAREHOLDERS

SECTION 1. PLACE OF MEETINGS. Meetings of the shareholders may be held at such place or places, within or without the State of New York, as shall be fixed by the directors and stated in the notice of the meeting.

SECTION 2. ANNUAL MEETING. The annual meeting of shareholders for the election of directors and the transaction of such other business as may properly come before the meeting shall be held on the date selected by the Board of Directors in each calendar year.<sup>1</sup>

SECTION 3. NOTICE OF ANNUAL MEETING. Notice of the annual meeting shall be given to each shareholder entitled to vote, at least ten days prior to the meeting.

SECTION 4. SPECIAL MEETINGS. Special meetings of the shareholders for any purpose or purposes may be called by only the President or a majority of the entire Board of Directors then in office.

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<sup>1</sup> As amended at the April 30, 1984, special directors' meeting.

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SECTION 5. NOTICE OF SPECIAL MEETING. Notice of a special meeting, stating the time, place and purpose or purposes thereof, shall be given to each shareholder entitled to vote, at least ten days prior to the meeting. The notice shall also set forth at whose direction it is being issued.

SECTION 6. QUORUM. At any meeting of the shareholders, the holders of a majority of the shares of stock then entitled to vote, shall constitute a quorum for all purposes, except as otherwise provided by law or the Certificate of Incorporation.

SECTION 7. VOTING. At each meeting of the shareholders, every holder of stock then entitled to vote may vote in person or by proxy, and, except as may be otherwise provided by the Certificate or Incorporation, shall have one vote for each share of stock registered in his name.

SECTION 8. ADJOURNED MEETINGS. Any meeting of shareholders may be adjourned to a designated time and place by a vote of a majority in interest of the shareholders present in person or by proxy and entitled to vote, even though less than a quorum is so present. No notice of such an adjourned meeting need be given, other than by announcement at the meeting, and any business may be transacted which might have been transacted at the meeting as originally called.

SECTION 9. ACTION BY WRITTEN CONSENT OF SHAREHOLDERS. Whenever by any provision of statute or of the Certificate of Incorporation or of these By-Laws, the vote of shareholders at a meeting thereof is required or permitted to be taken in connection with any corporate action, the meeting and vote of shareholders may be dispensed with, if all the shareholders who would have been entitled to vote upon the action if such meeting were held, shall consent in writing to such corporate action being taken.

SECTION 10. NOTICE OF SHAREHOLDER NOMINEES. Only persons who are nominated in accordance with the following procedures set forth in these By-Laws shall be eligible for election as directors of the corporation. Nominations of persons for election to the Board of Directors may be made at any annual meeting of shareholders (a) by or at the direction of the Board of Directors (or any duly authorized committee thereof) or (b) by any shareholder of the corporation (i) who is a shareholder of record on the date of the giving of notice provided for in this Section 10 and on the record date for the determination of shareholders entitled to vote at such annual meeting and (ii) who complies with the notice procedures set forth in this Section 10.

In addition to any other applicable requirements, for a nomination to be made by a shareholder, such shareholder must have given timely notice thereof in proper written form to the Secretary of the corporation.

To be timely, a shareholder's notice to the Secretary must be delivered to or mailed and received at the principal executive offices of the corporation not less than ninety (90) days nor more than one hundred and twenty (120) days prior to the anniversary date of the immediately preceding annual meeting of shareholders; provided, however, that in the event that the annual meeting is called for a date that is not within thirty (30) days before or after such anniversary date, notice by the shareholder in order to be timely must be so received not later than the close of business on the tenth (10th) day following the day on which notice of the date of the annual meeting was mailed or such public disclosure of the date of the annual meeting was made, whichever first occurs.

To be in proper written form, a shareholder's notice to the Secretary must set forth (a) as to each person whom the shareholder proposes to nominate for election as a director (i) the name, age, business address and residence address of the person, (ii) the principal occupation or employment of the person, (iii) the class or series and number of shares of capital stock of the corporation which are owned beneficially or of record by the person and (iv) any other information relating to the person that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for election of directors pursuant to Section 14 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the rules and regulations promulgated thereunder; and (b) as to the shareholder giving the notice (i) the name and record address of such shareholder, (ii) the class or series and number of shares of capital stock of the corporation which are owned beneficially or of record by such shareholder, (iii) a description of all arrangements or understandings between such shareholder and each proposed nominee and any other person or persons (including their names) pursuant to which the nomination(s) are to be made by such shareholder, (iv) a representation that such shareholder intends to appear in person or by proxy at the annual meeting to nominate the persons named in its notice and (v) any other information relating to such shareholder that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for election of directors pursuant to Section 14 of the Exchange Act and the rules and regulations promulgated thereunder. Such notice must be accompanied by a written consent of each proposed nominee to be named as a nominee and to serve as a director if elected.

No person shall be eligible for election as a director of the corporation unless nominated in accordance with the procedures set forth in this Section 10. If the Chairman of the annual meeting determines that a nomination was not made in accordance with the foregoing procedures, the Chairman shall declare to the meeting that the nomination was defective and such defective nomination shall be disregarded.

**SECTION 11. NOTICE OF SHAREHOLDER BUSINESS.** No business may be transacted at an annual meeting of shareholders, other than business that is either (a) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board of Directors (or any duly authorized committee thereof), (b) otherwise properly brought before the annual meeting by or at the direction of the Board of Directors (or any duly authorized committee thereof) or (c) otherwise properly brought before the annual meeting by any shareholder of the corporation (i) who is a shareholder of record on the date of the giving of the notice provided for in this Section 11 and on the record date for the determination of shareholders entitled to vote at such annual meeting and (ii) who complies with the notice procedures set forth in this Section 11.

In addition to any other applicable requirement, for business to be properly brought before an annual meeting by a shareholder, such shareholder must have given timely notice thereof in proper written form to the Secretary of the corporation.

To be timely, a shareholder's notice to the Secretary must be delivered to or mailed and received at the principal executive offices of the corporation not less than ninety (90) days nor more than one hundred and twenty (120) days prior to the anniversary date of the immediately preceding annual meeting of shareholders; provided, however, that in the event that the annual meeting is called for a date that is not within thirty (30) days before or after such anniversary date, notice by the shareholder in order to be timely must be so received not later than the close of business on the tenth (10th) day following the day on which notice of the date of the annual meeting was mailed or public disclosure of the date of the annual meeting was made, whichever first occurs.

To be in proper written form, a shareholder's notice to the Secretary must set forth as to each matter such shareholder proposes to bring before the annual meeting (i) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, (ii) the name and record address of such shareholder, (iii) the class or series and number of shares of capital stock of the corporation which are owned beneficially or of record by such shareholder, (iv) a description of all arrangements or understandings between such shareholder and any other person or persons (including their names) in connection with the proposal of such business by such shareholder and any material interest of such shareholder in such business and (v) a representation that such shareholder intends to appear in person or by proxy at the annual meeting to bring such business before the meeting.

No business shall be conducted at the annual meeting of shareholders except business brought before the annual meeting in accordance with the procedures set forth in this Section 11, provided, however, that, once business has been properly brought before the annual meeting in accordance with such procedures, nothing in this Section 11 shall be deemed to preclude discussion by any shareholder of any such business. If the Chairman of an annual meeting determines that business was not properly brought before the annual meeting in accordance with the foregoing procedures, the Chairman shall declare to the meeting that the business was not properly brought before the meeting and such business shall not be transacted.

### ARTICLE III

#### DIRECTORS

SECTION 1. NUMBER. The number of directors of the corporation shall be determined from time to time by resolutions of the directors, who shall hold office for the term of one year and until their successors are duly elected and qualify. The number of directors may be less than three when all of the shares are owned by less than three shareholders, but in such event the number of directors may not be less than the number of shareholders. Directors need not be shareholders.

SECTION 2. POWERS. The Board of Directors may adopt such rules and regulations for the conduct of its meetings, the exercise of its powers and the management of the affairs of the corporation as it may deem proper, not inconsistent with the laws of the State of New York, the Certificate of Incorporation or these By-Laws.

In addition to the powers and authorities by these By-Laws expressly conferred upon them, the Board of Directors may exercise all such powers of the corporation and do such lawful acts and things except as are by statute, the Certificate of Incorporation or these By-Laws directed or required to be exercised or done by the shareholders.

SECTION 3. MEETING, QUORUM, ACTION WITHOUT MEETING. Meetings of the Board of Directors may be held at any place, either within or outside the State of New York, provided a quorum be in attendance. Except as may be otherwise provided by the Certificate of Incorporation or by the Business Corporation Law, a majority of the directors in office shall constitute a quorum at any meeting of the Board of Directors and the vote of a majority of a quorum of directors shall constitute the act of the Board of Directors.

The Board of Directors may hold an annual meeting, without notice, immediately after the annual meeting of shareholders. Regular meetings of the Board of Directors may be established by a resolution adopted by the Board of Directors. The Chairman of the Board of Directors may call, and at the request of any two directors must call, a special meeting of the Board of Directors, three days notice of which shall be given by overnight United States Mail or by Federal Express or any other private overnight courier service, or two days notice of which shall be given personally or by telephone, telecopier or telefax (or similar communications equipment), telegram or cable, to each director.<sup>2</sup>

Any one or more members of the Board of Directors or any Committee thereof may participate in a meeting of such Board of Directors or Committee by means of a conference telephone call or similar communications equipment allowing all persons participating in the meeting to hear each other at the same time, if before the meeting the Chairman of the Board of Directors or the Chairman of such Committee, as the case may be, determines that an emergency or other extraordinary circumstances exist, making telephone participation in the meeting by one or more directors appropriate. The determination by the Chairman of the Board of Directors or the Chairman of a Committee thereof, as the case may be, that an emergency or other extraordinary circumstances exist, making telephone participation in the meeting by one or more directors appropriate, shall be final and conclusive. Where authorized by the Chairman of the Board of Directors or the Chairman of a Committee thereof, as described above in this paragraph, participation by means of a conference telephone call or similar communications equipment allowing all persons participating in the meeting to hear each other at the same time shall constitute presence in person at the meeting.<sup>3</sup>

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<sup>2</sup> As amended at the November 17, 1988, directors' meeting.

<sup>3</sup> As amended at the April 25, 1989, directors' meeting.

Any action required or permitted to be taken by the Board of Directors or any Committee thereof may be taken without a meeting if all members of the Board of Directors or the Committee consent in writing to the adoption of a resolution authorizing the action. The resolution and the written consents thereto by the members of the Board of Directors or Committee shall be filed with the minutes of the meetings of the Board of Directors or Committee.

SECTION 4. VACANCIES, REMOVAL. Except where the Certificate of Incorporation contains provisions authorizing cumulative voting or the election of one or more directors by class or their election by holders of bonds, or requires all action by shareholders to be by a greater vote, any one or more of the directors may be removed, (a) for cause, at any time, by vote of the shareholders holding a majority of the outstanding stock of the corporation entitled to vote, present in person or by proxy, at any special meeting of the shareholders or by written consent of all of the shareholders entitled to vote, or (b) for cause, by action of the Board of Directors at any regular or special meeting of the Board of Directors. Shareholders may not remove directors without cause. A vacancy or vacancies occurring from such removal may be filled at a special meeting of shareholders called for such purpose or at a regular or special meeting of the Board of Directors.

SECTION 5. COMMITTEES. The Board of Directors, by resolution adopted by a majority of the entire Board of Directors, may designate from its members an Executive Committee or other committee or committees, each consisting of three or more members, with such powers and authority (to the extent permitted by law) as may be provided in said resolution.

## ARTICLE IV

### OFFICERS

SECTION 1. EXECUTIVE OFFICERS. The executive officers of the corporation shall be a Chairman of the Board, a President, a Treasurer and a Secretary, all of whom shall be elected annually by the Board of Directors, who shall hold office at the pleasure of the Board of Directors. No one person may serve simultaneously as both President and Secretary of the corporation, but any two or more other offices may be held simultaneously by the same person. All vacancies occurring among any of the officers shall be filled by the Board of Directors.<sup>4</sup>

SECTION 2. OTHER OFFICERS. The Board of Directors may appoint such other officers and agents with such powers and duties as it shall deem necessary.

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<sup>4</sup> As amended at the November 17, 1988, directors' meeting.

SECTION 3. THE CHAIRMAN OF THE BOARD. The Chairman of the Board of Directors shall be the chief executive officer of the corporation and, while the Board of Directors is not in session, shall have general management and control of the business and affairs of the corporation. He shall also preside at all meetings of the Board of Directors, and shall have and perform such other duties as from time to time may be assigned to him by the Board of Directors.<sup>5</sup>

SECTION 4. THE PRESIDENT. The President, who may but need not be a director, shall, in the absence of a Chairman of the Board, preside at all meetings of the shareholders and directors. He shall have and perform such other duties as from time to time may be assigned to him by the Board of Directors or the Chairman of the Board.<sup>6</sup>

SECTION 5. THE VICE-PRESIDENT. The Vice-President, if one be elected, or if there be more than one, the senior Vice-President as determined by the Board of Directors, in the absence or disability of the President, shall exercise the powers and perform the duties of the President and each Vice-President shall exercise such other powers and perform such other duties as from time to time may be assigned to him by the Board of Directors, the Chairman of the Board, or the President.<sup>7</sup>

SECTION 6. THE TREASURER. The Treasurer shall have custody of all funds, securities and evidences of indebtedness of the corporation; he shall receive and give receipts and acquittances for moneys paid in on account of the corporation, and shall pay out of the funds on hand all bills, payrolls, and other just debts of the corporation, of whatever nature, upon maturity; he shall enter regularly in books to be kept by him for that purpose, full and accurate accounts of all moneys received and paid out by him on account of the corporation, and he shall perform all other duties incident to the office of Treasurer and as may be prescribed by the Board of Directors.

SECTION 7. THE SECRETARY. The Secretary shall keep the minutes of all meetings of the Board of Directors and of the shareholders; he shall attend to the giving and serving of all notices to shareholders and directors or other notice required by law or by these By-Laws; he shall affix the seal of the corporation to deeds, contracts and other instruments in writing requiring a seal, when duly signed or when so ordered by the Board of Directors; he shall have charge of the certificate books and stock books and such other books and papers as the Board of Directors may direct, and he shall perform all other duties incident to the office of Secretary.

SECTION 8. SALARIES. The salaries and other compensation of all officers and employees shall be fixed by the Board of Directors, or by any committee designated from among the directors (in accordance with Article III, Section 5, of these By-Laws) to handle such compensation matters, and the fact that any officer is a director shall not preclude him from receiving a salary and other compensation as an officer, or from voting upon the resolution providing the same.<sup>8</sup>

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<sup>5</sup> As amended at the November 17, 1988, directors' meeting.

<sup>6</sup> As amended at the November 17, 1988, directors' meeting.

<sup>7</sup> As amended at the November 17, 1988, directors' meeting.

<sup>8</sup> As amended by the Unanimous Written Action by Board of Directors dated June 9, 1992.



ARTICLE V

CAPITAL STOCK

SECTION 1. FORM AND EXECUTION OF CERTIFICATES. Certificates of stock shall be in such form as required by the Business Corporation Law of New York and as shall be adopted by the Board of Directors. They shall be numbered and registered in the order issued; shall be signed by the Chairman or a Vice-Chairman of the Board of Directors (if any) or by the President or Vice-President and by the Secretary or an Assistant Secretary or the Treasurer or an Assistant Treasurer and may be sealed with the corporate seal or a facsimile thereof. When such a certificate is countersigned by a transfer agent or registered by a registrar, the signatures of any such officers may be facsimile.

SECTION 2. TRANSFER. Transfer of shares shall be made only upon the books of the corporation by the registered holder in person or by attorney, duly authorized, and upon surrender of the certificate or certificates for such shares properly assigned for transfer.

SECTION 3. LOST OR DESTROYED CERTIFICATES. The holder of any certificate representing shares of stock of the corporation may notify the corporation of any loss, theft or destruction thereof, and the Board of Directors may thereupon, in its discretion, cause a new certificate for the same number of shares, to be issued to such holder upon satisfactory proof of such loss, theft or destruction, and the deposit of indemnity by way of bond or otherwise, in such form and amount and with such surety or sureties as the Board of Directors may require, to indemnify the corporation against any loss or liability by reason of the issuance of such new certificates.

SECTION 4. RECORD DATE. In lieu of closing the books of the corporation, for the purpose of determining the shareholders entitled to notice of or to vote at any meeting of shareholders or any adjournment thereof, or to express consent to or dissent from any proposal without a meeting, or for the purpose of determining shareholders entitled to receive payment of any dividend or the allotment of any rights, or for the purpose of any other action, the Board of Directors may fix, in advance, a date, not exceeding sixty days, nor less than ten days, as the record date for any such determination of shareholders.

ARTICLE VI

MISCELLANEOUS

SECTION 1. DIVIDENDS. The Board of Directors may declare dividends from time to time upon the capital stock of the corporation from the surplus or net profits available therefor.

SECTION 2. SEAL. The Board of Directors shall provide a suitable corporate seal and shall be used as authorized by the By-Laws.

SECTION 3. FISCAL YEAR. The fiscal year of the corporation shall be determined by the Board of Directors.

SECTION 4. CHECKS, NOTES, ETC. Checks, notes, drafts, bills of exchange and orders for the payment of money shall be signed or endorsed in such manner as shall be determined by the Board of Directors.

The funds of the corporation shall be deposited in such bank or trust company, and checks drawn against such funds shall be signed in such manner as may be determined from time to time by the Board of Directors.

SECTION 5. NOTICE AND WAIVER OF NOTICE. Any notice required to be given under these By-Laws may be waived by the person entitled thereto, in writing, by telecopier or telefax (or similar communications equipment), telegram, cable or radiogram, and the presence of any person at a meeting shall constitute waiver of notice thereof as to such person.<sup>9 10</sup>

ARTICLE VII

AMENDMENTS

SECTION 1. BY SHAREHOLDERS. These By-Laws may be amended at any shareholders' meeting by vote of the shareholders holding a majority (unless the Certificate of Incorporation requires a larger vote) of the outstanding stock having voting power, present either in person or by proxy, provided notice of the amendment is included in the notice or waiver of notice of such meeting.

SECTION 2. BY DIRECTORS. The Board of Directors may also amend these By-Laws at any regular or special meeting of the Board by a majority (unless the Certificate of Incorporation requires a larger vote) vote of the entire Board, but any By-Laws so made by the Board of Directors may be altered or repealed by the shareholders.

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<sup>9</sup> As amended at the November 17, 1988, directors' meeting.

<sup>10</sup> Section 6 "Indemnification" was deleted in its entirety pursuant to a unanimous written consent of directors dated October 19, 1992.

BY-LAWS  
OF  
HARRIS & HARRIS GROUP, INC.

I certify that the following By-Laws, consisting of nine pages, each of which I have initialed for identification, are the By-Laws:

- (1) Adopted, as contemplated by Section 601(a) of the New York Business Corporation Law, as amended, for and on behalf of the shareholders of Harris & Harris Group, Inc. (the "corporation"), by a written action signed by the corporation's sole incorporator and dated as of December 1, 1981;
- (2) Approved and adopted by the corporation's Board of Directors by a unanimous written consent in lieu of an organizational meeting dated as of December 1, 1981; and
- (3) As amended by the corporation's Board of Directors (a) at its March 23, 1984, special meeting; (b) by a unanimous written consent of directors dated as of April 13, 1984; (c) at its April 30, 1984, special meeting; (d) at its July 9, 1984, meeting; (e) at its October 19, 1984, meeting; (f) at its July 11, 1985, meeting; (g) at its November 17, 1988, meeting; (h) at its April 25, 1989, meeting; (i) by a unanimous written consent of directors dated June 9, 1992; and (j) by a unanimous written consent of directors dated October 19, 1992.

/s/ Rachel M. Pernia  
\_\_\_\_\_  
Rachel M. Pernia, Secretary

Dated: November 4, 1998

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Number  
NY

Shares

COMMON STOCK

HARRIS & HARRIS GROUP, INC.

INCORPORATED UNDER THE LAWS OF THE STATE OF NEW YORK

SEE REVERSE FOR CERTAIN DEFINITIONS  
CUSIP 413833 10 4

THIS CERTIFIES That

is the owner of

FULLY PAID AND NON-ASSESSABLE SHARES OF COMMON STOCK OF THE PAR VALUE OF ONE CENT (\$.01) PER SHARE OF

HARRIS & HARRIS GROUP, INC transferable on the books of the Corporation by the holder hereof in person or by duly authorized attorney upon surrender of this certificate properly endorsed. This certificate and the shares represented are issued and shall be held subject to all of the provisions of the Certificate of Incorporation and By-Laws of the Corporation and any lawful amendment thereto.

This Certificate is not valid until countersigned by the Transfer Agent.

WITNESS the facsimile seal of the Corporation and the facsimile signatures of its duly authorized officers.

[SEAL] DATED:

COUNTERSIGNED AND REGISTERED:  
AMERICAN STOCK TRANSFER & TRUST COMPANY (NEW YORK)  
TRANSFER AGENT AND REGISTRAR

BY:

AUTHORIZED SIGNATURE

/s/ Sandra M. Forman  
SECRETARY

/s/ Daniel B. Wolfe  
PRESIDENT

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The following abbreviations, when used in the inscription on the face of this certificate, shall be construed as though they were written out in full according to applicable laws or regulations:

TEN COM -	as tenants in common	UNIF GIFT MIN ACT--	.....Custodian.....
TEN ENT -	as tenants by the entireties		(Cust) (Minor)
JT TEN -	as joint tenants with right of survivorship and not as tenants in common		under Uniform Gifts to Minors Act..... (State)

Additional abbreviations may also be used though not in the above list.

For Value Received \_\_\_\_\_ hereby sell, assign and transfer unto

PLEASE INSERT SOCIAL SECURITY OR OTHER  
IDENTIFYING NUMBER OF ASSIGNEE

\_\_\_\_\_

\_\_\_\_\_

Please print or typewrite name and address including postal zip code of assignee

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_ Shares  
represented by the within Certificate, and do hereby irrevocably constitute and appoint

\_\_\_\_\_ Attorney  
to transfer the said shares on the books of the within-named Corporation, with full power of substitution  
in the premises.

Dated \_\_\_\_\_

X  
NOTICE: THE SIGNATURE TO THIS ASSIGNMENT MUST  
CORRESPOND THE SAME AS WRITTEN UPON THE  
FACE OF THE CERTIFICATE IN EVERY PARTICULAR  
WITHOUT ALTERATION OR ENLARGEMENT, OR ANY  
CHANGE WHATEVER.

The Corporation will furnish to any shareholder upon request and without charge, a full statement of the designation, relative rights, preferences and limitations of the shares of each class authorized to be issued, and with respect to any class of preferred shares in series, the designation, relative rights, preferences and limitations of each such series so far as the same has been fixed and the authority of the board to designate and fix the relative rights, preferences and limitations of other series.

\_\_\_\_\_

**FORM OF  
CUSTODY AGREEMENT**

AGREEMENT, dated as of March \_\_, 2009 between each entity listed on Exhibit A hereto, each such entity having its principal office and place of business at 111 West 57<sup>th</sup> Street, Suite 1100, New York, NY 10019 (the "Fund") and THE BANK OF NEW YORK MELLON, a New York corporation authorized to do a banking business having its principal office and place of business at One Wall Street, New York, New York 10286 ("Custodian").

**W I T N E S S E T H:**

That for and in consideration of the mutual promises hereinafter set forth the Fund and Custodian agree as follows:

**ARTICLE I  
DEFINITIONS**

Whenever used in this Agreement, the following words shall have the meanings set forth below:

1. **"Authorized Person"** shall be any person, whether or not an officer or employee of the Fund, duly authorized by the Fund's board to execute any Certificate or to give any Oral Instruction with respect to one or more Accounts, such persons to be designated in a Certificate annexed hereto as Schedule I hereto or such other Certificate as may be received by Custodian from time to time.
  2. **"BNY Affiliate"** shall mean any office, branch or subsidiary of The Bank of New York Mellon Corporation.
  3. **"Book-Entry System"** shall mean the Federal Reserve/Treasury book-entry system for receiving and delivering securities, its successors and nominees.
  4. **"Business Day"** shall mean any day on which Custodian and relevant Depositories are open for business.
  5. **"Certificate"** shall mean any notice, instruction, or other instrument in writing, authorized or required by this Agreement to be given to Custodian, which is actually received by Custodian by letter or facsimile transmission and signed on behalf of the Fund by an Authorized Person or a person reasonably believed by Custodian to be an Authorized Person.
  6. **"Certificated Security"** shall mean a promissory note or other debt obligation or a warrant or similar right to purchase shares, each in physical form and from time to time contained in a Loan Document File (as hereinafter defined) or otherwise delivered to Custodian pursuant to this Agreement or held at a Subcustodian.
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7. **“Composite Currency Unit”** shall mean the Euro or any other composite currency unit consisting of the aggregate of specified amounts of specified currencies, as such unit may be constituted from time to time.

8. **“Depository”** shall include (a) the Book-Entry System, (b) the Depository Trust Company, (c) any other clearing agency or securities depository registered with the Securities and Exchange Commission identified to the Fund from time to time, and (d) the respective successors and nominees of the foregoing.

9. **“Foreign Depository”** shall mean (a) Euroclear, (b) Clearstream Banking, societe anonyme, (c) each Eligible Securities Depository as defined in Rule 17f-7 under the Investment Company Act of 1940, as amended, identified to the Fund from time to time, and (d) the respective successors and nominees of the foregoing.

10. **“Instructions”** shall mean communications actually received by Custodian by S.W.I.F.T., tested telex, letter, facsimile transmission, or other method or system specified by Custodian as available for use in connection with the services hereunder.

11. **“Loan Document File”** shall mean a hard copy file, which the Fund represents contains Loan Documents (as hereinafter defined), delivered to and received by Custodian hereunder.

12. **“Loan Documents”** shall mean all documents and instruments relating to any Loans (as hereinafter defined), including, without limitation, loan or credit agreements, assignment and acceptance agreements, promissory notes, deeds, mortgages and security agreements contained in a Loan Document File.

13. **“Loans”** shall mean loans or loan commitments by the Fund to its customers.

14. **“Oral Instructions”** shall mean verbal instructions received by Custodian from an Authorized Person or from a person reasonably believed by Custodian to be an Authorized Person.

15. **“Series”** shall mean the various portfolios, if any, of the Fund listed on Schedule II hereto, and if none are listed references to Series shall be references to the Fund.

16. **“Securities”** shall mean any common stock and other equity securities, bonds, debentures, promissory notes and other debt securities and warrants or any instruments representing rights to receive, purchase, or subscribe for the same, or representing any other rights or interests therein whether constituting a Certificated Security or held in book-entry form in a Depository or a Foreign Depository.

17. **“Subcustodian”** shall mean a bank (including any branch thereof) or other financial institution (other than a Foreign Depository) located outside the U.S. which is utilized by Custodian in connection with the purchase, sale or custody of Securities hereunder and identified to the Fund from time to time, and their respective successors and nominees.

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18. **“Uncertificated Securities”** shall mean any Securities which are not Certificated Securities.

**ARTICLE II**  
**APPOINTMENT OF CUSTODIAN; ACCOUNTS;**  
**REPRESENTATIONS, WARRANTIES, AND COVENANTS**

1. (a) The Fund hereby appoints Custodian as custodian of all Securities, cash and Loan Documents at any time delivered to Custodian during the term of this Agreement. Except as otherwise agreed, Certificated Securities shall be held in registered form in the Fund’s name. Custodian hereby accepts such appointment and agrees to establish and maintain one or more securities accounts and cash accounts for each Series in which Custodian will hold Securities and cash and Loan Document Files as provided herein. Custodian shall maintain books and records segregating the assets of each Series from the assets of any other Series. Such accounts (each, an “Account”; collectively, the “Accounts”) shall be in the name of the Fund. All Loan Document Files (and any Certificated Securities that may be contained therein) shall be maintained and held by Custodian in its vaults or the vaults of a Subcustodian.

(b) Custodian may from time to time establish on its books and records such sub-accounts within each Account as the Fund and Custodian may agree upon (each a “Special Account”), and Custodian shall reflect therein such assets as the Fund may specify in a Certificate or Instructions.

(c) Custodian may from time to time establish pursuant to a written agreement with and for the benefit of a broker, dealer, future commission merchant or other third party identified in a Certificate or Instructions such accounts on such terms and conditions as the Fund and Custodian shall agree, and Custodian shall transfer to such account such Securities and money as the Fund may specify in a Certificate or Instructions.

2. The Fund hereby represents and warrants, which representations and warranties shall be continuing and shall be deemed to be reaffirmed upon each delivery of a Certificate or each giving of Oral Instructions or Instructions by the Fund, that:

(a) It is duly organized and existing under the laws of the jurisdiction of its organization, with full power to carry on its business as now conducted, to enter into this Agreement, and to perform its obligations hereunder;

(b) This Agreement has been duly authorized, executed and delivered by the Fund, approved by a resolution of its board, constitutes a valid and legally binding obligation of the Fund, enforceable in accordance with its terms, and there is no statute, regulation, rule, order or judgment binding on it, and no provision of its charter or by-laws, nor of any mortgage, indenture, credit agreement or other contract binding on it or affecting its property, which would prohibit its execution or performance of this Agreement;

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(c) It is conducting its business in substantial compliance with all applicable laws and requirements, both state and federal, and has obtained all regulatory licenses, approvals and consents necessary to carry on its business as now conducted;

(d) It will not use the services provided by Custodian hereunder in any manner that is, or will result in, a violation of any law, rule or regulation applicable to the Fund;

(e) To the extent applicable, its board or its foreign custody manager, as defined in Rule 17f-5 under the Investment Company Act of 1940, as amended (the "40 Act"), has determined that use of each Subcustodian (including any Replacement Custodian) which Custodian is authorized to utilize in accordance with Section 1(a) of Article III hereof satisfies the applicable requirements of the 40 Act and Rule 17f-5 thereunder;

(f) To the extent applicable, the Fund or its investment adviser has determined that the custody arrangements of each Foreign Depository provide reasonable safeguards against the custody risks associated with maintaining assets with such Foreign Depository within the meaning of Rule 17f-7 under the 40 Act;

(g) It is fully informed of the protections and risks associated with various methods of transmitting Instructions and Oral Instructions and delivering Certificates to Custodian, shall, and shall cause each Authorized Person, to safeguard and treat with extreme care any user and authorization codes, passwords and/or authentication keys, understands that there may be more secure methods of transmitting or delivering the same than the methods selected by it, agrees that the security procedures (if any) to be followed in connection therewith provide a commercially reasonable degree of protection in light of its particular needs and circumstances, and acknowledges and agrees that Instructions need not be reviewed by Custodian, may conclusively be presumed by Custodian to have been given by person(s) duly authorized, and may be acted upon as given;

(h) It shall manage its borrowings, including, without limitation, any advance or overdraft (including any day-light overdraft) in the Accounts, so that the aggregate of its total borrowings does not exceed the amount permitted to be borrowed under the 40 Act;

(i) Its transmission or giving of, and Custodian acting upon and in reliance on, Certificates, Instructions, or Oral Instructions pursuant to this Agreement shall at all times comply with the 40 Act;

(j) It shall impose and maintain restrictions on the destinations to which cash may be disbursed by Instructions to ensure that each disbursement is for a proper purpose;

(k) It has the right to make the pledge and grant the security interest and security entitlement to Custodian contained in Section 1 of Article V hereof, free of any right of redemption or prior claim of any other person or entity, such pledge and such grants shall have a first priority subject to no setoffs, counterclaims, or other liens or grants prior to or on a parity therewith, and it shall take such additional steps as Custodian may require to assure such priority; and

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(l) Each Loan Document File delivered to Custodian hereunder shall contain all relevant Loan Documents pertaining to the Loan to which it relates.

3. The Fund hereby covenants that it shall from time to time complete and execute and deliver to Custodian upon Custodian's request a Form FR U-1 (or successor form) whenever the Fund borrows from Custodian any money to be used for the purchase or carrying of margin stock as defined in Federal Reserve Regulation U.

### ARTICLE III CUSTODY OF SECURITIES AND RELATED SERVICES

1. (a) Subject to the terms hereof, the Fund hereby authorizes Custodian to hold any Securities received by it from time to time for the Fund's account. Custodian shall be entitled to utilize, subject to subsection (c) of this Section 1, Depositories, Subcustodians, and, subject to subsection (d) of this Section 1, Foreign Depositories, to the extent possible in connection with its performance hereunder. Uncertificated Securities and cash held in a Depository or Foreign Depository will be held subject to the rules, terms and conditions of such entity. Securities and cash held through Subcustodians shall be held subject to the terms and conditions of Custodian's agreements with such Subcustodians. Subcustodians may be authorized to hold Uncertificated Securities in Foreign Depositories in which such Subcustodians participate. Unless otherwise required by local law or practice or a particular subcustodian agreement, Uncertificated Securities deposited with a Subcustodian, a Depository or a Foreign Depository will be held in a commingled account, in the name of Custodian, holding only Securities held by Custodian as custodian for its customers. Custodian shall identify on its books and records the Securities and cash belonging to the Fund, whether held directly or indirectly through Depositories, Foreign Depositories, or Subcustodians. Custodian shall, directly or indirectly through Subcustodians, Depositories, or Foreign Depositories, endeavor, to the extent feasible, to hold Securities in the country or other jurisdiction in which the principal trading market for such Securities is located, where such Securities are to be presented for cancellation and/or payment and/or registration, or where such Securities are acquired. Custodian at any time may cease utilizing any Subcustodian and/or may replace a Subcustodian with a different Subcustodian (the "Replacement Subcustodian"). In the event Custodian selects a Replacement Subcustodian, Custodian shall not utilize such Replacement Subcustodian until after the Fund's board or foreign custody manager has determined that utilization of such Replacement Subcustodian satisfies the requirements of the 40 Act and Rule 17f-5 thereunder.

(b) Unless Custodian has received a Certificate or Instructions to the contrary, Custodian shall hold Securities indirectly through a Subcustodian only if (i) the Securities are not subject to any right, charge, security interest, lien or claim of any kind in favor of such Subcustodian or its creditors or operators, including a receiver or trustee in bankruptcy or similar authority, except for a claim of payment for the safe custody or administration of Securities on behalf of the Fund by such Subcustodian, and (ii) beneficial ownership of the Securities is freely transferable without the payment of money or value other than for safe custody or administration.

(c) With respect to each Depository, Custodian (i) shall exercise due care in accordance with reasonable commercial standards in discharging its duties as a securities intermediary to obtain and thereafter maintain Uncertificated Securities or financial assets deposited or held in such Depository, and (ii) will provide, promptly upon request by the Fund, such reports as are available concerning the internal accounting controls and financial strength of Custodian.

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(d) With respect to each Foreign Depository, Custodian shall exercise reasonable care, prudence, and diligence (i) to provide the Fund with an analysis of the custody risks associated with maintaining assets with the Foreign Depository, and (ii) to monitor such custody risks on a continuing basis and promptly notify the Fund of any material change in such risks. The Fund acknowledges and agrees that such analysis and monitoring shall be made on the basis of, and limited by, information gathered from Subcustodians or through publicly available information otherwise obtained by Custodian, and shall not include any evaluation of Country Risks. As used herein the term "Country Risks" shall mean with respect to any Foreign Depository: (a) the financial infrastructure of the country in which it is organized, (b) such country's prevailing custody and settlement practices, (c) nationalization, expropriation or other governmental actions, (d) such country's regulation of the banking or securities industry, (e) currency controls, restrictions, devaluations or fluctuations, and (f) market conditions which affect the order execution of securities transactions or affect the value of securities.

2. Custodian shall furnish the Fund with an advice of daily transactions (including a confirmation of each transfer of Securities) and a monthly summary of all transfers to or from the Accounts.

3. With respect to all Uncertificated Securities held hereunder, Custodian shall, unless otherwise instructed to the contrary:

(a) Receive all income and other payments and advise the Fund as promptly as practicable of any such amounts due but not paid;

(b) Present for payment and receive the amount paid upon all Uncertificated Securities which may mature and advise the Fund as promptly as practicable of any such amounts due but not paid;

(c) Forward to the Fund copies of all information or documents that it may actually receive from an issuer of Uncertificated Securities which, in the reasonable opinion of Custodian, are intended for the beneficial owner of Uncertificated Securities;

(d) Execute, as custodian, any certificates of ownership, affidavits, declarations or other certificates under any tax laws now or hereafter in effect in connection with the collection of bond and note coupons;

(e) Hold directly or through a Depository, a Foreign Depository, or a Subcustodian all rights and similar Securities issued with respect to any Securities credited to an Account hereunder; and

(f) Endorse for collection checks, drafts or other negotiable instruments.

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(g) (i) Custodian shall notify the Fund of rights or discretionary actions with respect to Uncertificated Securities held hereunder, and of the date or dates by when such rights must be exercised or such action must be taken, provided that Custodian has actually received, from the issuer or the relevant Depository (with respect to Uncertificated Securities issued in the United States) or from the relevant Subcustodian, Foreign Depository, or a nationally or internationally recognized bond or corporate action service to which Custodian subscribes, timely notice of such rights or discretionary corporate action or of the date or dates such rights must be exercised or such action must be taken. Absent actual receipt of such notice, Custodian shall have no liability for failing to so notify the Fund.

(ii) Whenever Uncertificated Securities (including, but not limited to, warrants, options, tenders, options to tender or non-mandatory puts or calls) confer discretionary rights on the Fund or provide for discretionary action or alternative courses of action by the Fund, the Fund shall be responsible for making any decisions relating thereto and for directing Custodian to act. In order for Custodian to act, it must receive the Fund's Certificate or Instructions at Custodian's offices, addressed as Custodian may from time to time request, not later than noon (New York time) at least two (2) Business Days prior to the last scheduled date to act with respect to such Uncertificated Securities (or such earlier date or time as Custodian may specify to the Fund). Absent Custodian's timely receipt of such Certificate or Instructions, Custodian shall not be liable for failure to take any action relating to or to exercise any rights conferred by such Uncertificated Securities.

(h) All voting rights with respect to Uncertificated Securities, however registered, shall be exercised by the Fund or its designee. Custodian will make available to the Fund proxy voting services upon the request of, and for the jurisdictions selected by, the Fund in accordance with terms and conditions to be mutually agreed upon by Custodian and the Fund.

(i) Custodian shall promptly advise the Fund upon Custodian's actual receipt of notification of the partial redemption, partial payment or other action affecting less than all Uncertificated Securities of the relevant class. If Custodian, any Subcustodian, any Depository, or any Foreign Depository holds any Uncertificated Securities in which the Fund has an interest as part of a fungible mass, Custodian, such Subcustodian, Depository, or Foreign Depository may select the Uncertificated Securities to participate in such partial redemption, partial payment or other action in any non-discriminatory manner that it customarily uses to make such selection.

4. With respect to all Certificated Securities held hereunder, the Fund shall, unless otherwise agreed in writing to the contrary:

(a) Cause the issuer of any Certificated Security to deposit with Custodian (by means of a check or draft payable to Custodian or its nominee or by wire transfer) all income and other payments or distributions on or with respect to such Certificated Security and advise Custodian in a Certificate of the amount to be received and if such amount relates to a particular Loan Document File, the identity of such Loan Document File;

(b) Direct Custodian in a detailed Certificate to present for payment on the date and at the address specified therein the Certificated Securities specified therein whether at maturity or for redemption, and to hold hereunder such amounts paid on or with respect to such particular Certificated Securities as Custodian may receive;

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(c) Obtain and execute any certificates of ownership, affidavits, declarations or other certificates under any tax laws now or hereafter in effect in connection with the collection of bond and note coupons;

(d) Cause the issuer to deposit with Custodian to be held hereunder such additional Certificated Securities or rights as may be issued with respect to any Certificated Securities credited to an Account hereunder and advise Custodian in a detailed Certificate, if the Certificated Securities are to be held in a particular Loan Document File;

(e) Be solely responsible for the exercise of rights or discretionary actions with respect to Certificated Securities held hereunder; and

(f) Exercise all voting rights with respect to Certificated Securities.

5. Custodian shall have no duty or obligation to notify the Fund of any rights or discretionary corporate action relating to a Certificated Security nor shall Custodian have any responsibility or liability in connection with the exercise of such rights or discretionary actions. Custodian shall have no duty or obligation to notify the Fund of any proxy solicitation with respect to a Certificated Security nor shall Custodian have any responsibility or liability relating to such proxy voting.

6. Custodian shall not under any circumstances accept bearer interest coupons which have been stripped from United States federal, state or local government or agency securities unless explicitly agreed to by Custodian in writing.

7. The Fund shall be liable for all taxes, assessments, duties and other governmental charges, including any interest or penalty with respect thereto ("Taxes"), with respect to any cash, Securities or Loan Document Files held on behalf of the Fund or any transaction related thereto. The Fund shall indemnify Custodian and each Subcustodian for the amount of any Tax that Custodian, any such Subcustodian or any other withholding agent is required under applicable laws (whether by assessment or otherwise) to pay on behalf of, or in respect of income earned by or payments or distributions made to or for the account of the Fund (including any payment of Tax required by reason of an earlier failure to withhold). Custodian shall, or shall instruct the applicable Subcustodian or other withholding agent to, withhold the amount of any Tax which is required to be withheld under applicable law upon collection of any dividend, interest or other distribution made with respect to any Uncertificated Security and any proceeds or income from the sale, loan or other transfer of any Uncertificated Security. In the event that Custodian or any Subcustodian is required under applicable law to pay any Tax on behalf of the Fund, Custodian is hereby authorized to withdraw cash from any cash account in the amount required to pay such Tax and to use such cash, or to remit such cash to the appropriate Subcustodian or other withholding agent, for the timely payment of such Tax in the manner required by applicable law. If the aggregate amount of cash in all cash accounts is not sufficient to pay such Tax, Custodian shall promptly notify the Fund of the additional amount of cash (in the appropriate currency) required, and the Fund shall directly deposit such additional amount in the appropriate cash account promptly after receipt of such notice, for use by Custodian as specified herein. In the event that Custodian reasonably believes that Fund is eligible, pursuant to applicable law or to the provisions of any tax treaty, for a reduced rate of, or exemption from, any Tax which is otherwise required to be withheld or paid on behalf of the Fund under any applicable law, Custodian shall, or shall instruct the applicable Subcustodian or withholding agent to, either withhold or pay such Tax at such reduced rate or refrain from withholding or paying such Tax, as appropriate; provided that Custodian shall have received from the Fund all documentary evidence of residence or other qualification for such reduced rate or exemption required to be received under such applicable law or treaty. In the event that Custodian reasonably believes that a reduced rate of, or exemption from, any Tax is obtainable only by means of an application for refund, Custodian and the applicable Subcustodian shall have no responsibility for the accuracy or validity of any forms or documentation provided by the Fund to Custodian hereunder. The Fund hereby agrees to indemnify and hold harmless Custodian and each Subcustodian in respect of any liability arising from any underwithholding or underpayment of any Tax which results from the inaccuracy or invalidity of any such forms or other documentation, and such obligation to indemnify shall be a continuing obligation of the Fund, its successors and assigns notwithstanding the termination of this Agreement.

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8. (a) For the purpose of settling Securities transactions, transactions relating to Loan Document Files and foreign exchange transactions, the Fund shall provide Custodian with sufficient immediately available funds for all transactions by such time and date as conditions in the relevant market dictate. As used herein, "sufficient immediately available funds" shall mean either (i) sufficient cash denominated in U.S. dollars to purchase the necessary foreign currency, or (ii) sufficient applicable foreign currency, to settle the transaction. Custodian shall provide the Fund with immediately available funds each day which result from the actual settlement of all sale transactions, based upon advices received by Custodian from Subcustodians, Depositories, and Foreign Depositories. Such funds shall be in U.S. dollars or such other currency as the Fund may specify to Custodian.

(b) Any foreign exchange transaction effected by Custodian in connection with this Agreement may be entered with Custodian or a BNY Affiliate acting as principal or otherwise through customary banking channels. The Fund may issue a standing Certificate or Instructions with respect to foreign exchange transactions, but Custodian may establish rules or limitations concerning any foreign exchange facility made available to the Fund, provided that the Custodian provides notice of the same. The Fund shall bear all risks of investing in Securities or holding cash denominated in a foreign currency.

(c) To the extent that Custodian has agreed to provide pricing or other information services for Securities hereunder (other than Certificated Securities contained in a Loan Document File), Custodian is authorized to utilize any vendor (including brokers and dealers of Securities) reasonably believed by Custodian to be reliable to provide such information. The Fund understands that certain pricing information with respect to complex financial instruments (e.g., derivatives) may be based on calculated amounts rather than actual market transactions and may not reflect actual market values, and that the variance between such calculated amounts and actual market values may or may not be material. Where vendors do not provide information for particular Securities or other property, an Authorized Person may advise Custodian in a Certificate regarding the fair market value of, or provide other information with respect to, such Securities or property as determined by it in good faith. Custodian shall not be liable for any loss, damage or expense incurred as a result of errors or omissions with respect to any pricing or other information utilized by Custodian hereunder.

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9. Except as otherwise provided by law, no person (other than an officer or employee of Custodian or a Subcustodian) shall be authorized or permitted to have access to the Securities, Loan Document Files and Loan Documents held in custody hereunder, except pursuant to a resolution of the Fund's board of directors. Each such resolution shall designate not more than five persons who shall be either officers or employees of the Fund and shall provide that access to such Securities, Loan Document Files and Loan Documents shall be limited to two or more such persons jointly, at least one of whom shall be an officer of the Fund; except that access to such Securities, Loan Document Files and Loan Documents shall be permitted to the Fund's independent public accountants jointly with any two persons so designated or with an officer or employee of Custodian. Loan Documents, Loan Document Files and Certificated Securities may be withdrawn from custody hereunder only pursuant to a resolution of the Fund's board of directors in connection with the sale, exchange, redemption, maturity or conversion, the exercise of warrants or rights, assents to changes in terms of a Loan or a Certificated Security or other transaction necessary or appropriate in the ordinary course of business relating to the management of Loans and Certificated Securities.

10. Until such time as Custodian receives a Certificate to the contrary with respect to a particular Uncertificated Security, Custodian may release the identity of the Fund to an issuer which requests such information pursuant to the Shareholder Communications Act of 1985 for the specific purpose of direct communications between such issuer and shareholder.

**ARTICLE IV  
PURCHASE AND SALE OF SECURITIES;  
CREDITS TO ACCOUNT**

1. Promptly after each purchase or sale of Securities by the Fund, the Fund shall deliver to Custodian a Certificate or Instructions, or with respect to a purchase or sale of a Security generally required to be settled on the same day the purchase or sale is made, Oral Instructions specifying all information Custodian may reasonably request to settle such purchase or sale. Custodian shall account for all purchases and sales of Securities on the actual settlement date unless otherwise agreed by Custodian.

2. The Fund understands that when Custodian is instructed to deliver Securities against payment, delivery of such Securities and receipt of payment therefor may not be completed simultaneously. Notwithstanding any provision in this Agreement to the contrary, settlements, payments and deliveries of Securities may be effected by Custodian or any Subcustodian in accordance with the customary or established securities trading or securities processing practices and procedures in the jurisdiction in which the transaction occurs, including, without limitation, delivery to a purchaser or dealer therefor (or agent) against receipt with the expectation of receiving later payment for such Securities. The Fund assumes full responsibility for all risks, including, without limitation, credit risks, involved in connection with such deliveries of Securities.

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3. Custodian may, as a matter of bookkeeping convenience or by separate agreement with the Fund, credit the Account with the proceeds from the sale, redemption or other disposition of Securities or interest, dividends or other distributions payable on Securities prior to its actual receipt of final payment therefor. All such credits shall be conditional until Custodian's actual receipt of final payment and may be reversed by Custodian to the extent that final payment is not received. Payment with respect to a transaction will not be "final" until Custodian shall have received immediately available funds which under applicable local law, rule and/or practice are irreversible and not subject to any security interest, levy or other encumbrance, and which are specifically applicable to such transaction.

**ARTICLE V  
CUSTODY OF LOAN DOCUMENT FILES AND RELATED SERVICES**

1. The Fund shall be solely responsible for the servicing of all Loans. The Fund shall cause all payments by or on behalf of borrowers under the Loans to be remitted to Custodian for credit to the Account.

2. The Fund shall be solely responsible for maintaining all records of account activity relating to each Loan, including without limitation, all amortization schedules, records of transfer, pay-off, assignment, participation, sale, modification, termination or other changes in the Loans.

3. The Fund shall, upon origination, modification or other change in any Loan, promptly deliver or cause to be delivered to Custodian all relevant Loan Documents. It is understood and agreed that Custodian will accept any file purporting to be a Loan Document File for custody hereunder "as is" and without any examination. Custodian shall have no duty or responsibility to review any Loan Document File, to determine the contents thereof or to review or inspect any Loan Document and shall rely, without independent verification, on information provided by the Fund regarding the Loan Document Files. Under no circumstances will Custodian be required to issue a trust receipt (or similar instrument) with respect to the Loan Document Files or their contents. Account statements will only reflect an inventory of the Loan Document Files that Custodian holds in custody hereunder without any representation as to the contents thereof.

4. The Fund shall be solely responsible for the settlement of each purchase or sale of Loans. Subject to Section 5 below, the Fund shall deliver to Custodian a Certificate specifying all Loan Document Files to be received or released in connection with such purchase or sale and any other relevant information concerning the custody of the Loan Document Files relating to the affected Loans. The Fund assumes full responsibility for all credit risks associated with any such sale or purchase or any loss, damage or destruction of any Loan Documents or Loan Document Files in transit.

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5. No director, officer, employee or agent of the Fund shall have physical access to the Loan Document Files or be authorized or permitted to withdraw any Loan Documents nor shall Custodian deliver any Loan Documents to any such person, unless such access or withdrawal has been duly authorized pursuant to Section 9 of Article III hereof.

#### **ARTICLE VI OVERDRAFTS OR INDEBTEDNESS**

1. If Custodian should in its sole discretion advance funds on behalf of any Series which results in an overdraft (including, without limitation, any day-light overdraft) because the money held by Custodian in an Account for such Series shall be insufficient to pay the total amount payable upon a purchase of Securities or Loans specifically allocated to such Series, as set forth in a Certificate, Instructions or Oral Instructions, or if an overdraft arises in the separate account of a Series for some other reason, including, without limitation, because of a reversal of a conditional credit or the purchase of any currency, or if the Fund is for any other reason indebted to Custodian with respect to a Series, including any indebtedness to The Bank of New York Mellon under the Fund's Cash Management and Related Services Agreement (except a borrowing for investment or for temporary or emergency purposes using Securities as collateral pursuant to a separate agreement and subject to the provisions of Section 2 of this Article), such overdraft or indebtedness shall be deemed to be a loan made by Custodian to the Fund for such Series payable on demand and shall bear interest from the date incurred at a rate per annum ordinarily charged by Custodian to its institutional customers, as such rate may be adjusted from time to time. Custodian shall endeavor to notify the Funds of such an overdraft or indebtedness, by way of written, or oral communication, or by making such information available on statements or electronically to the Fund, and will, upon request provide details related to the rate of interest to be charged in connection therewith. In addition, the Fund hereby agrees that Custodian shall to the maximum extent permitted by law have a continuing lien, security interest, and security entitlement in and to any property, including, without limitation, any investment property or any financial asset of such Series at any time held by Custodian for the benefit of such Series or in which such Series may have an interest which is then in Custodian's possession or control or in possession or control of any third party acting in Custodian's behalf. The Fund authorizes Custodian, in its sole discretion, at any time to charge any such overdraft or indebtedness together with interest due thereon against any balance of account standing to such Series' credit on Custodian's books.

2. If the Fund borrows money from any bank (including Custodian if the borrowing is pursuant to a separate agreement) for investment or for temporary or emergency purposes using Securities held by Custodian hereunder as collateral for such borrowings, the Fund shall deliver to Custodian a Certificate specifying with respect to each such borrowing: (a) the Series to which such borrowing relates; (b) the name of the bank, (c) the amount of the borrowing, (d) the time and date, if known, on which the loan is to be entered into, (e) the total amount payable to the Fund on the borrowing date, (f) the Securities or Loan Document Files to be delivered as collateral for such loan, including the name of the issuer, the title and the number of shares or the principal amount of any particular Securities, and (g) a statement that such loan is in conformance with the 40 Act and the Fund's prospectus. Custodian shall deliver on the borrowing date specified in a Certificate the specified collateral against payment by the lending bank of the total amount of the loan payable, provided that the same conforms to the total amount payable as set forth in the Certificate. Custodian may, at the option of the lending bank, keep such collateral in its possession, but such collateral shall be subject to all rights therein given the lending bank by virtue of any promissory note or loan agreement. Custodian shall deliver such Securities as additional collateral as may be specified in a Certificate to collateralize further any transaction described in this Section. The Fund shall cause all Securities or Loan Document Files released from collateral status to be returned directly to Custodian, and Custodian shall receive from time to time such return of collateral as may be tendered to it. In the event that the Fund fails to specify in a Certificate the Series, the name of the issuer, the title and number of shares or the principal amount of any particular Securities or to identify any particular Loan Document File to be delivered as collateral by Custodian, Custodian shall not be under any obligation to deliver any Securities or Loan Document File.

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**ARTICLE VII  
SALE AND REDEMPTION OF SHARES**

1. Whenever the Fund shall sell any shares issued by the Fund (“Shares”) it shall deliver to Custodian a Certificate or Instructions specifying the amount of money and/or Securities to be received by Custodian for the sale of such Shares and specifically allocated to an Account for such Series.

2. Upon receipt of such money, Custodian shall credit such money to an Account in the name of the Series for which such money was received.

3. Except as provided hereinafter, whenever the Fund desires Custodian to make payment out of the money held by Custodian hereunder in connection with a redemption of any Shares, it shall furnish to Custodian a Certificate or Instructions specifying the total amount to be paid for such Shares. Custodian shall make payment of such total amount to the transfer agent specified in such Certificate or Instructions out of the money held in an Account of the appropriate Series.

**ARTICLE VIII  
PAYMENT OF DIVIDENDS OR DISTRIBUTIONS**

1. Whenever the Fund shall determine to pay a dividend or distribution on Shares it shall furnish to Custodian Instructions or a Certificate setting forth with respect to the Series specified therein the date of the declaration of such dividend or distribution, the total amount payable, and the payment date.

2. Upon the payment date specified in such Instructions or Certificate, Custodian shall pay out of the money held for the account of such Series the total amount payable to the dividend agent of the Fund specified therein.

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**ARTICLE IX  
CONCERNING CUSTODIAN**

1. (a) Except as otherwise expressly provided herein, Custodian shall not be liable for any costs, expenses, damages, liabilities or claims, including attorneys' and accountants' fees (collectively, "Losses"), incurred by or asserted against the Fund, except those Losses arising out of Custodian's own negligence or willful misconduct. Custodian shall have no liability whatsoever for the action or inaction of any Depositories or of any Foreign Depositories, except in each case to the extent such action or inaction is a direct result of the Custodian's failure to fulfill its duties hereunder. With respect to any Losses incurred by the Fund as a result of the acts or any failures to act by any Subcustodian (other than a BNY Affiliate), Custodian shall take appropriate action to recover such Losses from such Subcustodian; and Custodian's sole responsibility and liability to the Fund shall be limited to amounts so received from such Subcustodian (exclusive of costs and expenses incurred by Custodian). In no event shall Custodian be liable to the Fund or any third party for special, indirect or consequential damages, or lost profits or loss of business, arising in connection with this Agreement, nor shall Custodian or any Subcustodian be liable: (i) for acting in accordance with any Certificate or Oral Instructions actually received by Custodian and reasonably believed by Custodian to be given by an Authorized Person; (ii) for acting in accordance with Instructions without reviewing the same; (iii) for conclusively presuming that all Instructions are given only by person(s) duly authorized; (iv) for conclusively presuming that all disbursements of cash directed by the Fund, whether by a Certificate, an Oral Instruction, or an Instruction, are in accordance with Section 2(i) of Article II hereof; (v) for holding property in any particular country, including, but not limited to, Losses resulting from nationalization, expropriation or other governmental actions; regulation of the banking or securities industry; exchange or currency controls or restrictions, devaluations or fluctuations; availability of cash or Securities or market conditions which prevent the transfer of property or execution of Securities transactions or affect the value of property; (vi) for any Losses due to forces beyond the control of Custodian, including without limitation strikes, work stoppages, acts of war or terrorism, insurrection, revolution, nuclear or natural catastrophes or acts of God, or interruptions, loss or malfunctions of utilities, communications or computer (software and hardware) services; (vii) for the insolvency of any Subcustodian (other than a BNY Affiliate), any Depository, or, except to the extent such action or inaction is a direct result of the Custodian's failure to fulfill its duties hereunder, any Foreign Depository; or (viii) for the contents of or deficiency in any Loan Document File, or (ix) for any Losses arising from the applicability of any law or regulation now or hereafter in effect, or from the occurrence of any event, including, without limitation, implementation or adoption of any rules or procedures of a Foreign Depository, which may affect, limit, prevent or impose costs or burdens on, the transferability, convertibility, or availability of any currency or Composite Currency Unit in any country or on the transfer of any Securities, and in no event shall Custodian be obligated to substitute another currency for a currency (including a currency that is a component of a Composite Currency Unit) whose transferability, convertibility or availability has been affected, limited, or prevented by such law, regulation or event, and to the extent that any such law, regulation or event imposes a cost or charge upon Custodian in relation to the transferability, convertibility, or availability of any cash currency or Composite Currency Unit, such cost or charge shall be for the account of the Fund, and Custodian may treat any account denominated in an affected currency as a group of separate accounts denominated in the relevant component currencies.

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(b) Custodian may enter into subcontracts, agreements and understandings with any BNY Affiliate, whenever and on such terms and conditions as it deems necessary or appropriate to perform its services hereunder. No such subcontract, agreement or understanding shall discharge Custodian from its obligations hereunder.

(c) The Fund agrees to indemnify Custodian and hold Custodian harmless from and against any and all Losses sustained or incurred by or asserted against Custodian by reason of or as a result of any action or inaction, or arising out of Custodian's performance hereunder, including reasonable fees and expenses of counsel incurred by Custodian in a successful defense of claims by the Fund, and any claims by a purchaser or transferee of any Loan Document File; provided however, that the Fund shall not indemnify Custodian for those Losses arising out of Custodian's own negligence or willful misconduct. This indemnity shall be a continuing obligation of the Fund, its successors and assigns, notwithstanding the termination of this Agreement.

2. Without limiting the generality of the foregoing, Custodian shall be under no obligation to inquire into, and shall not be liable for:

(a) Any Losses incurred by the Fund or any other person as a result of the receipt or acceptance of fraudulent, forged or invalid Securities, or Securities which are otherwise not freely transferable or deliverable without encumbrance in any relevant market;

(b) The validity of the issue of any Securities purchased, sold, or written by or for the Fund, the legality of the purchase, sale or writing thereof, or the propriety of the amount paid or received therefor;

(c) The legality of the sale or redemption of any Shares, or the propriety of the amount to be received or paid therefor;

(d) The legality of the declaration or payment of any dividend or distribution by the Fund;

(e) The legality of any borrowing by the Fund;

(f) The legality of any loan of portfolio Securities, nor shall Custodian be under any duty or obligation to see to it that any cash or collateral delivered to it by a broker, dealer or financial institution or held by it at any time as a result of such loan of portfolio Securities is adequate security for the Fund against any loss it might sustain as a result of such loan, which duty or obligation shall be the sole responsibility of the Fund. In addition, Custodian shall be under no duty or obligation to see that any broker, dealer or financial institution to which portfolio Securities of the Fund are lent makes payment to it of any dividends or interest which are payable to or for the account of the Fund during the period of such loan or at the termination of such loan;

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(g) The sufficiency or value of any amounts of money and/or Securities held in any Special Account in connection with transactions by the Fund; whether any broker, dealer, futures commission merchant or clearing member makes payment to the Fund of any variation margin payment or similar payment which the Fund may be entitled to receive from such broker, dealer, futures commission merchant or clearing member, or whether any payment received by Custodian from any broker, dealer, futures commission merchant or clearing member is the amount the Fund is entitled to receive, or to notify the Fund of Custodian's receipt or non-receipt of any such payment; or

(h) Whether any Securities at any time delivered to, or held by it or by any Subcustodian, for the account of the Fund and specifically allocated to a Series are such as properly may be held by the Fund or such Series under the provisions of its then current prospectus and statement of additional information, or to ascertain whether any transactions by the Fund, whether or not involving Custodian, are such transactions as may properly be engaged in by the Fund.

3. Custodian may, with respect to questions of law specifically regarding an Account, obtain the advice of counsel, which has been reasonably selected by Custodian, and shall be fully protected with respect to anything done or omitted by it in good faith in conformity with such advice.

4. Custodian shall be under no obligation to take action to collect any amount payable on Securities in default, or if payment is refused after due demand and presentment.

5. Custodian shall have no duty or responsibility to inquire into, make recommendations, supervise, or determine the suitability of any transactions affecting any Account.

6. The Fund shall pay to Custodian the fees and charges as may be specifically agreed upon from time to time and such other fees and charges at Custodian's standard rates for such services as may be applicable. The Fund shall reimburse Custodian for all costs, actually incurred, associated with the conversion of the Fund's Securities hereunder and the transfer of Securities and records kept in connection with this Agreement. The Fund shall also reimburse Custodian for actual out-of-pocket expenses which are a normal incident of the services provided hereunder.

7. Custodian has the right to debit any cash account for any amount payable by the Fund in connection with any and all obligations of the Fund to Custodian. In addition to the rights of Custodian under applicable law and other agreements, at any time when the Fund shall not have honored any of its obligations to Custodian, Custodian shall have the right, provided that Custodian shall endeavor to seek the Fund's direction as to its preferred source of funds from which to meet its obligations to the Custodian, to retain or set-off, against such obligations of the Fund, any Securities or cash Custodian or a BNY Affiliate may directly or indirectly hold for the account of the Fund, and any obligations (whether matured or unmatured) that Custodian or a BNY Affiliate may have to the Fund in any currency or Composite Currency Unit. Any such asset of, or obligation to, the Fund may be transferred to Custodian and any BNY Affiliate in order to effect the above rights.

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8. The Fund agrees to forward to Custodian a Certificate or Instructions confirming Oral Instructions by the close of business of the same day that such Oral Instructions are given to Custodian. The Fund agrees that the fact that such confirming Certificate or Instructions are not received or that a contrary Certificate or contrary Instructions are received by Custodian shall in no way affect the validity or enforceability of transactions authorized by such Oral Instructions and effected by Custodian. If the Fund elects to transmit Instructions through an on-line communications system offered by Custodian, the Fund's use thereof shall be subject to the Terms and Conditions attached as Appendix I hereto. If Custodian receives Instructions which appear on their face to have been transmitted by an Authorized Person via (i) computer facsimile, email, the Internet or other insecure electronic method, or (ii) secure electronic transmission containing applicable authorization codes, passwords and/or authentication keys, the Fund understands and agrees that Custodian cannot determine the identity of the actual sender of such Instructions and that Custodian shall conclusively presume that such Written Instructions have been sent by an Authorized Person, and the Fund shall be responsible for ensuring that only Authorized Persons transmit such Instructions to Custodian. If the Fund elects (with Custodian's prior consent) to transmit Instructions through an on-line communications service owned or operated by a third party, the Fund agrees that Custodian shall not be responsible or liable for the reliability or availability of any such service.

9. The books and records pertaining to the Fund which are in possession of Custodian shall be the property of the Fund. Such books and records shall be prepared and maintained as required by the 40 Act and the rules thereunder. The Fund, or its authorized representatives (including its independent public accountant), shall have access to such books and records during Custodian's normal business hours for purposes of inspection and, where appropriate, audit. Upon the reasonable request of the Fund, copies of any such books and records shall be provided by Custodian to the Fund or its authorized representative. Upon the reasonable request of the Fund, Custodian shall provide in hard copy or on computer disc any records included in any such delivery which are maintained by Custodian on a computer disc, or are similarly maintained.

10. It is understood that Custodian is authorized to supply any information regarding the Accounts which is required by any law, regulation or rule now or hereafter in effect. The Custodian shall provide the Fund with any report obtained by the Custodian on the system of internal accounting control of a Depository, and with such reports on its own system of internal accounting control as the Fund may reasonably request from time to time.

11. Custodian shall have no duties or responsibilities whatsoever except such duties and responsibilities as are specifically set forth in this Agreement, and no covenant or obligation shall be implied against Custodian in connection with this Agreement.

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**ARTICLE X  
TERMINATION**

1. Either of the parties hereto may terminate this Agreement by giving to the other party a notice in writing specifying the date of such termination, which shall be not less than ninety (90) days after the date of giving of such notice. In the event such notice is given by the Fund, it shall be accompanied by a copy of a resolution of the board of the Fund, certified by the Secretary or any Assistant Secretary, electing to terminate this Agreement and designating a successor custodian or custodians, each of which shall be a bank or trust company having not less than \$2,000,000 aggregate capital, surplus and undivided profits. In the event such notice is given by Custodian, the Fund shall, on or before the termination date, deliver to Custodian a copy of a resolution of the board of the Fund, certified by the Secretary or any Assistant Secretary, designating a successor custodian or custodians. In the absence of such designation by the Fund, Custodian may designate a successor custodian, which shall be a bank or trust company having not less than \$2,000,000 aggregate capital, surplus and undivided profits. Upon the date set forth in such notice this Agreement shall terminate, and Custodian shall upon receipt of a notice of acceptance by the successor custodian on that date deliver directly to the successor custodian all Securities, Loan Document Files and money then owned by the Fund and held by it as Custodian, after deducting all fees, expenses and other amounts for the payment or reimbursement of which it shall then be entitled.

2. If a successor custodian is not designated by the Fund or Custodian in accordance with the preceding Section, the Fund shall upon the date specified in the notice of termination of this Agreement and upon the delivery by Custodian of all Securities and Loan Document Files (other than Securities which cannot be delivered to the Fund) and money then owned by the Fund be deemed to be its own custodian and Custodian shall thereby be relieved of all duties and responsibilities pursuant to this Agreement, other than the duty with respect to Securities which cannot be delivered to the Fund to hold such Securities hereunder in accordance with this Agreement.

**ARTICLE XI  
MISCELLANEOUS**

1. The Fund agrees to furnish to Custodian a new Certificate of Authorized Persons in the event of any change in the then present Authorized Persons. Until such new Certificate is received, Custodian shall be fully protected in acting upon Certificates or Oral Instructions of such present Authorized Persons.

2. Any notice or other instrument in writing, authorized or required by this Agreement to be given to Custodian, shall be sufficiently given if addressed to Custodian and received by it at its offices at One Wall Street, New York, New York 10286, or at such other place as Custodian may from time to time designate in writing.

3. Any notice or other instrument in writing, authorized or required by this Agreement to be given to the Fund shall be sufficiently given if addressed to the Fund and received by it at its offices at 111 West 57<sup>th</sup> Street, Suite 1100, New York, NY 10019, or at such other place as the Fund may from time to time designate in writing.

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4. Each and every right granted to either party hereunder or under any other document delivered hereunder or in connection herewith, or allowed it by law or equity, shall be cumulative and may be exercised from time to time. No failure on the part of either party to exercise, and no delay in exercising, any right will operate as a waiver thereof, nor will any single or partial exercise by either party of any right preclude any other or future exercise thereof or the exercise of any other right.

5. In case any provision in or obligation under this Agreement shall be invalid, illegal or unenforceable in any exclusive jurisdiction, the validity, legality and enforceability of the remaining provisions shall not in any way be affected thereby. This Agreement may not be amended or modified in any manner except by a written agreement executed by both parties, except that any amendment to the Schedule I hereto need be signed only by the Fund and any amendment to Appendix I hereto need be signed only by Custodian. This Agreement shall extend to and shall be binding upon the parties hereto, and their respective successors and assigns; provided, however, that this Agreement shall not be assignable by either party without the written consent of the other.

6. This Agreement shall be construed in accordance with the substantive laws of the State of New York, without regard to conflicts of laws principles thereof. The Fund and Custodian hereby consent to the jurisdiction of a state or federal court situated in New York City, New York in connection with any dispute arising hereunder. The Fund hereby irrevocably waives, to the fullest extent permitted by applicable law, any objection which it may now or hereafter have to the laying of venue of any such proceeding brought in such a court and any claim that such proceeding brought in such a court has been brought in an inconvenient forum. The Fund and Custodian each hereby irrevocably waives any and all rights to trial by jury in any legal proceeding arising out of or relating to this Agreement.

7. The Fund hereby acknowledges that Custodian is subject to federal laws, including the Customer Identification Program (CIP) requirements under the USA PATRIOT Act and its implementing regulations, pursuant to which Custodian must obtain, verify and record information that allows Custodian to identify the Fund. Accordingly, prior to opening an Account hereunder Custodian will ask the Fund to provide certain information including, but not limited to, the Fund's name, physical address, tax identification number and other information that will help Custodian to identify and verify the Fund's identity such as organizational documents, certificate of good standing, license to do business, or other pertinent identifying information. The Fund agrees that Custodian cannot open an Account hereunder unless and until Custodian verifies the Fund's identity in accordance with its CIP.

8. This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original, but such counterparts shall, together, constitute only one instrument.

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**IN WITNESS WHEREOF**, the Fund and Custodian have caused this Agreement to be executed by their respective officers, thereunto duly authorized, as of the day and year first above written.

**HARRIS & HARRIS GROUP, INC.**

By: \_\_\_\_\_  
Title:

**THE BANK OF NEW YORK MELLON**

By: \_\_\_\_\_  
Title:

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**EXHIBIT A**

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**SCHEDULE I**  
**CERTIFICATE OF AUTHORIZED PERSONS**  
**(The Fund - Oral and Written Instructions)**

The undersigned hereby certifies that he/she is the duly elected and acting \_\_\_\_\_ of \* (the "Fund"), and further certifies that the following officers or employees of the Fund have been duly authorized in conformity with the Fund's Declaration of Trust and By-Laws to deliver Certificates and Oral Instructions to The Bank of New York Mellon ("Custodian") pursuant to the Custody Agreement between the Fund and Custodian dated \_\_\_\_\_, and that the signatures appearing opposite their names are true and correct:

Name	Title	Signature
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Name	Title	Signature
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Name	Title	Signature
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Name	Title	Signature
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Name	Title	Signature
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Name	Title	Signature
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Name	Title	Signature
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This certificate supersedes any certificate of Authorized Persons you may currently have on file.

[seal] By: \_\_\_\_\_  
Title: \_\_\_\_\_

Date:

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**SCHEDULE II**

SERIES

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## APPENDIX I

### ELECTRONIC SERVICES TERMS AND CONDITIONS

1 . License; Use. (a) This Appendix I shall govern the Fund's use of electronic communications, information delivery, portfolio management and banking services, that The Bank of New York Mellon and its affiliates ("Custodian") may provide to the Fund, such as The Bank of New York Inform <sup>TM</sup> and The Bank of New York CASH-Register Plus <sup>®</sup>, and any computer software, proprietary data and documentation provided by Custodian to the Fund in connection therewith (collectively, the "**Electronic Services**"). In the event of any conflict between the terms of this Appendix I and the main body of this Agreement with respect to the Fund's use of the Electronic Services, the terms of this Appendix I shall control.

(b) Custodian grants to the Fund a personal, nontransferable and nonexclusive license to use the Electronic Services to which the Fund subscribes solely for the purpose of transmitting instructions and information ("Written Instructions"), obtaining reports, analyses and statements and other information and data, making inquiries and otherwise communicating with Custodian in connection with the Fund's relationship with Custodian. The Fund shall use the Electronic Services solely for its own internal and proper business purposes and not in the operation of a service bureau. Except as set forth herein, no license or right of any kind is granted to with respect to the Electronic Services. The Fund acknowledges that Custodian and its suppliers retain and have title and exclusive proprietary rights to the Electronic Services, including any trade secrets or other ideas, concepts, know-how, methodologies, and information incorporated therein and the exclusive rights to any copyrights, trade dress, look and feel, trademarks and patents (including registrations and applications for registration of either), and other legal protections available in respect thereof. The Fund further acknowledges that all or a part of the Electronic Services may be copyrighted or trademarked (or a registration or claim made therefor) by Custodian or its suppliers. The Fund shall not take any action with respect to the Electronic Services inconsistent with the foregoing acknowledgments, nor shall the Fund attempt to decompile, reverse engineer or modify the Electronic Services. The Fund may not copy, distribute, sell, lease or provide, directly or indirectly, the Electronic Services or any portion thereof to any other person or entity without Custodian's prior written consent. The Fund may not remove any statutory copyright notice or other notice included in the Electronic Services. The Fund shall reproduce any such notice on any reproduction of any portion of the Electronic Services and shall add any statutory copyright notice or other notice upon Custodian's request.

(c) Portions of the Electronic Services may contain, deliver or rely on data supplied by third parties ("Third Party Data"), such as pricing data and indicative data, and services supplied by third parties ("Third Party Services") such as analytic and accounting services. Third Party Data and Third Party Services supplied hereunder are obtained from sources that Custodian believes to be reliable but are provided without any independent investigation by Custodian. Custodian and its suppliers do not represent or warrant that the Third Party Data or Third Party Services are correct, complete or current. Third Party Data and Third Party Services are proprietary to their suppliers, are provided solely for the Fund's internal use, and may not be reused, disseminated or redistributed in any form. The Fund shall not use any Third Party Data in any manner that would act as a substitute for obtaining a license for the data directly from the supplier. Third Party Data and Third Party Services should not be used in making any investment decision. CUSTODIAN AND ITS SUPPLIERS ARE NOT RESPONSIBLE FOR ANY RESULTS OBTAINED FROM THE USE OF OR RELIANCE UPON THIRD PARTY DATA OR THIRD PARTY SERVICES. Custodian's suppliers of Third Party Data and Services are intended third party beneficiaries of this Section 1(c) and Section 5 below.

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(d) The Fund understands and agrees that any links in the Electronic Services to Internet sites may be to sites sponsored and maintained by third parties. Custodian make no guarantees, representations or warranties concerning the information contained in any third party site (including without limitation that such information is correct, current, complete or free of viruses or other contamination), or any products or services sold through third party sites. All such links to third party Internet sites are provided solely as a convenience to the Fund and the Fund accesses and uses such sites at its own risk. A link in the Electronic Services to a third party site does not constitute Custodian's endorsement, authorisation or sponsorship of such site or any products and services available from such site.

2 . Equipment. The Fund shall obtain and maintain at its own cost and expense all equipment and services, including but not limited to communications services, necessary for it to utilize and obtain access to the Electronic Services, and Custodian shall not be responsible for the reliability or availability of any such equipment or services.

3 . Proprietary Information. The Electronic Services, and any proprietary data (including Third Party Data), processes, software, information and documentation made available to the Fund (other than which are or become part of the public domain or are legally required to be made available to the public) (collectively, the "Information"), are the exclusive and confidential property of Custodian or its suppliers. However, for the avoidance of doubt, reports generated by the Fund containing information relating to its account(s) (except for Third Party Data contained therein) are not deemed to be within the meaning of the term "Information." the Fund shall keep the Information confidential by using the same care and discretion that the Fund uses with respect to its own confidential property and trade secrets, but not less than reasonable care. Upon termination of the Agreement or the licenses granted herein for any reason, the Fund shall return to Custodian any and all copies of the Information which are in its possession or under its control (except that the Fund may retain reports containing Third Party Data, provided that such Third Party Data remains subject to the provisions of this Appendix). The provisions of this Section 3 shall not affect the copyright status of any of the Information which may be copyrighted and shall apply to all information whether or not copyrighted.

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4 . Modifications. Custodian reserves the right to modify the Electronic Services from time to time. The Fund agrees not to modify or attempt to modify the Electronic Services without Custodian's prior written consent. The Fund acknowledges that any modifications to the Electronic Services, whether by the Fund or Custodian and whether with or without Custodian's consent, shall become the property of Custodian.

5 . NO REPRESENTATIONS OR WARRANTIES; LIMITATION OF LIABILITY. CUSTODIAN AND ITS MANUFACTURERS AND SUPPLIERS MAKE NO WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE ELECTRONIC SERVICES OR ANY THIRD PARTY DATA OR THIRD PARTY SERVICES, EXPRESS OR IMPLIED, IN FACT OR IN LAW, INCLUDING BUT NOT LIMITED TO WARRANTIES OF MERCHANTABILITY, NON-INFRINGEMENT AND FITNESS FOR A PARTICULAR PURPOSE. THE FUND ACKNOWLEDGES THAT THE ELECTRONIC SERVICES, THIRD PARTY DATA AND THIRD PARTY SERVICES ARE PROVIDED "AS IS." TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, IN NO EVENT SHALL CUSTODIAN OR ANY SUPPLIER BE LIABLE FOR ANY DAMAGES, WHETHER DIRECT, INDIRECT SPECIAL, OR CONSEQUENTIAL, WHICH CUSTOMER MAY INCUR IN CONNECTION WITH THE ELECTRONIC SERVICES, THIRD PARTY DATA OR THIRD PARTY SERVICES, EVEN IF CUSTODIAN OR SUCH SUPPLIER KNEW OF THE POSSIBILITY OF SUCH DAMAGES. IN NO EVENT SHALL CUSTODIAN OR ANY SUPPLIER BE LIABLE FOR ACTS OF GOD, MACHINE OR COMPUTER BREAKDOWN OR MALFUNCTION, INTERRUPTION OR MALFUNCTION OF COMMUNICATION FACILITIES, LABOR DIFFICULTIES OR ANY OTHER SIMILAR OR DISSIMILAR CAUSE BEYOND THEIR REASONABLE CONTROL.

6 . Security; Reliance; Unauthorized Use; Funds Transfers. Custodian will establish security procedures to be followed in connection with the use of the Electronic Services, and the Fund agrees to comply with the security procedures. The Fund understands and agrees that the security procedures are intended to determine whether instructions received by Custodian through the Electronic Services are authorized but are not (unless otherwise specified in writing) intended to detect any errors contained in such instructions. The Fund will cause all persons utilizing the Electronic Services to treat any user and authorization codes, passwords, authentication keys and other security devices with the highest degree of care and confidentiality. Upon termination of the Fund's use of the Electronic Services, the Fund shall return to Custodian any security devices (e.g., token cards) provided by Custodian. Custodian is hereby irrevocably authorized to comply with and rely upon on Written Instructions and other communications, whether or not authorized, received by it through the Electronic Services. The Fund acknowledges that it has sole responsibility for ensuring that only Authorized Persons use the Electronic Services and that to the fullest extent permitted by applicable law Custodian shall not be responsible nor liable for any unauthorized use thereof or for any losses sustained by the Fund arising from or in connection with the use of the Electronic Services or Custodian's reliance upon and compliance with Written Instructions and other communications received through the Electronic Services. With respect to instructions for a transfer of funds issued through the Electronic Services, when instructed to credit or pay a party by both name and a unique numeric or alpha-numeric identifier (e.g. ABA number or account number), the Custodian, its affiliates, and any other bank participating in the funds transfer, may rely solely on the unique identifier, even if it identifies a party different than the party named. Such reliance on a unique identifier shall apply to beneficiaries named in such instructions as well as any financial institution which is designated in such instructions to act as an intermediary in a funds transfer. It is understood and agreed that unless otherwise specifically provided herein, and to the extent permitted by applicable law, the parties hereto shall be bound by the rules of any funds transfer system utilized to effect a funds transfer hereunder.

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7 . Acknowledgments. Custodian shall acknowledge through the Electronic Services its receipt of each Written Instruction communicated through the Electronic Services, and in the absence of such acknowledgment Custodian shall not be liable for any failure to act in accordance with such Written Instruction and the Fund may not claim that such Written Instruction was received by Custodian. Custodian may in its discretion decline to act upon any instructions or communications that are insufficient or incomplete or are not received by Custodian in sufficient time for Custodian to act upon, or in accordance with such instructions or communications.

8 . Viruses. The Fund agrees to use reasonable efforts to prevent the transmission through the Electronic Services of any software or file which contains any viruses, worms, harmful component or corrupted data and agrees not to use any device, software, or routine to interfere or attempt to interfere with the proper working of the Electronic Services.

9 . Encryption. The Fund acknowledges and agrees that encryption may not be available for every communication through the Electronic Services, or for all data. The Fund agrees that Custodian may deactivate any encryption features at any time, without notice or liability to the Fund, for the purpose of maintaining, repairing or troubleshooting its systems.

10 . On-Line Inquiry and Modification of Records. In connection with the Fund's use of the Electronic Services, Custodian may, at the Fund's request, permit the Fund to enter data directly into a Custodian database for the purpose of modifying certain information maintained by Custodian's systems, including, but not limited to, change of address information. To the extent that the Fund is granted such access, the Fund agrees to indemnify and hold Custodian harmless from all loss, liability, cost, damage and expense (including attorney's fees and expenses) to which Custodian may be subjected or which may be incurred in connection with any claim which may arise out of or as a result of changes to Custodian database records initiated by the Fund.

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11. Agents. the Fund may, on advance written notice to the Custodian, permit its agents and contractors (“Agents”) to access and use the Electronic Services on the Fund’s behalf, except that the Custodian reserves the right to prohibit the Fund’s use of any particular Agent for any reason. The Fund shall require its Agent(s) to agree in writing to be bound by the terms of the Agreement, and the Fund shall be liable and responsible for any act or omission of such Agent in the same manner, and to the same extent, as though such act or omission were that of the Fund. Each submission of a Written Instruction or other communication by the Agent through the Electronic Services shall constitute a representation and warranty by the Fund that the Agent continues to be duly authorized by the Fund to so act on its behalf and the Custodian may rely on the representations and warranties made herein in complying with such Written Instruction or communication. Any Written Instruction or other communication through the Electronic Services by an Agent shall be deemed that of the Fund, and the Fund shall be bound thereby whether or not authorized. The Fund may, subject to the terms of this Agreement and upon advance written notice to the Bank, provide a copy of the Electronic Service user manuals to its Agent if the Agent requires such copies to use the Electronic Services on the Fund’s behalf. Upon cessation of any such Agent's services, the Fund shall promptly terminate such Agent’s access to the Electronic Services, retrieve from the Agent any copies of the manuals and destroy them, and retrieve from the Agent any token cards or other security devices provided by Custodian and return them to Custodian.

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FORM OF  
INDEMNIFICATION AGREEMENT

This is an Indemnification Agreement dated as of \_\_\_\_\_ between HARRIS & HARRIS GROUP, INC., a New York corporation (the "Company"), and \_\_\_\_\_ (the "Indemnitee").

1. Recitals. The Indemnitee is an officer of the Company. Article 8 of the Company's Certificate of Incorporation, as currently amended, obligates the Company to indemnify its directors and officers to the fullest extent permitted by the New York Business Corporation Law, as amended (the "NYBCL"), subject to the limitations imposed by the Investment Company Act of 1940 and the Rules and Regulations adopted thereunder. In accordance with the NYBCL and in consideration of the Indemnitee's continuing services to the Company, the Company and the Indemnitee desire to enter into this Agreement.

2. Indemnitee's Services. The Indemnitee shall diligently administer the Company's affairs in the position or positions described in paragraph 1. Subject to any obligation imposed by contract or by operation of law, (a) the Indemnitee may at any time and for any reason resign from such position or positions, and (b) the Company may at any time and for any reason (or no reason) terminate the Indemnitee's employment in such position or positions.

3. Indemnification. The Company shall indemnify the Indemnitee and hold the Indemnitee harmless against any loss or liability related to or arising from the Indemnitee's service as a director, officer, employee, or agent of the Company, or of any subsidiary or affiliate of the Company (a "Subsidiary") or in any capacity whether as a director, officer, employee, agent or in any other capacity, for any other corporation, investee, partnership, joint venture, trust, employee benefit plan or other enterprise on behalf of the Company or its subsidiaries ("Entity"), upon the following terms and conditions:

(a) The Company shall, to the fullest extent permitted by the NYBCL as now in effect--and to such greater or, with respect to acts or omissions occurring thereafter, to such lesser extent as the NYBCL (or of any successor codification of the New York corporation laws) may hereafter from time to time permit -- hold the Indemnitee harmless from and indemnify the Indemnitee against (1) all judgments rendered, fines levied, and other assessments (including amounts paid in settlement of any claims, if approved by the Company), plus (2) all reasonable costs and expenses (including, without limitation, attorneys fees, retainers, court costs, transcript costs, experts' fees, witness fees, travel expenses, duplicating costs, printing and binding costs, telephone charges, postage, and delivery service fees), incurred in connection with the defense of any threatened, pending, or completed action or proceeding, whether civil, criminal, administrative, or investigative (an "Action"), related to or arising from (1) any actual or alleged act or omission of the Indemnitee at any time as a director, officer, employee, or agent of the Company or of any Subsidiary or Entity, or (2) the Indemnitee's past, present, or future status as a director, officer, employee, or agent of the Company or of any Subsidiary or Entity.

(b) Subject to a determination by a majority of the disinterested directors or a committee thereof who are not a party to such Action or by independent legal counsel in a written opinion that the Indemnitee is likely to have satisfied the standard for indemnification under the NYBCL and the Investment Company Act of 1940, upon presentation from time to time of such invoices, statements for services rendered, or other similar documentation as the Company may reasonably request, the Company shall advance to or reimburse the Indemnitee for all reasonable costs and expenses incurred of the types specified in paragraph 3(a) in the defense of any threatened, pending, or completed Action, as and when such costs are incurred.

(c) The Company shall indemnify the Indemnitee under paragraph 3(a) only as authorized in a specific case upon a determination that indemnification of the Indemnitee is proper in the circumstances because the Indemnitee has met the applicable standard of conduct set forth in the NYBCL or in any other applicable provision of New York law. Such determination shall be made, as the Indemnitee chooses, either (1) by a majority vote of a quorum of the Company's disinterested directors who are not parties to such Action, or (2) by independent legal counsel in a written opinion. The Company shall pay the fees and expenses of any independent legal counsel chosen by the Company to make the determination contemplated by this paragraph 3(c).

(d) The indemnification provided by this Agreement shall apply only to (1) actual or alleged acts or omissions that occur during the Indemnitee's service as a director, officer, employee, or agent of the Company or of any Subsidiary or Entity, and (2) actual or threatened Actions in which the Indemnitee is joined or named as a party, but which relate to or arise from alleged acts or omissions that occurred before the Indemnitee's service as a director, officer, employee, or agent of the Company or of any Subsidiary or Entity, or which relate to acts or omissions alleged against any former directors, officers, employees, or agents of the Company or of any Subsidiary or Entity.

(e) Nothing in this Agreement shall be deemed or construed to create any liability of the Company (1) to former directors, officers, employees, or agents or their predecessors other than Indemnitee, or to any other person not a party to this Agreement, or (2) exceeding the liability that the Company may lawfully incur in accordance with applicable New York law.

#### 4. Conduct of Litigation.

(a) If any Action is made, brought, or threatened against the Indemnitee for which the Indemnitee may be indemnified under this Agreement, the Indemnitee shall, to the extent not inconsistent with any private insurance coverage obtained by the Company:

(1) Permit the Company to conduct the Indemnitee's defense of the Action at the Company's expense and with the use of counsel selected by the Company; or

(2) Retain counsel acceptable to the Indemnitee and the Company to defend or counsel the Indemnitee with respect to the Action, and permit the Company to monitor and direct the Indemnitee's defense.

(b) The Company shall at all times have the option to undertake the Indemnitee's defense of any Action for which the Indemnitee may be indemnified under this Agreement. If the Company elects to conduct the Indemnitee's defense, the Indemnitee shall cooperate fully with the Company in the defense of the Action. If the Company elects to conduct the Indemnitee's defense after the Indemnitee proceeds under paragraph 4(a)(2), the Company shall advance or reimburse the Indemnitee for the reasonable costs, including attorneys' fees, incurred by the Indemnitee in enabling the Company to undertake the Indemnitee's defense.

5. Reimbursement of Expenses. As required by the NYBCL, if the Company makes any payment to the Indemnitee under this Agreement, and if it is ultimately determined that the Indemnitee was not entitled to be indemnified by the Company under the NYBCL or the Investment Company Act of 1940, the Indemnitee shall promptly repay the Company for all amounts paid to the Indemnitee under this Agreement which exceed the indemnification to which the Indemnitee is lawfully entitled.

6. Enforcement of Agreement. If the Indemnitee makes a claim for indemnification under this Agreement and the Company refuses to indemnify the Indemnitee, and if the Indemnitee then prevails in an action or proceeding brought to enforce this Agreement, the Company shall pay all reasonable costs and expenses (including attorneys' fees) incurred by the Indemnitee in connection with the action or proceeding in addition to any other indemnification required under this Agreement.

7. Notice of Claims. If the Indemnitee receives a complaint, claim, or other notice of any loss, claim, damage, or liability giving rise to a claim for indemnification under this Agreement, the Indemnitee shall promptly notify the Company of the complaint, claim, or other notice. Any failure to notify the Company, however, shall not relieve the Company from any liability under this Agreement unless the Company (a) is materially prejudiced by the failure (such as, for example, where the failure results in the exclusion or denial of the Company's otherwise available insurance coverage), and (b) had no actual knowledge of the complaint, claim, or other notice. In no event shall the Company be obligated to indemnify the Indemnitee for any settlement of any Action effected without the Company's prior consent.

8. Termination.

(a) This Agreement shall terminate (1) upon termination of the Indemnitee's service as a director, officer, employee, or agent of the Company or of any Subsidiary or Entity, or (2) upon the Company's written notice to the Indemnitee that, in the reasonable opinion of the Company, the Indemnitee has not complied with paragraph 4 of this Agreement. The Company shall not issue any such notice merely because it disagrees with a business judgment or judgments of the Indemnitee.

(b) The termination of this Agreement shall not:

(1) Terminate the Company's liability to the Indemnitee for (A) Actions against the Indemnitee related to or arising from acts or omissions occurring or alleged to have occurred before termination of this Agreement, or (B) Actions that name or join the Indemnitee as a party, but relate to or arise from acts or omissions alleged to have occurred before the Indemnitee's service as a director, officer, employee, or agent, or acts or omissions alleged against former directors, officers, employees, or agents.

(2) Render the terms and conditions of this Agreement inapplicable to any Actions subject to paragraph 8(b) (1).

9 . Subrogation. If the Company makes any payment to the Indemnitee under this Agreement, the Company shall be subrogated to the extent of such payment to all of the Indemnitee's rights of recovery and the Indemnitee shall execute any documents and take any actions necessary to secure such rights (including execution of any documents necessary to enable the Company to bring suit to enforce such rights).

10. Insurance Reimbursements. The Company shall not be required to make any payment of amounts otherwise indemnifiable under this Agreement if and to the extent that the Indemnitee has otherwise actually received such payment under any insurance policy, contract, agreement, or otherwise.

11 . Notices. Any notice or other communication required or permitted under this Agreement shall be deemed given when hand-delivered or sent by registered United States mail, postage prepaid and return-receipt requested, to the intended recipient at the address set forth below or at such other address as the recipient shall hereafter furnish the sender in writing:

If to the Indemnitee:

If to the Company: Harris & Harris Group, Inc.  
111 West 57<sup>th</sup> Street  
New York, New York 10019  
Attn: The Chairman of the Board

12 . Governing Law. The laws of New York and to the extent inconsistent therewith, the Investment Company Act of 1940, shall govern the validity, interpretation, and construction of this Agreement. Nothing in this Agreement shall require any unlawful action or inaction by any party.

13. Modification. No modification of this Agreement shall be binding unless executed in writing by the Indemnitee and the Company.

14. Headings. All "paragraph" references in this Agreement refer to numbered paragraphs of this Agreement. Paragraph headings are not part of this Agreement, but are solely for convenience of reference and shall not affect the meaning or interpretation of this Agreement or any provision in it.

15. Sole Benefit. Nothing expressed or referred to in this Agreement is intended or shall be construed to give any person other than the Company, its successors and assigns, and the Indemnitee and the Indemnitee's personal representatives, heirs, or devisees, any legal or equitable right, remedy, or claim under or with respect to this Agreement or any provisions contained herein. The assumption of obligations and statements of responsibilities and all conditions and provisions of this Agreement are for the sole benefit of the Company, its successors and assigns, and the Indemnitee and the Indemnitee's personal representatives, heirs, or devisees.

16. Effect of Prior Agreements. This Agreement contains the entire understanding between the Company and the Indemnitee with respect to the subject matter hereof and supersedes any prior indemnification agreement between the Company or any predecessor of the Company and the Indemnitee.

IN WITNESS WHEREOF, the Indemnitee and the Company have executed several originals of this Agreement as of \_\_\_\_\_ but actually on the dates set forth below.

THE "INDEMNITEE"

HARRIS & HARRIS GROUP, INC.

\_\_\_\_\_

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

Date: \_\_\_\_\_

**AMENDMENT NO. 1  
TO  
DEFERRED COMPENSATION AGREEMENT**

AMENDMENT made as of March 20, 2003, to Deferred Compensation Agreement made as of February 2, 2000 (the "Agreement"), by and between Harris & Harris Group, Inc., a corporation organized under the laws of the State of New York (the "Company"), and Charles E. Harris (the "Executive").

WHEREAS Charles E. Harris has offered for the benefit of the Company in connection with its establishment of the Harris & Harris Group, Inc. Executive Mandatory Retirement Benefit Plan (the "Plan") to waive certain benefit rights;

NOW, THEREFORE, the parties hereto agree as follows:

1. Section 7 of the Agreement is hereby amended to read in its entirety as follows:

**"Section 7. Effect on Other Benefits.**

"Any deferred compensation payable under this Agreement shall not be deemed salary or other compensation to the Executive for the purpose of computing benefits to which he may be entitled under any pension plan or other arrangement of the Company for the benefit of its employees, except under the Harris & Harris Group, Inc. Executive Mandatory Retirement Benefit Plan."

IN WITNESS WHEREOF, the Company has caused this Amendment No. 1 to the Agreement to be executed by its duly authorized officer and the Executive has executed this Amendment No. 1 to the Agreement as of the date first above written.

HARRIS & HARRIS GROUP, INC.

By /s/ Mel P. Melsheimer

Mel P. Melsheimer, President

By /s/ Charles E. Harris

Charles E. Harris

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**HARRIS & HARRIS GROUP, INC.**  
**2006 EQUITY INCENTIVE PLAN**  
**FORM OF**  
**NON-QUALIFIED STOCK OPTION AGREEMENT**

THIS NON-QUALIFIED STOCK OPTION AGREEMENT (the "Agreement"), dated as of \_\_\_\_\_, 20\_\_ , is made between Harris & Harris Group, Inc., a corporation organized under the laws of the State of New York (the "Company"), and \_\_\_\_\_ (the "Optionee").

WHEREAS, the Company has adopted the Harris & Harris Group, Inc., 2006 Equity Incentive Plan (the "Plan"), pursuant to which options may be granted to purchase Stock;

WHEREAS, the Company desires to grant to the Optionee a non-qualified stock option (or "NQSO") to purchase the number of shares of Stock provided for herein;

NOW, THEREFORE, in consideration of the recitals and the mutual agreements herein contained, the parties hereto agree as follows:

**Section 1. Grant of Option**

(a) *Grant of Option.* The Company hereby grants to the Optionee an Option to purchase \_\_\_\_\_ shares of Stock on the terms and conditions set forth in this Agreement and as otherwise provided in the Plan. The Option is *not* intended to be treated, and shall not be construed, as an ISO.

(b) *Incorporation of Plan.* The provisions of the Plan are hereby incorporated herein by reference. Except as otherwise expressly set forth herein, this Agreement shall be construed in accordance with the provisions of the Plan and any capitalized terms not otherwise defined in this Agreement shall have the definitions set forth in the Plan. The Board shall have final authority to interpret and construe the Plan and this Agreement and to make any and all determinations under them, and its decision shall be binding and conclusive upon the Optionee and his/her legal representative in respect of any questions arising under the Plan or this Agreement. To the extent that the Committee has been given the authority to administer and interpret the Plan, the Committee shall also have all of the authority otherwise granted to the Board under this Agreement.

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Section 2. **Terms and Conditions of Option**

(a) *Exercise Price.* The price at which the Optionee shall be entitled to purchase shares of Stock upon the exercise of all or any portion of the Option shall be \$\_\_\_\_\_ per share.

(b) *Expiration Date.* The Option shall expire at the close of business on the \_\_\_\_\_ anniversary of the date of this Agreement.

(c) *Exercisability of Option.* Subject to the other terms of this Agreement regarding the exercisability of the Option, the Option shall vest and become exercisable in accordance with the schedule set forth below for the cumulative percentages of Stock subject to the Option set forth below; provided, however, that the Option shall become fully vested and exercisable (1) when the market price of the shares of Stock reaches \$\_\_\_\_\_ per share at the close of business on three consecutive trading days on the Nasdaq Global Market, or (2) when the Board of Directors accepts an offer for the sale of substantially all of the Company's assets; and provided, further, that the Optionee is employed by the Company as of each such date:

<u>Date</u>	<u>Percentage of Shares</u>
_____	_____
_____	_____
_____	_____
_____	_____

The Board may, but shall not be required to, provide at any time for the acceleration of the schedule set forth above.

(d) *Method of Exercise.* The Option may be exercised only by written notice in such form as the Company may adopt from time to time, delivered in person or by mail in accordance with Section 3(a) and accompanied by payment therefor or pursuant to such other procedure as the Company may adopt from time to time. The purchase price of the shares of Stock shall be paid to the Company (i) in cash or its equivalent, (ii) to the extent permitted by law, by a "broker cashless exercise" procedure approved by the Board, or (iii) by a combination of the foregoing methods. If requested by the Board, the Optionee shall deliver this Agreement evidencing the Option to the Chief Compliance Officer of the Company who shall endorse thereon a notation of such exercise and return such Agreement to the Optionee. A minimum of 100 shares of Stock must be purchased upon the exercise of the Option unless a lesser number of shares of Stock so purchased constitutes the total number of shares of Stock then purchasable under the Option.

(e) *Exercise Following Termination of Employment.* Subject to Section 2(g), in the event that the Optionee ceases to be employed by the Company, that portion of the Option that is not then exercisable shall immediately terminate and that portion of the Option that is exercisable at the time of the Optionee's termination of employment with the Company shall terminate as follows:

(i) If the Optionee's termination of employment is due to his/her death or disability, as determined by the Board, the Option (to the extent exercisable at the time of the Optionee's termination) shall be exercisable for a period of six months following such termination of employment, and shall thereafter terminate;

(ii) If the Optionee's termination of employment is by the Company or an Affiliate for Cause (as defined below), the Option shall terminate on the date of the Optionee's termination;

(iii) If the Optionee voluntarily terminates his/her employment (other than by retirement), the Option (to the extent exercisable at the time of the Optionee's termination) shall be exercisable for a period of 90 days following such termination of employment, and shall thereafter terminate; and

(iv) If the Optionee (1) voluntarily terminates his/her employment, (2) is an "Entitled Retiree" within the meaning of the Company's retiree medical plan as in effect from time to time and (3) executes a post-termination non-solicitation agreement in a form reasonably acceptable to the Company, the Option (to the extent exercisable at the time of the Optionee's termination) shall remain exercisable until the expiration of its term set forth in Section 2(b); and

(v) If the Optionee's termination of employment is for any other reason, the Option (to the extent exercisable at the time of the Optionee's termination) shall be exercisable for a period of 90 days following such termination of employment, and shall thereafter terminate.

For purposes of this Agreement, "Cause" shall have the meaning ascribed to such term in the Optionee's individual employment, severance or consulting agreement with the Company or, in the absence of any such agreement, "Cause" means (i) that the Optionee has materially failed to perform the duties and responsibilities of his or her position with the Company for reasons other than disability or has been insubordinate; (ii) that the Optionee has violated any securities law or regulation, been convicted of a felony or a crime involving moral turpitude (regardless of whether involving the Company) or has not complied to a significant degree with any material policy of the Company; or (iii) that the Optionee has committed any act of fraud, embezzlement, or similar conduct against the Company or any of its shareholders constituting dishonesty, intentional breach of fiduciary obligation, or intentional and material wrongdoing or gross misfeasance or that results in a material economic detriment to the assets, business or prospects of the Company.

Notwithstanding the foregoing, no provision in this Section 2(e) shall extend the exercise period of an Option beyond its original term set forth in Section 2(b).

(f) *Nontransferability.* The Option shall not be transferable by the Optionee other than by will or the laws of descent and distribution.

(g) *Rights as a Stockholder.* The Optionee shall not be deemed for any purpose to be the owner of any shares of Stock subject to the Option unless, until and to the extent that (i) the Option shall have been exercised pursuant to its terms, (ii) the Company shall have issued and delivered to the Optionee the shares of Stock for which the Option shall have been exercised, and (iii) the Optionee's name shall have been entered as a stockholder of record with respect to such shares of Stock on the books of the Company.

(i) *Income Taxes.* The Company may, in its discretion, require that the Optionee pay to the Company at or after (as determined by the Board) the time of exercise of any portion of the Option any such additional amount as the Company deems necessary to satisfy its liability to withhold federal, state or local income tax or any other taxes incurred by reason of the exercise or the transfer of shares of Stock thereupon.

### Section 3. **Miscellaneous**

(a) *Notices.* Unless otherwise determined by the Board, any and all notices, designations, consents, offers, acceptances and any other communications provided for herein shall be given in writing and shall be delivered either personally or by registered or certified mail, postage prepaid, which shall be addressed, in the case of the Company to the General Counsel of the Company at the principal office of the Company and, in the case of the Optionee, to Optionee's address appearing on the books of the Company or to Optionee's residence or to such other address as may be designated in writing by the Optionee.

(b) *No Right to Continued Employment.* Nothing in the Plan or in this Agreement shall confer upon the Optionee any right to continue in the employ of the Company or shall interfere with or restrict in any way the right of the Company, which is hereby expressly reserved, to remove, terminate or discharge the Optionee at any time for any reason whatsoever, with or without Cause. For purposes of this Agreement, the terms "employ" and "employment" shall be interpreted as applicable to the Optionee's service with the Company if the Optionee is a non-employee director of the Company, or an advisor or consultant to the Company.

(c) *Bound by Plan.* By signing this Agreement, the Optionee acknowledges that he/she has received a copy of the Plan and has had an opportunity to review the Plan and agrees to be bound by all the terms and provisions of the Plan.

(d) *Company Policies.* By signing this Agreement, the Optionee acknowledges that he/she is subject to the Company's (i) Code of Ethics Pursuant to Rule 17-J-1 and (ii) Stock Ownership Guidelines and that non-compliance with either such policy may constitute Cause for the termination of the Optionee's employment with the Company.

(e) *Successors.* The terms of this Agreement shall be binding upon and inure to the benefit of the Company, its successors and assigns, and of the Optionee and the beneficiaries, executors, administrators, heirs and successors of the Optionee.

(f) *Validity/Invalidity.* The invalidity or unenforceability of any particular provision hereof shall not affect the other provisions hereof, and this Agreement shall be construed in all respects as if such invalid or unenforceable provision had been omitted.

(g) *Modifications.* No change, modification or waiver of any provision of this Agreement shall be valid unless the same be in writing and signed by the parties hereto.

(h) *Entire Agreement.* This Agreement and the Plan contain the entire agreement and understanding of the parties hereto with respect to the subject matter contained herein and therein and supersede all prior communications, representations and negotiations in respect thereto.

(i) *Governing Law.* This Agreement and the rights of the Optionee hereunder shall be construed and determined in accordance with the laws of the State of New York.

(j) *Headings.* The headings of the Sections hereof are provided for convenience only and are not to serve as a basis for interpretation or construction, and shall not constitute a part, of this Agreement.

(k) *Counterparts.* This Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

20\_\_ IN WITNESS WHEREOF, this Agreement has been executed and delivered by the parties hereto on the \_\_\_\_ day of \_\_\_\_\_,

HARRIS & HARRIS GROUP, INC.

By: \_\_\_\_\_  
Its \_\_\_\_\_

[OPTIONEE]

Signature: \_\_\_\_\_

Printed Name: \_\_\_\_\_

Address: \_\_\_\_\_

\_\_\_\_\_

**Certification of Chief Executive Officer  
Pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a)**

I, Douglas W. Jamison, certify that:

1. I have reviewed this Annual Report on Form 10-K of Harris & Harris Group, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Douglas W. Jamison

\_\_\_\_\_  
Name: Douglas W. Jamison

Title: Chief Executive Officer

Date: March 13, 2009

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**Certification of Chief Financial Officer  
Pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a)**

I, Daniel B. Wolfe, certify that:

1. I have reviewed this Annual Report on Form 10-K of Harris & Harris Group, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Daniel B. Wolfe

\_\_\_\_\_  
Name: Daniel B. Wolfe

Title: Chief Financial Officer

Date: March 13, 2009

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**Certification of CEO and CFO Pursuant to  
18 U.S.C. Section 1350,  
as Adopted Pursuant to  
Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Annual Report on Form 10-K of Harris & Harris Group, Inc. (the "Company") for the year ended December 31, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Douglas W. Jamison, as Chief Executive Officer of the Company, and Daniel B. Wolfe, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Douglas W. Jamison

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Name: Douglas W. Jamison

Title: Chief Executive Officer

Date: March 13, 2009

/s/ Daniel B. Wolfe

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Name: Daniel B. Wolfe

Title: Chief Financial Officer

Date: March 13, 2009

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