

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2008

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

For the transition period from _____ to _____

Commission file number: 0-11576

HARRIS & HARRIS GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

New York

13-3119827

(State or Other Jurisdiction of
Incorporation or Organization)

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

111 West 57th Street, New York, New York

10019

(Address of Principal Executive Offices)

(Zip Code)

(212) 582-0900

(Registrant's Telephone Number, Including Area Code)

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 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 Exchange Act).

Yes ☐

No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class

Outstanding at November 7, 2008

Common Stock, \$0.01 par value per share

25,859,573 shares

Harris & Harris Group, Inc.
Form 10-Q, September 30, 2008

Page Number

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements	1
Consolidated Statements of Assets and Liabilities	2
Consolidated Statements of Operations	3
Consolidated Statements of Cash Flows	4
Consolidated Statements of Changes in Net Assets	5
Consolidated Schedule of Investments	6
Notes to Consolidated Financial Statements	21
Financial Highlights	32
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	33
Background and Overview	33
Results of Operations	37
Financial Condition	42
Liquidity	44
Capital Resources	45
Critical Accounting Policies	45
Recent Developments - Other	48
Recent Developments - Portfolio Companies	48
Forward-Looking Statements	48
Item 3. Quantitative and Qualitative Disclosures About Market Risk	49
Item 4. Controls and Procedures	51

PART II. OTHER INFORMATION

Item 1A. Risk Factors	52
Item 6. Exhibits	54
Signatures	55
Exhibit Index	56

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

The information furnished in the accompanying consolidated financial statements reflects all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the interim period presented.

Harris & Harris Group, Inc.[®] (the "Company," "us," "our" and "we"), is an internally managed venture capital company that has elected to operate as a business development company under the Investment Company Act of 1940 (the "1940 Act"). Certain information and disclosures normally included in the consolidated financial statements in accordance with Generally Accepted Accounting Principles have been condensed or omitted as permitted by Regulation S-X and Regulation S-K. The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2007, contained in our Annual Report on Form 10-K for the year ended December 31, 2007.

On September 25, 1997, our Board of Directors approved a proposal to seek qualification as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code (the "Code"). At that time, we were taxable under Subchapter C of the Code (a "C Corporation"). We filed for the 1999 tax year to elect treatment as a RIC. 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, gains from the sale of securities and similar sources; (2) quarterly, meet certain investment diversification requirements; and (3) annually, distribute at least 90 percent of our investment company taxable income as a dividend. 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 taxable net capital gains from investments, but any net capital gains not distributed could be subject to corporate level tax. Further, we could be subject to a four percent excise tax to the extent we fail to distribute at least 98 percent of our annual investment company taxable income and would be subject to income tax to the extent we fail to distribute 100 percent of our investment company taxable income.

Because of the specialized nature of our investment portfolio, we generally can satisfy the diversification requirements under Subchapter M of the Code if we receive a certification from the Securities and Exchange Commission ("SEC") that we are "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."

On May 30, 2008, we received SEC certification for 2007, permitting us to qualify for RIC treatment for 2007 (as we had for the years 1999 through 2006) pursuant to Section 851(e) of the Code. Although the SEC certification for 2007 was issued, there can be no assurance that we will qualify for or receive such certification for subsequent years (to the extent we need additional certification as a result of changes in our portfolio) or that we will actually qualify for Subchapter M treatment in subsequent years. In 2007, we qualified for RIC treatment even without certification. In addition, under certain circumstances, even if we qualified for Subchapter M treatment in 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. Because Subchapter M does not permit deduction of operating expenses against long-term capital gains, it is not clear that the Company and its shareholders have paid less taxes since 1999 than they would have paid had the Company remained a C Corporation.

<p align="center">HARRIS & HARRIS GROUP, INC. CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES</p>
--

ASSETS

	September 30, 2008	December 31, 2007
	(Unaudited)	
Investments, in portfolio securities at value		
(cost: \$87,913,862 and \$82,677,528, respectively)	\$ 63,942,445	\$ 78,110,384
Investments, in U.S. Treasury obligations at value		
(cost: \$56,206,231 and \$59,552,933, respectively)	57,032,781	60,193,593
Cash and cash equivalents	937,914	330,009
Restricted funds (Note 9)	124,664	2,667,020
Receivable from portfolio company	0	524
Interest receivable	463,732	647,337
Prepaid expenses	148,515	488,667
Other assets	426,449	455,798
Total assets	<u>\$ 123,076,500</u>	<u>\$ 142,893,332</u>

LIABILITIES & NET ASSETS

Accounts payable and accrued liabilities (Note 9)	\$ 1,953,125	\$ 4,515,463
Deferred rent	9,715	14,525
Total liabilities	<u>1,962,840</u>	<u>4,529,988</u>
Net assets	<u>\$ 121,113,660</u>	<u>\$ 138,363,344</u>
Net assets are comprised of:		
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 9/30/08 and 12/31/07; 27,688,313 issued at 9/30/08 and 25,143,313 issued at 12/31/07	276,884	251,434
Additional paid in capital (Note 7)	179,619,630	160,927,691
Accumulated net realized loss	(32,232,456)	(15,483,766)
Accumulated unrealized depreciation of investments	(23,144,867)	(3,926,484)
Treasury stock, at cost (1,828,740 shares at 9/30/08 and 12/31/07)	<u>(3,405,531)</u>	<u>(3,405,531)</u>
Net assets	<u>\$ 121,113,660</u>	<u>\$ 138,363,344</u>
Shares outstanding	<u>25,859,573</u>	<u>23,314,573</u>
Net asset value per outstanding share	<u>\$ 4.68</u>	<u>\$ 5.93</u>

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

<p style="text-align: center;">HARRIS & HARRIS GROUP, INC. CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)</p>
--

Three Months Ended Sept. 30		Nine Months Ended Sept. 30	
2008	2007	2008	2007

Investment income:

Interest from:

Fixed-income securities	\$ 585,418	\$ 743,375	\$ 1,626,176	\$ 2,033,574
Miscellaneous income	2,500	39	5,669	39
Total investment income	587,918	743,414	1,631,845	2,033,613

Expenses:

Salaries, benefits and stock-based compensation (Note 5)	2,205,980	3,230,838	7,101,077	8,409,888
Administration and operations	252,884	311,332	838,100	1,049,375
Professional fees	138,461	155,999	478,559	673,261
Rent	80,358	60,314	197,960	178,634
Directors' fees and expenses	79,318	80,364	263,633	333,717
Depreciation	13,447	16,734	41,251	47,955
Custodian fees	14,209	5,428	26,905	17,163
Total expenses	2,784,657	3,861,009	8,947,485	10,709,993

Net operating loss	(2,196,739)	(3,117,595)	(7,315,640)	(8,676,380)
--------------------	-------------	-------------	-------------	-------------

Net realized (loss) gain from investments:

Realized (loss) gain from investments	(4,373,124)	14,828	(9,384,082)	5,941
Income tax expense (Note 6)	2,102	4,083	48,968	88,988
Net realized (loss) gain from investments	(4,375,226)	10,745	(9,433,050)	(83,047)

Net (increase) decrease in unrealized depreciation on investments:

Change as a result of investment sales	4,278,500	0	9,293,153	0
Change on investments held	(31,739,282)	3,711,087	(28,511,536)	(1,120,140)
Net (increase) decrease in unrealized depreciation on investments	(27,460,782)	3,711,087	(19,218,383)	(1,120,140)

Net (decrease) increase in net assets resulting from operations

	\$ (34,032,747)	\$ 604,237	\$ (35,967,073)	\$ (9,879,567)
--	-----------------	------------	-----------------	----------------

Per average basic and diluted outstanding share	\$ (1.32)	\$ 0.03	\$ (1.48)	\$ (0.45)
---	-----------	---------	-----------	-----------

Average outstanding shares	25,859,573	23,235,023	24,271,270	22,084,893
----------------------------	------------	------------	------------	------------

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

<p style="text-align: center;">HARRIS & HARRIS GROUP, INC. CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)</p>

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Cash flows used in operating activities:		
Net decrease in net assets resulting from operations	\$ (35,967,073)	\$ (9,879,567)
Adjustments to reconcile net decrease in net assets resulting from operations to net cash used in operating activities:		
Net realized and unrealized loss on investments	28,602,465	1,114,199
Depreciation of fixed assets, amortization of premium or discount on U.S. government securities, and bridge note interest	(160,283)	31,425
Stock-based compensation expense	4,333,892	5,725,031
Changes in assets and liabilities:		
Restricted funds	2,542,356	(384,144)
Receivable from portfolio company	524	(5,000)
Receivable from broker	0	819,905
Interest receivable	213,520	126,292
Income tax receivable	0	7,209
Prepaid expenses	340,152	(131,514)
Other assets	1,619	25,630
Accounts payable and accrued liabilities	(2,562,338)	122,356
Accrued profit sharing	0	(261,661)
Deferred rent	(4,810)	(5,101)
Net cash used in operating activities	(2,659,976)	(2,694,940)
Cash flows from investing activities:		
Purchase of U.S. government securities	(75,932,334)	(60,744,292)
Sale of U.S. government securities	79,326,692	56,454,594
Investment in private placements and notes	(14,635,185)	(17,480,885)
Proceeds from sale of private placements and notes	140,257	51,669
Purchase of fixed assets	(15,046)	(36,367)
Net cash used in investing activities	(11,115,616)	(21,755,281)
Cash flows from financing activities:		
Proceeds from stock option exercises (Note 5)	0	9,673,662
Proceeds from stock offering (Note 7)	14,383,497	12,993,168
Net cash provided by financing activities	14,383,497	22,666,830
Net increase (decrease) in cash and cash equivalents:		
Cash and cash equivalents at beginning of the period	330,009	2,071,788
Cash and cash equivalents at end of the period	937,914	288,397
Net increase (decrease) in cash and cash equivalents	\$ 607,905	\$ (1,783,391)
Supplemental disclosures of cash flow information:		
Income taxes paid	\$ 48,427	\$ 87,920

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

<p align="center">HARRIS & HARRIS GROUP, INC. CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS</p>

	Nine Months Ended September 30, 2008 (Unaudited)	Year Ended December 31, 2007
Changes in net assets from operations:		
Net operating loss	\$ (7,315,640)	\$ (11,827,543)
Net realized (loss) gain on investments	(9,433,050)	30,162
Net decrease in unrealized depreciation on investments sold	9,293,153	0
Net (increase) decrease in unrealized depreciation on investments held	(28,511,536)	5,080,936
Net decrease in net assets resulting from operations	(35,967,073)	(6,716,445)
Changes in net assets from capital stock transactions:		
Issuance of common stock upon the exercise of stock options	0	9,996
Issuance of common stock on offering	25,450	13,000
Additional paid-in capital on common stock issued	14,358,047	23,075,683
Stock-based compensation expense	4,333,892	8,050,807
Net increase in net assets resulting from capital stock transactions	18,717,389	31,149,486
Net (decrease) increase in net assets	(17,249,684)	24,433,041
Net assets:		
Beginning of the period	138,363,344	113,930,303
End of the period	\$ 121,113,660	\$ 138,363,344

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

<p style="text-align: center;">HARRIS & HARRIS GROUP, INC. CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2008 (Unaudited)</p>
--

	<u>Method of</u> <u>Valuation (1)</u>	<u>Shares/</u> <u>Principal</u>	<u>Value</u>
Investments in Unaffiliated Companies (2)(3) - 13.7% of net assets at value			
Private Placement Portfolio (Illiquid) - 13.7% of net assets at value			
BioVex Group, Inc. (4)(5)(6)(7) -- Developing novel biologics for treatment of cancer and infectious disease			
Series E Convertible Preferred Stock	(M)	2,799,552	\$ 1,250,000
D-Wave Systems, Inc. (4)(5)(6)(8) -- Developing high-performance quantum computing systems			
Series B Convertible Preferred Stock	(M)	1,144,869	1,199,212
Series C Convertible Preferred Stock	(M)	450,450	471,831
Series D Convertible Preferred Stock	(M)	1,533,395	1,606,181
			<u>3,277,224</u>
Exponential Business Development Company (4)(5) - Venture capital partnership focused on early stage companies			
Limited Partnership Interest	(M)	1	2,219
Molecular Imprints, Inc. (4)(5) -- Manufacturing nanoimprint lithography capital equipment			
Series B Convertible Preferred Stock	(M)	1,333,333	1,029,693
Series C Convertible Preferred Stock	(M)	1,250,000	965,337
Warrants at \$2.00 expiring 12/31/11	(I)	125,000	36,875
			<u>2,031,905</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	3,000,003
			<u>5,370,116</u>
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>

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

<p style="text-align: center;">HARRIS & HARRIS GROUP, INC. CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2008 (Unaudited)</p>

<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
------------------------------------	------------------------------	--------------

Investments in Unaffiliated Companies (2)(3) - 13.7% of net assets at value (cont.)

Private Placement Portfolio (Illiquid) - 13.7% of net assets at value (cont.)

NeoPhotonics Corporation (4)(5) -- Developing and manufacturing optical devices and components

Common Stock	(M)	716,195	\$ 93,106
Series 1 Convertible Preferred Stock	(M)	1,831,256	613,941
Series 2 Convertible Preferred Stock	(M)	741,898	243,932
Series 3 Convertible Preferred Stock	(M)	2,750,000	904,184
Series X Convertible Preferred Stock	(M)	2,000	400,000
Warrants at \$0.15 expiring 01/26/10	(I)	16,364	884
Warrants at \$0.15 expiring 12/05/10	(I)	14,063	760
			2,256,807

Polatis, Inc. (4)(5)(6)(9) -- 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
			0

PolyRemedy, Inc. (4)(5)(6)(10) --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
			0

Total Unaffiliated Private Placement Portfolio (cost: \$24,854,430)		\$ 16,556,930
--	--	----------------------

Total Investments in Unaffiliated Companies (cost: \$24,854,430)		\$ 16,556,930
---	--	----------------------

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

<p style="text-align: center;">HARRIS & HARRIS GROUP, INC. CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2008 (Unaudited)</p>

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
Investments in Non-Controlled Affiliated Companies (2)(11) - 33.9% of net assets at value			
Private Placement Portfolio (Illiquid) - 33.9% of net assets at value			
Adesto Technologies Corporation (4)(5)(6) -- Developing semiconductor-related products enabled at the nanoscale			
Series A Convertible Preferred Stock	(M)	6,547,619	\$ 1,100,000
Ancora Pharmaceuticals, Inc. (4)(5)(6) -- Developing synthetic carbohydrates for pharmaceutical applications			
Series B Convertible Preferred Stock	(M)	1,663,808	1,200,000
BridgeLux, Inc. (4)(5)(12) -- Manufacturing high-power light emitting diodes			
Series B Convertible Preferred Stock	(M)	1,861,504	2,792,256
Series C Convertible Preferred Stock	(M)	2,130,699	3,196,050
Series D Convertible Preferred Stock	(M)	666,667	1,000,001
Warrants at \$0.7136 expiring 02/02/17	(I)	98,340	137,184
Warrants at \$0.7136 expiring 04/26/17	(I)	65,560	91,784
			<u>7,217,275</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)(13) -- Developing batteries using nanostructured materials			
Series A Convertible Preferred Stock	(M)	1,208,262	946,528

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

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2008
(Unaudited)

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
Investments in Non-Controlled Affiliated Companies (2)(10) - 33.9% of net assets at value (cont.)			
Private Placement Portfolio (Illiquid) - 33.9% of net assets at value (cont.)			
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	4,006
Warrants at \$0.78 expiring 05/12/13	(I)	2,350	618
Warrants at \$0.78 expiring 08/08/13	(I)	4,396	1,187
			<u>335,742</u>
CSwitch Corporation (4)(5)(6)(14) -- 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)	\$ 1,581,202	493,411
			<u>493,411</u>
Ensemble Discovery Corporation (4)(5)(6)(15) -- 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)	251,328	251,328
			<u>1,251,328</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 SEPTEMBER 30, 2008
(Unaudited)

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
Investments in Non-Controlled Affiliated Companies (2)(10) - 33.9% of net assets at value (cont.)			
Private Placement Portfolio (Illiquid) - 33.9% of net assets at value (cont.)			
Kereos, Inc. (4)(5)(6) -- Developing emulsion-based imaging agents and targeted therapeutics to image and treat cancer and cardiovascular disease			
Series B Convertible Preferred Stock	(M)	545,456	\$ 0
Kovio, Inc. (4)(5)(6) -- Developing semiconductor products using printed electronics and thin-film technologies			
Series C Convertible Preferred Stock	(M)	2,500,000	3,125,000
Series D Convertible Preferred Stock	(M)	800,000	1,000,000
			<u>4,125,000</u>
Mersana Therapeutics, Inc. (4)(5)(6)(16) -- 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	37,658
Unsecured Convertible Bridge Note (including interest)	(M)	203,068	203,068
			<u>1,175,677</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	131,739
			<u>1,367,614</u>
NanoGram Corporation (4)(5) -- Developing solar power products enabled by silicon-based nanomaterials			
Series I Convertible Preferred Stock	(M)	63,210	62,262
Series II Convertible Preferred Stock	(M)	1,250,904	1,232,141
Series III Convertible Preferred Stock	(M)	1,242,144	1,223,512
Series IV Convertible Preferred Stock	(M)	432,179	425,696
			<u>2,943,611</u>

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

<p style="text-align: center;">HARRIS & HARRIS GROUP, INC. CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2008 (Unaudited)</p>

	<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
Investments in Non-Controlled Affiliated Companies (2)(10) - 33.9% of net assets at value (cont.)			
Private Placement Portfolio (Illiquid) - 33.9% of net assets at value (cont.)			
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>
Nextreme Thermal Solutions, Inc. (4)(5) -- Developing thin-film thermoelectric devices for cooling and energy conversion			
Series A Convertible Preferred Stock	(M)	1,750,000	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	193,846
Warrants at \$1.50 expiring 11/19/08	(I)	5,000	0
Warrants at \$1.50 expiring 11/19/09	(I)	5,000	125
			<u>193,971</u>
Siluria Technologies, Inc. (4)(5)(6) -- Developing next-generation nanomaterials			
Series S-2 Convertible Preferred Stock	(M)	482,218	40,181
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>

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

<p style="text-align: center;">HARRIS & HARRIS GROUP, INC. CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2008 (Unaudited)</p>

<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
------------------------------------	------------------------------	--------------

**Investments in Non-Controlled Affiliated Companies (2)(10) -
33.9% of net assets at value (cont.)**

**Private Placement Portfolio (Illiquid) - 33.9% of net assets
at value (cont.)**

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

Total Non-Controlled Private Placement Portfolio (cost: \$56,974,432)

\$ 41,080,899

Total Investments in Non-Controlled Affiliated Companies (cost: \$56,974,432)

\$ 41,080,899

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

<p style="text-align: center;">HARRIS & HARRIS GROUP, INC. CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2008 (Unaudited)</p>

<u>Method of Valuation (1)</u>	<u>Shares/ Principal</u>	<u>Value</u>
------------------------------------	------------------------------	--------------

**Investments in Controlled Affiliated Companies (2)(17) -
5.2% of net assets at value**

**Private Placement Portfolio (Illiquid) - 5.2% of
net assets at value**

Laser Light Engines, Inc. (4)(5)(6)(10) -- 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	135,686
--------------------------------------	-----	---------	---------

Series A-1 Convertible Preferred Stock	(M)	2,966,667	1,723,930
--	-----	-----------	-----------

Series A-2 Convertible Preferred Stock	(M)	4,207,537	2,445,000
--	-----	-----------	-----------

			<u>4,304,616</u>
--	--	--	------------------

Total Controlled Private Placement Portfolio (cost: \$6,085,000)			\$ <u>6,304,616</u>
---	--	--	----------------------------

Total Investments in Controlled Affiliated Companies (cost: \$6,085,000)			\$ <u>6,304,616</u>
---	--	--	----------------------------

Total Private Placement Portfolio (cost: \$87,913,862)			\$ <u>63,942,445</u>
---	--	--	-----------------------------

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

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2008
(Unaudited)

<u>Method of</u> <u>Valuation (1)</u>	<u>Shares/</u> <u>Principal</u>	<u>Value</u>
--	------------------------------------	--------------

U.S. Government and Agency Securities (18) - 47.1% of net assets at value

U.S. Treasury Bill -- due date 02/12/09	(M)	\$ 4,495,000	\$ 4,477,200
U.S. Treasury Notes -- due date 01/15/09, coupon 3.25%	(M)	3,000,000	3,020,640
U.S. Treasury Notes -- due date 02/15/09, coupon 4.50%	(M)	5,100,000	5,158,956
U.S. Treasury Notes -- due date 04/15/09, coupon 3.125%	(M)	3,000,000	3,024,840
U.S. Treasury Notes -- due date 07/15/09, coupon 3.625%	(M)	3,000,000	3,041,940
U.S. Treasury Notes -- due date 10/15/09, coupon 3.375%	(M)	3,000,000	3,046,410
U.S. Treasury Notes -- due date 01/15/10, coupon 3.625%	(M)	3,000,000	3,068,430
U.S. Treasury Notes -- due date 04/15/10, coupon 4.00%	(M)	3,000,000	3,097,980
U.S. Treasury Notes -- due date 06/30/10, coupon 2.875%	(M)	1,250,000	1,270,600
U.S. Treasury Notes -- due date 07/15/10, coupon 3.875%	(M)	3,000,000	3,108,060
U.S. Treasury Notes -- due date 09/15/10, coupon 3.875%	(M)	2,000,000	2,077,500
U.S. Treasury Notes -- due date 10/15/10, coupon 4.25%	(M)	2,000,000	2,092,660
U.S. Treasury Notes -- due date 12/15/10, coupon 4.375%	(M)	2,000,000	2,102,040
U.S. Treasury Notes -- due date 03/31/11, coupon 4.750%	(M)	2,000,000	2,131,560
U.S. Treasury Notes -- due date 06/30/11, coupon 5.125%	(M)	2,000,000	2,157,960
U.S. Treasury Notes -- due date 09/30/11, coupon 4.500%	(M)	2,000,000	2,126,400
U.S. Treasury Notes -- due date 12/31/11, coupon 4.625%	(M)	2,000,000	2,133,600
U.S. Treasury Notes -- due date 10/31/12, coupon 3.875%	(M)	2,000,000	2,091,880
U.S. Treasury Notes -- due date 02/15/13, coupon 3.875%	(M)	7,500,000	7,804,125

Total Investments in U.S. Government and Agency Securities (cost: \$56,206,231)	\$ 57,032,781
--	----------------------

Total Investments (cost: \$144,120,093)	\$ 120,975,226
--	-----------------------

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

<p style="text-align: center;">HARRIS & HARRIS GROUP, INC. CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2008 (Unaudited)</p>

Notes to Consolidated Schedule of Investments

- (1) See Footnote to Consolidated Schedule of Investments on page 17 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 \$24,854,430. The gross unrealized appreciation based on the tax cost for these securities is \$2,035,048. The gross unrealized depreciation based on the tax cost for these securities is \$10,332,548.
- (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.
- (8) 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 3. Summary of Significant Accounting Policies."

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

<p style="text-align: center;">HARRIS & HARRIS GROUP, INC. CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2008 (Unaudited)</p>

- (9) Continuum Photonics, Inc., merged with Polatis, Ltd., to form Polatis, Inc.
- (10) Initial investment was made during 2008.
- (11) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is \$56,974,432. The gross unrealized appreciation based on the tax cost for these securities is \$6,545,710. The gross unrealized depreciation based on the tax cost for these securities is \$22,439,243.
- (12) BridgeLux, Inc., was previously named eLite Optoelectronics, Inc.
- (13) On February 28, 2008, Lifco, Inc., merged with CFX Battery, Inc. The surviving entity is CFX Battery, Inc.
- (14) With our investments in secured convertible bridge notes issued by CSwitch, we received two warrants to purchase a number of shares of the class of stock sold in the next financing of CSwitch equal to \$529,322 and \$985,835, 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 and \$986, respectively.
- (15) 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.
- (16) Mersana Therapeutics, Inc., was previously named Nanopharma Corp.
- (17) 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 \$219,616. The gross unrealized depreciation based on the tax cost for these securities is \$0.
- (18) The aggregate cost for federal income tax purposes of our U.S. government securities is \$56,206,231. The gross unrealized appreciation on the tax cost for these securities is \$941,828. The gross unrealized depreciation on the tax cost of these securities is \$115,278.

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

<p style="text-align: center;">HARRIS & HARRIS GROUP, INC. FOOTNOTE TO CONSOLIDATED SCHEDULE OF INVESTMENTS (Unaudited)</p>
--

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.

<p style="text-align: center;">NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)</p>

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.,SM is a 100 percent wholly owned subsidiary of the Company. Harris & Harris Enterprises, Inc., is a partner in Harris Partners I, L.P.,SM 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 period ended September 30, 2008, there was no non-passive investment income. The Company consolidates the results of its subsidiaries for financial reporting purposes.

NOTE 2. INTERIM FINANCIAL STATEMENTS

Our interim financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and in conformity with generally accepted accounting principles applicable to interim financial information. Accordingly, they do not include all information and disclosures necessary for a presentation of our financial position, results of operations and cash flows in conformity with generally accepted accounting principles in the United States of America. In the opinion of management, these financial statements reflect all adjustments, consisting of valuation adjustments and normal recurring accruals, necessary for a fair presentation of our financial position, results of operations and cash flows for such periods. The results of operations for any interim period are not necessarily indicative of the results for the full year. These financial statements should be read in conjunction with the financial statements and notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

NOTE 3. 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 for investment companies and include the accounts of the Company and its wholly owned subsidiaries. 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 as of September 30, 2008, and December 31, 2007, and the reported amounts of revenues and expenses for the three months and nine months ended September 30, 2008, and 2007. 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 and money market instruments with maturities of less than three months. 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 September 30, 2008, our financial statements include private venture capital investments valued at \$63,942,445, 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. Effective January 1, 2008, the Company adopted SFAS No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The adoption of SFAS No. 157 did not have a material impact on the fair value measurements of the Company's investments.

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 nine months ended September 30, 2008, included in the net decrease in unrealized depreciation on investments was a \$186,684 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. The Company ceases accruing interest when securities are determined to be non-income producing 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 Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment," ("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 6. 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.

Property and Equipment. Property and equipment are included in "Other Assets" and are carried at cost, less accumulated depreciation of \$377,454. Depreciation is provided using the straight-line method over the estimated useful lives of the premises and equipment.

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 4. FAIR VALUE MEASUREMENTS

At September 30, 2008, our financial assets were categorized as follows in the fair value hierarchy for SFAS No. 157 purposes:

Fair Value Measurement at Reporting Date Using:

Description	September 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government Securities	\$ 57,032,781	\$ 0	\$ 57,032,781	\$ 0
Portfolio Companies	\$ 63,942,445	\$ 0	\$ 0	\$ 63,942,445
Total	\$ 120,975,226	\$ 0	\$ 57,032,781	\$ 63,942,445

The following chart shows the components of change in the financial assets categorized as Level 3, for the three months ended September 30, 2008.

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

	Portfolio Companies
Beginning Balance, July 1, 2008	\$ 92,335,524
Total realized losses included in changes in net assets	(4,371,987)
Total unrealized losses included in changes in net assets	(27,847,181)
Purchases and interest on bridge notes	3,832,612
Disposals	(6,523)
Ending Balance, September 30, 2008	\$ 63,942,445

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

\$ (32,125,681)

The following chart shows the components of change in the financial assets categorized as Level 3, for the nine months ended September 30, 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	(9,386,640)
Total unrealized losses included in changes in net assets	(19,404,273)
Purchases and interest on bridge notes	14,756,711
Disposals	(133,737)
Ending Balance, September 30, 2008	<u>\$ 63,942,445</u>

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

\$ (28,697,427)

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 on June 29, 2007, the Company 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 any additional stockholder approval required, the Compensation Committee may, in the future, authorize awards of stock options under the Stock Plan to non-employee directors of the Company and authorize grants of restricted stock to employees, subject to shareholder approval.

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 may 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.

On March 19, 2008, the Compensation Committee of the Board of Directors and the full Board of Directors of the Company approved a grant of individual Non-Qualified Stock Option ("NQSO") awards for certain officers and employees of the Company. The terms and conditions of the stock options granted were set forth in award agreements between the Company and each award recipient entered into on that date. Options to purchase a total of 348,032 shares of stock were granted with vesting periods ranging from March 2009 to March 2012 and with an exercise price of \$6.18, which was the closing volume weighted average price of our shares of common stock on March 19, 2008. Upon exercise, the shares would be issued from our previously authorized but unissued shares.

On August 13, 2008, the Compensation Committee of the Board of Directors and the full Board of Directors of the Company approved a grant of individual Non-Qualified Stock Option ("NQSO") awards for certain officers and employees of the Company. The terms and conditions of the stock options granted were set forth in award agreements between the Company and each award recipient entered into on that date. Options to purchase a total of 1,163,724 shares of stock were granted with vesting periods ranging from December 2008 to August 2012 and with an exercise price of \$6.92, which was the closing volume weighted average price of our shares of common stock on August 13, 2008. 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. At September 30, 2008, and December 31, 2007, 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 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:

Type of Award	Term	Number of Options Granted	Expected Term in Yrs	Expected Volatility Factor	Expected Dividend Yield	Risk-free Interest Rates	Weighted Average Fair Value Per Share
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:

Type of Award	Term	Number of Options Granted	Expected Term in Yrs	Expected Volatility Factor	Expected Dividend Yield	Risk-free Interest Rates	Weighted Average Fair Value Per Share
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	<u>187,039</u>	4.88%	50.6%	0%	3.24%	\$ 3.25
Total		<u>1,163,724</u>					

For the three months and nine months ended September 30, 2008, the Company recognized \$1,367,567 and \$4,333,892 of compensation expense in the Consolidated Statements of Operations. As of September 30, 2008, there was approximately \$9,206,698 of unrecognized compensation cost related to unvested stock option awards. This cost is expected to be recognized over a weighted-average period of approximately two years.

For the three months and nine months ended September 30, 2008, no stock options were exercised.

For the three months and nine months ended September 30, 2008, 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 in the event of significant decreases in the amount of unrecognized compensation cost.

A summary of the changes in outstanding stock options is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term (Yrs)	Aggregate Intrinsic Value
Options Outstanding at January 1, 2008	3,967,744	\$ 10.54	\$ 4.77		
Granted	1,511,756	\$ 6.75	\$ 3.64	9.25	
Exercised	0	\$ 0	\$ 0		
Forfeited or Expired	(465,087)	\$ 10.15	\$ 2.70		
Options Outstanding at September 30, 2008	<u>5,014,413</u>	\$ 9.43	\$ 4.62	5.82	\$ 69,357
Options Exercisable at September 30, 2008	<u>1,760,544</u>	\$ 10.42	\$ 5.34	4.89	\$ 0
Options Exercisable and Expected to be Exercisable at September 30, 2008	<u>4,943,565</u>	\$ 9.42	\$ 4.59	5.80	\$ 69,357

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 \$6.38 on the last trading day of the third quarter of 2008 and the exercise price, multiplied by the number of in-the-money options. This 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 September 30, 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. 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 management investment companies which 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 2004 through 2007 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 2003 through 2007 tax years remain open for examination by the tax authorities under a four year statute of limitations.

For the nine months ended September 30, 2008, and 2007, our income tax expense was \$48,968 and \$88,988, respectively.

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 7. CAPITAL TRANSACTIONS

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 8. 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 three and nine months ended September 30, 2008, and September 30, 2007.

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2008	2007	2008	2007
Numerator for (decrease) increase in net assets per share	\$ (34,032,747)	\$ 604,237	\$ (35,967,073)	\$ (9,879,567)
Denominator for basic and diluted weighted average shares	25,859,573	23,235,023	24,271,270	22,084,893
Basic and diluted net (decrease) increase in net assets per share resulting from operations	\$ (1.32)	\$ 0.03	\$ (1.48)	\$ (0.45)

NOTE 9. EMPLOYEE BENEFITS

We have established a rabbi trust for the purpose of accumulating funds to satisfy the obligations incurred by us under Mr. Harris's Supplemental Executive Retirement Plan ("SERP"), which amounted to \$124,664 and \$2,667,020 at September 30, 2008, and December 31, 2007, respectively, and is included in accounts payable and accrued liabilities. The restricted funds for the SERP Account totaled \$124,664 and \$2,667,020 at September 30, 2008, and December 31, 2007, respectively. Mr. Harris's rights to benefits pursuant to this SERP will be no greater than those of a general creditor of us.

During the nine months ended September 30, 2008, Mr. Harris received a \$2,889,717 distribution from the SERP Account. Any subsequent balance of the SERP Account will be paid on July 31, 2009.

NOTE 10. COMMITMENTS AND CONTINGENCIES

On July 1, 2008, we signed a five-year lease for office space in Palo Alto, California. The lease expires on August 31, 2013. 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.

NOTE 11. SUBSEQUENT EVENTS

The Proxy Statement for the 2008 Annual Meeting of Shareholders stated that if the named executive officers, exclusive of our Chief Executive Officer, Charles E. Harris, as he is scheduled to retire on December 31, 2008, do not receive sufficient cash from the exercise and sale of stock options in a year to provide market-competitive total compensation, as determined by the Compensation Committee, based on advice from the independent compensation consultant, the Committee will pay the named executive officers cash bonuses. Accordingly, should sufficient stock option exercises fail to occur prior to December 31, 2008, and based on market information provided by the independent compensation consultant, on October 30, 2008, the Compensation Committee of the Company resolved to award bonuses on December 31, 2008, totaling \$395,000. Mr. Harris will not receive a bonus owing to his scheduled retirement.

On October 7, 2008, we made a \$240,000 new investment in a privately held tiny technology portfolio company.

On October 8, 2008, we made a \$250,000 new investment in a privately held tiny technology portfolio company.

On October 31, 2008, we made a \$250,000 follow-on investment in a privately held tiny technology portfolio company.

On November 7, 2008, we made a \$42,542 follow-on investment in a privately held tiny technology portfolio company.

HARRIS & HARRIS GROUP, INC.
FINANCIAL HIGHLIGHTS
(Unaudited)

Three Months Ended Sept. 30		Nine Months Ended Sept. 30	
2008	2007	2008	2007

Per Share Operating Performance

Net asset value per share, beginning

of period	\$	5.95	\$	5.54	\$	5.93	\$	5.42
Net operating (loss)*		(0.09)		(0.13)		(0.30)		(0.39)
Net realized income (loss)								
on investments*(1)		(0.17)		0.00		(0.36)		(0.01)
Net (increase) decrease in unrealized								
depreciation as a result of sales*(1)		0.17		0.00		0.41		(0.00)
Net decrease (increase) in unrealized								
depreciation on investments held*		(1.23)		0.16		(1.17)		(0.05)
Total from investment operations*		(1.32)		0.03		(1.42)		(0.45)
Net increase as a result of stock-								
based compensation*		0.05		0.10		0.18		0.26
(Decrease) Increase as a result of stock-								
offering, net of offering expenses		0.00		0.00		(0.01)		0.26
Net increase as a result of proceeds								
from exercise of options		0.00		0.02		0.00		0.20
Total increase from capital								
stock transactions		0.05		0.12		0.17		0.72
Net asset value per share, end								
of period	\$	4.68	\$	5.69	\$	4.68	\$	5.69
Stock price per share, end								
of period	\$	6.38	\$	10.64	\$	6.38	\$	10.64
Total return based on stock price (2)		6.33%		(5.00)%		(27.42)%		(11.99)%

Supplemental Data:

Net assets, end of period	\$	121,113,660	\$	132,442,597	\$	121,113,660	\$	132,442,597
Ratio of expenses to average								
net assets (2)		2.0%		3.0%		6.5%		8.8%
Ratio of net operating income (loss) to								
average net assets (2)		(1.6)%		(2.4)%		(5.3)%		(7.1)%
Cash dividend paid per share	\$	0.00	\$	0.00	\$	0.00	\$	0.00
Deemed dividend per share	\$	0.00	\$	0.00	\$	0.00	\$	0.00
Number of shares outstanding,								
end of period		25,859,573		23,271,858		25,859,573		23,271,858

*Based on Average Shares Outstanding

(1) Net realized and unrealized gains (losses) include rounding adjustments to reconcile change in net asset value per share. See Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a description of realized and unrealized gains and losses.

(2) Not annualized

The accompanying notes are an integral part of this schedule.

Item 2. 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 unaudited September 30, 2008 Consolidated Financial Statements and the Company's audited 2007 Consolidated Financial Statements and notes thereto.

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 and invested \$406,936 in Otisville BioTech, Inc., which also completed an initial public offering later that year. In 1984, Charles E. Harris purchased a controlling interest in us which also made him the control person of Otisville. We then divested our other assets and became a financial services company, with the investment in Otisville as the initial focus of our business activity.

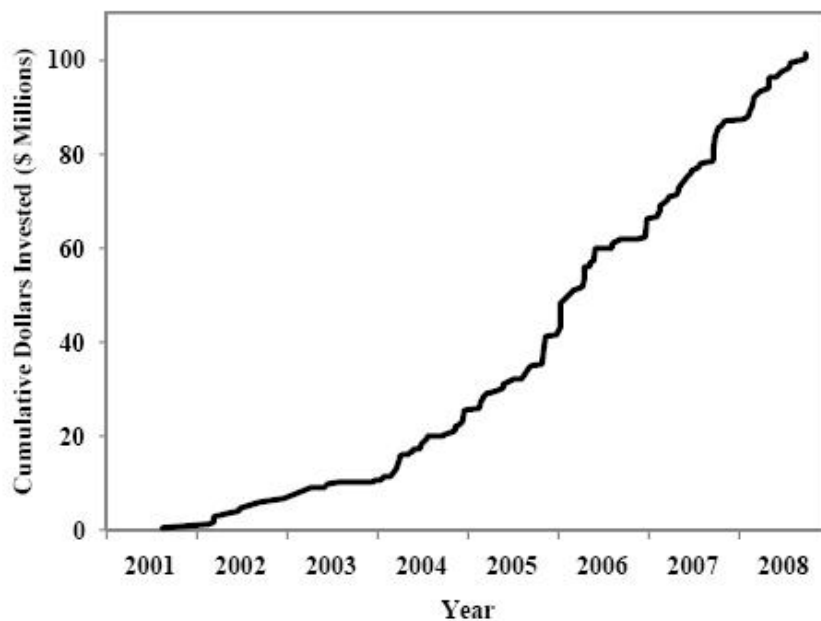
In 1992, we registered as an investment company under the 1940 Act, commencing operations as a closed-end, non-diversified investment company. In 1995, we elected to become a business development company subject to the provisions of Sections 55 through 65 of the 1940 Act.

Throughout our corporate history, we have made early stage venture capital investments in a variety of industries. We define venture capital investments as investments in start-up firms and small businesses with exceptional growth potential. We have invested a substantial portion of our assets in venture capital investments of private, development stage or start-up companies. These private 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 September 30, 2008, \$63,942,445, or 52.8 percent, of our net assets at fair value consisted of private venture capital investments, net of unrealized depreciation of \$23,971,417. 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 September 30, 2008, we have made a total of 82 venture capital investments, including four private placement investments in securities of publicly traded companies. We have exited 50 of these 82 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 investment in a tiny technology company developing nanotechnology, Nanophase Technologies Corporation. From August 2001 through September 30, 2008, all 40 of our initial investments have been in tiny technology. From August 2001 through September 30, 2008, we have invested a total (before any subsequent write-ups, write-downs or dispositions) of \$101,270,435 in tiny technology.

**Our Cumulative Dollars Invested In Tiny Technology
From August 8, 2001 to September 30, 2008**



We currently have 31 active tiny technology companies in our portfolio, including one tiny technology investment made prior to 2001. At September 30, 2008, from first dollar in, the average and median holding periods for these 31 active tiny technology investments were 3.64 years and 3.37 years, respectively.

In our Form 10-Q for the quarter ended March 31, 2008, we stated, "Two of our portfolio companies have been considering with their advisors the possibility of filing for initial public offerings (IPOs) in 2008. There can be no assurance that either of them will file for an IPO in 2008, and a variety of factors, including stock market and general business conditions, could lead either or both of them to terminate such considerations." In the quarter ended September 30, 2008, there was only one venture capital-backed IPO in the United States, and there have been only seven thus far in 2008. We believe that until stock market conditions for IPOs improve, it is unlikely that any of our portfolio companies will file for IPOs. Additionally, we believe until such time that conditions improve, the recent substantial decrease in the general availability of capital has greatly increased the risk that companies that need to raise money to reach cash-flow breakeven or complete an exit (i.e., complete an IPO or be acquired) will either have to pay a higher price than heretofore for capital or not be able to raise additional capital at all.

The following is a summary of our initial and follow-on investments in tiny technology from 2001 to the present. We consider a "round led" to be a round where we issued the term sheet, were the new investor or led 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.

	2001	2002	2003	2004	2005	2006	2007	YTD 9/30/08
Total Incremental Investments	\$489,999	\$6,240,118	\$3,812,600	\$14,837,846	\$16,251,339	\$24,408,187	\$20,595,161	\$14,635,185
No. of New Investments	1	7	5	8	4	6	7	2
No. of Follow-On Investment Rounds	0	1	5	21	13	14	20	19
No. of Rounds Led	0	1	0	2	0	7	3	3
Average Dollar Amount - Initial	\$489,999	\$ 784,303	\$ 437,156	\$ 911,625	\$ 1,575,000	\$ 2,383,424	\$ 1,086,441	\$ 1,122,250
Average Dollar Amount - Follow-On	N/A	\$ 750,000	\$ 325,364	\$ 359,278	\$ 765,488	\$ 721,974	\$ 649,504	\$ 652,141

We value our private venture capital investments each quarter as determined in good faith by our Valuation Committee, a committee of 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 "Consolidated Financial Statements.")

In the years 2001 through September 30, 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.

	2001	2002	2003	2004	2005	2006	2007	YTD 9/30/08
Net Asset Value, BOY	\$31,833,475	\$24,334,770	\$27,256,046	\$40,682,738	\$74,744,799	\$117,987,742	\$113,930,303	\$138,363,344
Gross Write-Downs During Year	\$ (2,532,730)	\$ (5,400,005)	\$ (1,256,102)	\$ (5,711,229)	\$ (3,450,236)	\$ (4,211,323)	\$ (7,810,794)	\$ (29,518,963)
Gross Write-Ups During Year	\$ 1,528,866	\$ 285	\$ 847,578	\$ 6,288,397	\$ 23,485,176	\$ 279,363	\$ 11,694,618	\$ 821,365
Gross Write-Downs as a Percentage of Net Asset Value, BOY	-7.96%	-22.19%	-4.61%	-14.04%	-4.62%	-3.57%	-6.86%	-21.33%
Gross Write-Ups as a Percentage of Net Asset Value, BOY	4.80%	0.00%	3.11%	15.46%	31.42%	0.24%	10.26%	0.59%
Net Write-Downs/Write-Ups as a Percentage of Net Asset Value, BOY	-3.15%	-22.19%	-1.49%	1.42%	26.8%	-3.33%	3.40%	-20.74%

During the nine months ended September 30, 2008, we recorded gross write-downs of \$29,518,963. These write-downs are owing primarily 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 define non-performance risk as the risk that a negative cash flow 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 September 30, 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 securities.

We have discretion in the investment of our capital. However, we invest primarily in illiquid equity securities of private companies. Generally, these investments take the form of preferred stock, are subject to restrictions on resale and have no established trading market. 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.

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 Income / (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.

Results of Operations

Three months ended September 30, 2008, as compared with the three months ended September 30, 2007

In the three months ended September 30, 2008, we had a net decrease in net assets resulting from operations of \$(34,032,747). In the three months ended September 30, 2007, we had a net increase in net assets resulting from operations of \$604,237.

Investment Income and Expenses:

We had net operating losses of \$2,196,739 and \$3,117,595 for the three months ended September 30, 2008, and September 30, 2007, respectively. The variation in these results is primarily owing to the changes in investment income and operating expenses, including non-cash expenses of \$1,367,567 in 2008 and \$2,302,394 in 2007 associated with amortization of stock options. During the three months ended September 30, 2008, and 2007, total investment income was \$587,918 and \$743,414, respectively. During the three months ended September 30, 2008, and 2007, total operating expenses were \$2,784,657 and \$3,861,009, respectively, including the non-cash expense of \$1,367,567 in 2008 and \$2,302,394 in 2007 associated with amortization of stock options.

During the three months ended September 30, 2008, as compared with the same period in 2007, investment income decreased, reflecting a decrease in our average holdings of U.S. government securities. During the three months ended September 30, 2008, our average holdings of such securities were \$58,057,162, as compared with \$67,656,776 during the three months ended September 30, 2007.

Operating expenses were \$2,784,657 and \$3,861,009 for the three months ended September 30, 2008, and September 30, 2007, respectively, including non-cash, stock option-based compensation expense of \$1,367,567 in 2008 and \$2,302,394 in 2007. The decrease in operating expenses for the three months ended September 30, 2008, as compared with the three months ended September 30, 2007, was primarily owing to decreases in salaries, benefits and stock-based compensation expense, administration and operations expense and professional fees, partially offset by an increase in our rent expense. Salaries, benefits and stock-based compensation expense decreased by \$1,024,858, or 31.7 percent, through September 30, 2008, as compared with September 30, 2007, primarily as a result of a decrease in non-cash expense of \$934,827 associated with the Stock Plan. Although the non-cash, stock-based compensation expense for the Stock Plan was \$1,367,567, this expense 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 \$58,448, or 18.8 percent, through September 30, 2008, as compared with September 30, 2007, primarily as a result of a decrease in our directors' and officers' liability insurance expense and decreases in the cost of the annual report and proxy-related expenses. Professional fees decreased by \$17,538, or 11.2 percent, for the three months ended September 30, 2008, as compared with the same period in 2007, primarily as a result of a reduction in certain legal, accounting and consulting fees. Rent expense increased by \$20,044, or 33.2 percent, through September 30, 2008, as compared to September 30, 2007, as a result of the lease of new office space in Palo Alto, CA.

Realized Income and Losses From Investments:

During the three months ended September 30, 2008, we realized net losses on investments of \$4,373,124, as compared with realized net gains on investments of \$14,828 during the three months ended September 30, 2007.

During the three months ended September 30, 2008, we realized net losses of \$4,373,124, consisting primarily of realized losses on Evolved Nanomaterial Sciences, Inc., of \$2,800,000, on Phoenix Molecular Corporation of \$93,487 and on Zia Laser, Inc., of \$1,478,500.

During the three months ended September 30, 2007, we realized net gains of \$14,828, consisting primarily of realized gains on the sale of U.S. government and agency securities and a gain realized from a distribution from Exponential Business Development Company.

Net Unrealized Appreciation and Depreciation of Portfolio Securities:

During the three months ended September 30, 2008, net unrealized depreciation on total investments increased by \$27,460,782, or 636.3 percent, from net unrealized appreciation of \$4,315,915 at June 30, 2008, to net unrealized depreciation of \$23,144,867 at September 30, 2008, owing primarily to the non-performance risk associated with our portfolio companies in the current economic environment. During the three months ended September 30, 2007, net unrealized depreciation on total investments decreased by \$3,711,087, or 26.8 percent, from net unrealized depreciation of \$13,838,647 at June 30, 2007, to net unrealized depreciation of \$10,127,560 at September 30, 2007.

During the three months ended September 30, 2008, net unrealized depreciation on our venture capital investments increased by \$27,847,181, from net unrealized appreciation of \$3,875,764 at June 30, 2008, to net unrealized depreciation of \$23,971,417 at September 30, 2008, owing primarily to decreases in the valuations of the following investments held, offset by an increase in the valuation of Questech Corporation of \$54,693:

<u>Investment</u>	<u>Amount of Write-Down</u>
Adesto Technologies Corporation	\$1,100,000
Ancora Pharmaceuticals, Inc.	400,000
BioVex Group, Inc.	1,250,000
BridgeLux, Inc.	983
Cambrios Technologies Corporation	1,297,012
Crystal IS, Inc.	997,401
CSwitch Corporation	4,519,350
D-Wave Systems, Inc.	8,397
Ensemble Discovery Corporation	1,000,000
Exponential Business Development Company	168
Innovalight, Inc.	1,927,946
Kereos, Inc.	90,371
Mersana Therapeutics, Inc.	1,006,602
Metabolon, Inc.	1,395,874
Molecular Imprints, Inc.	2,296,178
NanoGram Corporation	2,943,611
Nanomix, Inc.	691,090
Neophotonics Corporation	2,364,458
Nextreme Thermal Solutions, Inc.	2,182,233
Polatis, Inc.	276,526
PolyRemedy, Inc.	122,250
Siluria Technologies, Inc.	120,542
Solazyme, Inc.	5,378,325
Starfire Systems, Inc.	690,000

We also had decreases in unrealized depreciation attributable to the reversal of unrealized depreciation owing to realization of net losses on Evolved Nanomaterial Sciences, Inc., of \$2,800,000 and on Zia Laser, Inc., of \$1,478,500. We had a decrease owing to foreign currency translation of \$121,057 on our investment in D-Wave Systems, Inc. Unrealized appreciation on our U.S. government securities portfolio increased from \$440,151 at June 30, 2008, to \$826,550 at September 30, 2008.

During the three months ended September 30, 2007, net unrealized depreciation on our venture capital investments decreased by \$3,028,058, from \$13,320,521 to \$10,292,463, owing primarily to increases in the valuations of our investments in AlphaSimplex Group, LLC, of \$113,964, CSwitch Corporation of \$48,935, Exponential Business Development Company of \$1,973, Innovalight, Inc., of \$3,218,216 and SiOnyx, Inc., of \$899,566, partially offset by decreases in the valuations of our investments in BridgeLux, Inc., of \$41,605, Chlorogen, Inc., of \$23,122, Evolved Nanomaterial Sciences, Inc., of \$438,042, Nanomix, Inc., of \$549,774, NanoOpto Corporation of \$60,000, Polatis, Inc., of \$184,323 and Questech Corporation of \$85,210. We also had an increase in the value of our investment in D-Wave Systems, Inc., of \$127,480 owing to foreign currency translation. Unrealized depreciation on our U.S. government and agency securities portfolio decreased from \$518,126 at June 30, 2007, to an unrealized appreciation of \$164,903 at September 30, 2007.

Nine months ended September 30, 2008, as compared with the nine months ended September 30, 2007

In the nine months ended September 30, 2008, and September 30, 2007, we had net decreases in net assets resulting from operations of \$35,967,073 and \$9,879,567, respectively.

Investment Income and Expenses:

We had net operating losses of \$7,315,640 and \$8,676,380 for the nine months ended September 30, 2008, and September 30, 2007, respectively. The variation in these results is primarily owing to the changes in investment income and operating expenses, including non-cash expenses of \$4,333,892 in 2008 and \$5,725,031 in 2007 associated with amortization of stock options. During the nine months ended September 30, 2008, and 2007, total investment income was \$1,631,845 and \$2,033,613, respectively. During the nine months ended September 30, 2008, and 2007, total operating expenses were \$8,947,485 and \$10,709,993, respectively.

During the nine months ended September 30, 2008, as compared with the same period in 2007, investment income decreased, reflecting a decrease in our average holdings throughout the period of U.S. government securities. During the nine months ended September 30, 2008, our average holdings of such securities were \$56,089,836, as compared with \$62,541,791 at September 30, 2007.

Operating expenses, including non-cash, stock-based compensation expense, were \$8,947,485 and \$10,709,993 for the nine months ended September 30, 2008, and September 30, 2007, respectively. The decrease in operating expenses for the nine months ended September 30, 2008, as compared with the nine months ended September 30, 2007, was primarily owing to decreases in salaries, benefits and stock-based compensation expense and to decreases in administration and operations expense, professional fees and directors' fees and expenses. Salaries, benefits and stock-based compensation expense decreased by \$1,308,811, or 15.6 percent, through September 30, 2008, as compared with September 30, 2007, primarily as a result of a decrease in non-cash expense of \$1,391,139 associated with the Stock Plan, offset by an increase in salaries and benefits owing to an increase in our head count as compared with that of the same period in 2007. While the non-cash, stock-based compensation expense for the Stock Plan increased our operating expenses by \$4,333,892, 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 \$211,275, or 20.1 percent, through September 30, 2008, as compared with September 30, 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 \$194,702, or 28.9 percent, for the nine months ended September 30, 2008, as compared with the same period in 2007, 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.

Realized Income and Losses from Investments:

During the nine months ended September 30, 2008, we realized net losses on investments of \$9,384,082, as compared with realized net gains on investments of \$5,941 during the nine months ended September 30, 2007.

During the nine months ended September 30, 2008, we realized net losses of \$9,384,082, 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 and on Zia Laser of \$1,478,500. During the nine months ended September 30, 2008, we received a payment of \$105,714 from the NanoOpto Corporation bridge note.

During the nine months ended September 30, 2007, we realized net gains of \$5,941, consisting primarily of net realized losses on the sale of U.S. government and agency securities, offset by income from our investments in AlphaSimplex Group, LLC and Exponential Business Development Company.

Net Unrealized Appreciation and Depreciation of Portfolio Securities:

During the nine months ended September 30, 2008, net unrealized depreciation on total investments increased by \$19,218,383, or 489.5 percent, from net unrealized depreciation of \$3,926,484 at December 31, 2007, to net unrealized depreciation of \$23,144,867 at September 30, 2008, owing primarily to the non-performance risk associated with our portfolio companies in the current economic environment. During the nine months ended September 30, 2007, net unrealized depreciation on total investments increased by \$1,120,140, or 12.4 percent, from net unrealized depreciation of \$9,007,420 at December 31, 2006, to net unrealized depreciation of \$10,127,560 at September 30, 2007.

During the nine months ended September 30, 2008, net unrealized depreciation on our venture capital investments increased by \$19,404,273, from net unrealized depreciation of \$4,567,144 at December 31, 2007, to net unrealized depreciation of \$23,971,417 at September 30, 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.	1,250,000
BridgeLux, Inc.	2,721
Cambrios Technologies Corporation	1,297,012
Crystal IS, Inc.	997,796
CSwitch Corporation	4,519,350
Ensemble Discovery Corporation	1,000,000
Innovalight, Inc.	1,927,946
Kereos, Inc.	159,743
Mersana Therapeutics, Inc.	1,015,673
Metabolon, Inc.	2,132,386
Molecular Imprints, Inc.	2,468,095
NanoGram Corporation	2,943,611
Nanomix, Inc.	980,418
Neophotonics Corporation	3,401,952
Nextreme Thermal Solutions, Inc.	2,182,133
Polatis, Inc.	276,526
PolyRemedy, Inc.	122,250
Questech Corporation	398,283
Siluria Technologies, Inc.	120,542
Starfire Systems, Inc.	750,000

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 and on Zia Laser, Inc., of \$1,478,672. For the nine months ended September 30, 2008, we had increases in the valuations of our investments in D-Wave Systems, Inc., of \$5,199, Exponential Business Development Company of \$25 and Solazyme, Inc., of \$821,340. We had a decrease owing to foreign currency translation of \$178,286 on our investment in D-Wave Systems, Inc. Unrealized appreciation on our U.S. government securities portfolio increased from \$640,660 at December 31, 2007, to \$826,550 at September 30, 2008.

During the nine months ended September 30, 2007, net unrealized depreciation on our venture capital investments increased by \$1,841,494, from \$8,450,969 to \$10,292,463, owing primarily to decreases in the valuations of our investments in Chlorogen, Inc., of \$1,326,073, Evolved Nanomaterial Sciences, Inc., of \$2,800,000, Nanomix, Inc., of \$1,009,546, NanoOpto Corporation of \$1,475,599, Polatis, Inc., of \$9,534 and Questech Corporation of \$249,749, offset partially by increases in the valuation of our investments in AlphaSimplex Group, LLC, of \$113,964, BridgeLux, Inc., of \$328,369, CSwitch Corporation of \$48,935, Exponential Business Development Company of \$1,973, Innovalight, Inc., of \$3,218,216, Kovio, Inc., of \$125,000 and SiOnyx, Inc., of \$899,566. We also had an increase owing to foreign currency translation of \$291,796 on our investment in D-Wave Systems, Inc. Unrealized depreciation on our U.S. government and agency securities portfolio decreased from \$556,451 at December 31, 2006, to unrealized appreciation of \$164,903 at September 30, 2007.

Financial Condition

September 30, 2008

At September 30, 2008, our total assets and net assets were \$123,076,500 and \$121,113,060, respectively. At December 31, 2007, they were \$142,893,332 and \$138,363,344, respectively.

At September 30, 2008, net asset value per share ("NAV") was \$4.68, as compared with \$5.93 at December 31, 2007. At September 30, 2008, our shares outstanding increased to 25,859,573, from 23,314,573 at December 31, 2007.

Significant developments in the nine months ended September 30, 2008, included a decrease in the value of our venture capital investments of \$14,167,939 and a decrease in the value of our investment in U.S. government obligations of \$3,160,812. The decrease in the value of our venture capital investments, from \$78,110,384 at December 31, 2007, to \$63,942,445 at September 30, 2008, resulted primarily from two new and 19 follow-on investments of \$14,635,185, offset by a decrease in the net value of our venture capital investments of \$19,404,273. The decrease in the net value of our venture capital investments is owing primarily 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 \$57,032,781 at September 30, 2008, is primarily owing to the investment of net proceeds of \$14,383,497 received through the registered direct stock offering, offset by net operating expenses and by new and follow-on venture capital investments, totaling \$14,635,185.

The following table is a summary of additions to our portfolio of venture capital investments made during the nine months ended September 30, 2008:

<u>New Investment</u>	<u>Amount</u>
PolyRemedy, Inc.	\$ 244,500
Laser Light Engines, Inc.	\$ 2,000,000
<u>Follow-on Investment</u>	
Adesto Technologies Corporation	\$ 1,052,174
Ancora Pharmaceuticals Inc.	\$ 800,000
BridgeLux, Inc.	\$ 1,000,001
CSwitch Corporation	\$ 986,821
D-Wave Systems, Inc.	\$ 736,019
D-Wave Systems, Inc.	\$ 487,804
Ensemble Discovery Corporation	\$ 250,286
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
Solazyme, Inc.	\$ 2,000,000
Solazyme, Inc.	\$ 1,000,000
Total	<u>\$14,635,185</u>

The following tables summarize the values of our portfolios of venture capital investments and U.S. government obligations, as compared with their cost, at September 30, 2008, and December 31, 2007:

	September 30, 2008	December 31, 2007
Venture capital investments, at cost	\$ 87,913,862	\$ 82,677,528
Net unrealized depreciation ⁽¹⁾	<u>23,971,417</u>	<u>4,567,144</u>
Venture capital investments, at fair value	<u>\$ 63,942,445</u>	<u>\$ 78,110,384</u>
	September 30, 2008	December 31, 2007
U.S. government obligations, at cost	\$ 56,206,231	\$ 59,552,933
Net unrealized appreciation ⁽¹⁾	<u>826,550</u>	<u>640,660</u>
U.S. government obligations, at value	<u>\$ 57,032,781</u>	<u>\$ 60,193,593</u>

⁽¹⁾At September 30, 2008, and December 31, 2007, the net accumulated unrealized depreciation on investments was \$23,144,867 and \$3,926,484, respectively.

The following table summarizes the fair value composition of our venture capital investment portfolio at September 30, 2008, and December 31, 2007.

Category	September 30, 2008	December 31, 2007
Tiny Technology	99.9%	99.9%
Other Venture Capital Investments	<u>0.1%</u>	<u>0.1%</u>
Total Venture Capital Investments	<u>100.0%</u>	<u>100.0%</u>

Liquidity

Our primary sources of liquidity are cash, receivables and freely marketable securities, net of short-term indebtedness. Our secondary sources of liquidity are restricted securities of companies that are publicly traded.

At September 30, 2008, and December 31, 2007, our total net primary liquidity was \$58,446,900 and \$61,183,136, respectively, and our secondary liquidity was \$0 and \$0, respectively.

The decrease in our primary liquidity from December 31, 2007, to September 30, 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.

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 portfolio companies does not impact our daily liquidity. At September 30, 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.

Capital Resources

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 tiny technology, as well as for follow-on investments in our existing venture capital investments and for working capital. Through September 30, 2008, we have used \$6,483,163 of the net proceeds from this offering for these purposes.

On June 25, 2007, we completed the sale of 1,300,000 shares of our common stock from our 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 tiny technology, as well as for follow-on investments in our existing venture capital investments and for working capital. Through September 30, 2008, we have used all of the net proceeds from this offering for these purposes.

Critical Accounting Policies

The Company's significant accounting policies are described in Note 3 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 business development company, 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 September 30, 2008, our financial statements include private venture capital investments valued at \$63,942,445, the fair values of which were determined in good faith by, or under the direction of, the Board of Directors. At September 30, 2008, approximately 51.9 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 credit crisis, decline in the stock market and decline in economic activity (and evidence of a 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. 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 negative cash flow 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 September 30, 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 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 September 30, 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 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.

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 Moody's Aa Corporate Bond Index and 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 benefit obligation as of December 31, 2007, and to calculate our 2008 expense was 6.55 percent, which is an increase from the 5.75 percent rate used in determining the 2007 expense.

Recent Developments — Other

The Proxy Statement for the 2008 Annual Meeting of Shareholders stated that if the named executive officers, exclusive of our Chief Executive Officer, Charles E. Harris, as he is scheduled to retire on December 31, 2008, do not receive sufficient cash from the exercise and sale of stock options in a year to provide market-competitive total compensation, as determined by the Compensation Committee, based on advice from the independent compensation consultant, the Committee will pay the named executive officers cash bonuses. Accordingly, should sufficient stock option exercises fail to occur prior to December 31, 2008, and based on market information provided by the independent compensation consultant, on October 30, 2008, the Compensation Committee of the Company resolved to award bonuses on December 31, 2008, totaling \$395,000. Mr. Harris will not receive a bonus owing to his scheduled retirement.

Recent Developments — Portfolio Companies

On October 7, 2008, we made a \$240,000 new investment in a privately held tiny technology portfolio company.

On October 8, 2008, we made a \$250,000 new investment in a privately held tiny technology portfolio company.

On October 31, 2008, we made a \$250,000 follow-on investment in a privately held tiny technology portfolio company.

On November 7, 2008, we made a \$42,542 follow-on investment in a privately held tiny technology portfolio company.

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-Q, and in our Form 10-K for the year ended December 31, 2007. The forward-looking statements made in this Form 10-Q 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.

Item 3. 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 1. Consolidated Financial Statements.")

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 nine months ended September 30, 2008, we recorded gross write-downs of \$29,518,963. These write-downs are owing primarily 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 also invest in short-term money market instruments, and 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 at September 30, 2008, were to increase by 25, 75 and 150 basis points, the weighted average value of these securities held by us at September 30, 2008, would decrease by approximately \$256,033, \$768,099 and \$1,536,197, 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 \$306,962 at September 30, 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 4. Controls and Procedures

(a) *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 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 September 30, 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.

(b) *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 third 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.

PART II. OTHER INFORMATION

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 in our Annual Report on Form 10-K for the year ended December 31, 2007, before you purchase any of our common stock. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. 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. In addition to the risks described in our Annual Report on Form 10-K, you should consider the following risks:

Unstable credit markets could adversely affect our portfolio companies.

Although our portfolio companies rely primarily on equity financing, some of them borrow funds as well. Given the current credit environment, there can be no assurance that portfolio companies will be able to borrow money on a timely basis or on reasonable terms, which could have a negative impact on their operating performance, raise their cost of capital, or even jeopardize their existence. Furthermore, certain of our portfolio companies manage their cash positions by investing in money-market funds, auction-rate securities, or other short-term securities that are vulnerable to current credit conditions. Lack of liquidity in such investments, or even defaults by issuers of such securities, could restrict the amount of cash available to such portfolio companies. These events could lead to financial losses in our portfolio.

A continuing lack of initial public offering opportunities 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, and for the first time in a quarter since 1978, no venture capital-backed companies completed IPOs in the quarter ended June 30, 2008, according to the National Venture Capital Association and Thomson Reuters. In the quarter ended September 30, 2008, there was only one venture capital-backed IPO in the United States, and there have been only seven thus far in 2008. Moreover, in 2007, according to the National Venture Capital Association, the venture capital-backed companies that completed IPOs had a median age of about 8.6 years, which was older than the median age of venture capital-backed IPOs in any period since 2001-2002. Now that some of our companies are becoming more mature, a continuing lack of IPO opportunities for venture capital-backed companies could lead to companies staying longer in our portfolio as private entities still requiring funding. This situation may adversely affect the amount of available funding for early-stage companies in particular as, in general, venture-capital firms are being forced to provide additional financing to late-stage companies that cannot complete an IPO. 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 fundings or are not able to access additional capital at all. A continuing lack of IPO opportunities for venture capital-backed companies is also causing some venture capital firms to change their strategies, leading some of them to reduce funding of their portfolio companies and making it more difficult for such companies to access capital and to fulfill their potential, which can result in write-downs and write-offs of such companies by other venture capital firms, such as ourselves, who are co-investors in such companies.

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. These events and their effect on valuation may not be measurable until they occur. 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 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. 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 time frame of our valuations.

Fluctuations in the price of oil may affect our alternative energy companies.

We have investments in securities of companies that are developing alternative solutions for energy and chemical production to those that rely on the use of oil. These alternative solutions are viable economically at varying prices of barrels of oil. As such, the recent decline and any future declines in the price of oil may adversely affect the business prospects and the value of our securities of these alternative energy companies.

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.

Item 6. Exhibits

- | | |
|--------|--|
| 10.1* | 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. |
| 10.2 | 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. |
| 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* | 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. |

*filed herewith

SIGNATURES

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

Harris & Harris Group, Inc.

/s/ Daniel B. Wolfe

By: Daniel B. Wolfe

Chief Financial Officer

/s/ Patricia N. Egan

By: Patricia N. Egan

Chief Accounting Officer
and Vice President

Date: November 7, 2008

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description</u>
10.1	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.
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	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.



STANDARD MULTI-TENANT OFFICE LEASE - GROSS

AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION

1. Basic Provisions ("Basic Provisions")

1.1 Parties: This Lease ("Lease"), dated for reference purposes only July 1, 2008, is made by and between Jack Rominger, Tommie Plemons and Dale Denson

and Harris & Harris Enterprise, Inc., a New York corporation

(collectively the "Parties", or individually a "Party").

1.2(a) Premises: That certain portion of the Project (as defined below), known as Suite Number(s) 200 (and 2nd floor(s)), consisting of approximately ±2,290 rentable square feet which includes use of the first floor conference room (defined in 1st Addendum) and approximately N/A useable square feet ("Premises"). The Premises are located at 420 Florence Street in the City of Palo Alto, County of Santa Clara, State of California, with zip code 94301. In addition to Lessee's rights to use and occupy the Premises as hereinafter specified, Lessee shall have non-exclusive rights to the Common Areas (as defined in Paragraph 2.7 below) as hereinafter specified, but shall not have any rights to the roof, the exterior walls, the area above the dropped ceilings, or the utility raceways of the building containing the Premises ("Building") or to any other buildings in the Project. The Premises, the Building, the Common Areas, the land upon which they are located, along with all other buildings and improvements thereon, are herein collectively referred to as the "Project." The Project consists of approximately 13,300 rentable square feet. (See also Paragraph 2)

1.2(b) Parking: N/A unreserved and N/A reserved vehicle parking spaces at a monthly cost of \$N/A per unreserved space and \$N/A per reserved space. (See Paragraph 2.6)

1.3 Term: Five (5) years and additional days pending lease commencement date and months ("Original Term") commencing August 1, 2008 as further defined in the Addendum ("Commencement Date") and ending August 31, 2013 ("Expiration Date"). (See also Paragraph 3)

1.4 Early Possession: Upon lease execution subject to terms defined in Addendum ("Early Possession Date"). (See also Paragraphs 3.2 and 3.3)

1.5 Base Rent: \$10,305.00 per month ("Base Rent"), payable on the first (1st) day of each month commencing August 1, 2008. (See also Paragraph 4)

☒ If this box is checked, there are provisions in this Lease for the Base Rent to be adjusted.

1.6 Lessee's Share of Operating Expense Increase: N/A percent (N/A) ("Lessee's Share"). Lessee's Share has been calculated by dividing the approximate rentable square footage of the Premises by the total approximate square footage of the rentable space contained in the Project and shall not be subject to revision except in connection with an actual change in the size of the Premises or a change in the space available for lease in the Project. There shall be no pass-through of operating expenses to Lessee during the initial lease term.

1.7 Base Rent and Other Monies Paid Upon Execution:

- (a) Base Rent: \$10,305.00 for the period August 1 - 31, 2008
- (b) Security Deposit: \$11,600.00 ("Security Deposit"). (See also Paragraph 5)
- (c) Parking: \$N/A for the period N/A
- (d) Other: \$N/A for N/A
- (e) Total Due Upon Execution of this Lease: \$21,905.00

1.8 Agreed Use: general office use in compliance with City of Palo Alto laws and ordinances

(See also Paragraph 6)

1.9 Base Year; Insuring Party: The Base Year is 2008. Lessor is the "Insuring Party". (See also Paragraphs 4.2 and 8)

1.10 Real Estate Brokers: (See also Paragraph 15)

(a) Representation: The following real estate brokers (the "Brokers") and brokerage relationships exist in this transaction (check applicable boxes):

- ☒ Cornish & Carey Commercial - Cherie Wittry represents Lessor exclusively ("Lessor's Broker");
- ☒ NAI BT Commercial represents Lessee exclusively ("Lessee's Broker"); or
- ☐ represents both Lessor and Lessee ("Dual Agency").

(b) Payment to Brokers: Upon execution and delivery of this Lease by both Parties, Lessor shall pay to the Brokers the brokerage fee agreed to in a separate written agreement. (or if there is no such agreement, the sum of _____ of the total Base Rent for the brokerage services rendered by the Brokers).

1.11 Guarantor: The obligations of the Lessee under this Lease shall be guaranteed by N/A ("Guarantor"). (See also Paragraph 37)

1.12 Business Hours for the Building: 8 a.m. to 6 p.m., Mondays through Fridays (except Building Holidays) and N/A a.m. to N/A p.m. on Saturdays (except Building Holidays). "Building Holidays" shall mean the dates of observation of New Year's Day, President's Day, Memorial Day, Independence Day, Labor Day, Thanksgiving Day, Christmas Day, and N/A.

1.13 Lessor Basic Services: Notwithstanding the provisions of Paragraph 11.1, Lessor is NOT obligated to provide the following:

- ☐ Janitorial services;
- ☐ Electricity;
- ☐ Other (specify): _____

1.14 Attachments: Attached hereto are the following, all of which constitute a part of this Lease: ☒ an Addendum consisting of Paragraphs Articles 1 through 12; ☐ a plot plan depicting the Premises;

© 1999 - American Industrial Real Estate Association

Page 1 of 13
REVISED

Initials

FORM OFG-1-9/99E

- ☒ a current set of the Rules and Regulations;
☐ a Work Letter;
☐ a janitorial schedule;
☒ other (specify): Floor plan

2. Premises

2.1 **Letting** Lessor hereby leases to Lessee, and Lessee hereby leases from Lessor, the Premises, for the term, at the rental, and upon all of the terms, covenants and conditions set forth in this Lease. Unless otherwise provided herein, any statement of size set forth in this Lease, or that may have been used in calculating Rent, is an approximation which the Parties agree is reasonable and any payments based thereon are not subject to revision whether or not the actual size is more or less. **Note: Lessee is advised to verify the actual size prior to executing this Lease.**

2.2 **Condition** Lessor shall deliver the Premises to Lessee in a clean condition on the Commencement Date or the Early Possession Date, whichever first occurs ("Start Date"), and warrants that the existing electrical, plumbing, fire sprinkler, lighting, heating, ventilating and air conditioning systems ("HVAC"), and all other items which the Lessor is obligated to construct pursuant to the Work Letter-First Addendum attached hereto, if any, other than those constructed by Lessee, shall be in good operating condition on said date.

2.3 **Compliance** To the best of Lessor's knowledge, Lessor warrants that the improvements comprising the Premises and the Common Areas comply with the building codes that were in effect at the time that each such improvement, or portion thereof, was constructed, and also with all applicable laws, covenants or restrictions of record, regulations, and ordinances ("Applicable Requirements") in effect on the Start Date for use of the Premises as general office space. Said warranty does not apply to the use to which Lessee will put the Premises, modifications which may be required by the Americans with Disabilities Act or any similar laws as a result of Lessee's particular use (see Paragraph 50), or to any Alterations or Utility Installations (as defined in Paragraph 7.3(a)) made or to be made by Lessee. **NOTE: Lessee is responsible for determining whether or not the zoning and other Applicable Requirements are appropriate for Lessee's intended use, and acknowledges that past uses of the Premises may no longer be allowed.** If the Premises do not comply with said warranty, Lessor shall, except as otherwise provided, promptly after receipt of written notice from Lessee setting forth with specificity the nature and extent of such non-compliance, rectify the same. In the event the Tenant Improvements set forth in the First Addendum to be constructed by Lessor trigger any Applicable Requirements, then the Tenant Improvements shall be altered so as to not trigger any Applicable Requirements. If the Applicable Requirements are hereafter changed so as to require during the term of this Lease the construction of an addition to or an alteration of the Premises, the remediation of any Hazardous Substance caused by Lessee, or the reinforcement or other physical modification of the Premises ("Capital Expenditure"), Lessor and Lessee shall allocate the cost of such work as follows:

(a) Subject to Paragraph 2.3(c) below, if such Capital Expenditures are required as a result of the specific and unique use of the Premises by Lessee as compared with uses by tenants in general, Lessee shall be fully responsible for the cost thereof, provided, however that if such Capital Expenditure is required during the last 2 years of this Lease and the cost thereof exceeds 8 months' Base Rent, Lessee may instead terminate this Lease unless Lessor notifies Lessee, in writing, within 10 days after receipt of Lessee's termination notice that Lessor has elected to pay the difference between the actual cost thereof and the amount equal to 6 months' Base Rent. If Lessee elects termination, Lessee shall immediately cease the use of the Premises which requires such Capital Expenditure and deliver to Lessor written notice specifying a termination date at least 90 days thereafter. Such termination date shall, however, in no event be earlier than the last day that Lessee could legally utilize the Premises without commencing such Capital Expenditure.

(b) If such Capital Expenditure is not the result of the specific and unique use of the Premises by Lessee (such as, governmentally mandated seismic modifications), then Lessor and Lessee shall allocate the cost of such Capital Expenditure as follows: Lessor shall advance the funds necessary for such Capital Expenditure but Lessee shall be obligated to pay, each month during the remainder of the term of this Lease, on the date on which Base Rent is due, an amount equal to the product of multiplying Lessee's share of the cost of such Capital Expenditure (the percentage specified in Paragraph 1.6 by a fraction, the numerator of which is one, and the denominator of which is 144 (i.e. 1/144th of the cost per month)). Lessee shall pay interest on the unamortized balance of Lessee's share at a rate that is commercially reasonable in the judgment of Lessor's accountants. Lessee may, however, prepay its obligation at any time. Provided, however, that if such Capital Expenditure is required during the last 2 years of this Lease or if Lessor reasonably determines that it is not economically feasible to pay its share thereof, Lessor shall have the option to terminate this Lease upon 90 days prior written notice to Lessee unless Lessee notifies Lessor, in writing, within 10 days after receipt of Lessor's termination notice that Lessee will pay for such Capital Expenditure. If Lessor does not elect to terminate, and fails to tender its share of any such Capital Expenditure, Lessee may advance such funds and deduct same, with interest, from Rent until Lessor's share of such costs have been fully paid. If Lessee is unable to finance Lessor's share, or if the balance of the Rent due and payable for the remainder of this Lease is not sufficient to fully reimburse Lessee on an offset basis, Lessee shall have the right to terminate this Lease upon 30 days written notice to Lessor.

(c) Notwithstanding the above, the provisions concerning Capital Expenditures are intended to apply only to nonvoluntary, unexpected, and new Applicable Requirements. If the Capital Expenditures are instead triggered by Lessee as a result of Lessee's particular use of the Premises as actual or proposed change in use, change in intensity of use, or modification to the Premises excluding the Tenant Improvements then, and in that event, Lessee shall be fully responsible for the cost thereof, and Lessee shall not have any right to terminate this Lease.

2.4 **Acknowledgements** Lessee acknowledges that: (a) Lessee has been advised by Lessor and/or Brokers to satisfy itself with respect to the condition of the Premises (including but not limited to the electrical, HVAC and fire sprinkler systems, security, environmental aspects, and compliance with Applicable Requirements), and their suitability for Lessee's intended use; (b) Lessee has made such investigation as it deems necessary with reference to such matters and assumes all responsibility therefor as the same relate to its occupancy of the Premises; and (c) neither Lessor, Lessor's agents, nor Brokers have made any oral or written representations or warranties with respect to said matters other than as set forth in this Lease. In addition, Lessor acknowledges that: (i) Brokers have made no representations, promises or warranties concerning Lessee's ability to honor the Lease or suitability to occupy the Premises; and (ii) it is Lessor's sole responsibility to investigate the financial capability and/or suitability of all proposed tenants.

2.5 **Lessee as Prior Owner/Occupant** The warranties made by Lessor in Paragraph 2 shall be of no force or effect if immediately prior to the Start Date, Lessee was the owner or occupant of the Premises. In such event, Lessee shall be responsible for any necessary corrective work.

2.6 **Vehicle Parking** So long as Lessee is not in default, and subject to the Rules and Regulations attached hereto, and as established by Lessor from time to time, Lessee shall be entitled to rent and use the number of parking spaces specified in Paragraph 1.2(b) at the rental rate applicable from time to time for monthly parking as set by Lessor and/or its Lessee.

(a) If Lessee commits, permits or allows any of the prohibited activities described in the Lease or the rules then in effect, then Lessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove or tow away the vehicle involved and charge the cost to Lessee, which cost shall be immediately payable upon demand by Lessor.

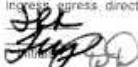
(b) The monthly rent per parking space specified in Paragraph 1.2(b) is subject to change upon 30 days prior written notice to Lessee. The rent for the parking is payable one month in advance prior to the first day of each calendar month.

2.7 **Common Areas - Definition** The term "Common Areas" is defined as all areas and facilities outside the Premises and within the exterior boundary line of the Project and interior utility roadways and installations within the Premises that are provided and designated by the Lessor from time to time for the general nonexclusive use of Lessor, Lessee and other tenants of the Project and their respective employees, suppliers, shippers, customers, contractors and invitees, including, but not limited to, common entrances, lobbies, corridors, stairwells, public restrooms, elevators, parking areas, loading and unloading areas, trash areas, roadways, walkways, driveways and landscaped areas.

2.8 **Common Areas - Lessee's Rights** Lessor grants to Lessee, for the benefit of Lessee and its employees, suppliers, shippers, contractors, customers and invitees, during the term of this Lease, the nonexclusive right to use, in common with others entitled to such use, the Common Areas as they exist from time to time, subject to any rights, powers, and privileges reserved by Lessor under the terms hereof or under the terms of any rules and regulations or restrictions governing the use of the Project. Under no circumstances shall the right herein granted to use the Common Areas be deemed to include the right to store any property, temporarily or permanently, in the Common Areas. Any such storage shall be permitted only by the prior written consent of Lessor or Lessor's designated agent, which consent may be revoked at any time. In the event that any unauthorized storage shall occur then Lessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove the property and charge the cost to Lessee, which cost shall be immediately payable upon demand by Lessor.

2.9 **Common Areas - Rules and Regulations** Lessor or such other person(s) as Lessor may appoint shall have the exclusive control and management of the Common Areas and shall have the right, from time to time, to adopt, modify, amend and enforce reasonable rules and regulations ("Rules and Regulations") for the management, safety, care, and cleanliness of the grounds, the parking and unloading of vehicles and the preservation of good order, as well as for the convenience of other occupants or tenants of the Building and the Project and their invitees. The Lessee agrees to abide by and conform to all such Rules and Regulations, and to cause its employees, suppliers, shippers, customers, contractors and invitees to so abide and conform. Lessor shall not be responsible to Lessee for the noncompliance with said Rules and Regulations by other tenants of the Project.

2.10 **Common Areas - Changes** Lessor shall have the right, in Lessor's sole discretion, from time to time:
 (a) To make changes to the Common Areas, including, without limitation, changes in the location, size, shape and number of the lobbies, windows, stairways, air shafts, elevators, escalators, restrooms, driveways, entrances, parking spaces, parking areas, loading and unloading areas, ingress, egress, direction of traffic, landscaped areas, walkways and utility roadways.




Initials:

(b) To close temporarily any of the Common Areas for maintenance purposes so long as reasonable access to the Premises remains available;

(c) To designate other land outside the boundaries of the Project to be a part of the Common Areas;

(d) To add additional buildings and improvements to the Common Areas;

(e) To use the Common Areas while engaged in making additional improvements, repairs or alterations to the Project, or any portion thereof; and

(f) To do and perform such other acts and make such other changes in, to or with respect to the Common Areas and Project as Lessor may, in the exercise of sound business judgment, deem to be appropriate provided Lessor does not unreasonably interfere with Lessee's use of the Premises or ingress and egress.

3. Term.

3.1 **Term.** The Commencement Date, Expiration Date and Original Term of this Lease are as specified in Paragraph 1.3.

3.2 **Early Possession.** If Lessee totally or partially occupies the Premises prior to the Commencement Date, the obligation to pay Base Rent shall be abated for the period of such early possession. All other terms of this Lease (including but not limited to the obligations to pay Lessee's Share of the Operating Expense Increase) shall, however, be in effect during such period. Any such early possession shall not affect the Expiration Date.

3.3 **Delay in Possession.** Lessor agrees to use its best commercially reasonable efforts to deliver possession of the Premises to Lessee by the Commencement Date. If, despite said efforts, Lessor is unable to deliver possession by such date, Lessor shall not be subject to any liability therefor, nor shall such failure affect the validity of this Lease. Lessee shall not, however, be obligated to pay Rent or perform its other obligations until Lessor delivers possession of the Premises and any period of rent abatement that Lessee would otherwise have enjoyed shall run from the date of delivery of possession and continue for a period equal to what Lessee would otherwise have enjoyed under the terms hereof, but minus any days of delay caused by the acts or omissions of Lessee. If possession is not delivered within 60 days after the Commencement Date, as the same may be extended under the terms of any Work Letter the First Addendum executed by Parties, Lessee may, at its option, by notice in writing within 10 days after the end of such 60 day period, cancel this Lease, in which event the Parties shall be discharged from all obligations hereunder. If such written notice is not received by Lessor within said 10 day period, Lessee's right to cancel shall terminate. If possession of the Premises is not delivered within 120 days after the Commencement Date, this Lease shall terminate unless other agreements are reached between Lessor and Lessee, in writing.

3.4 **Lessee Compliance.** Lessor shall not be required to deliver possession or early possession of the Premises to Lessee until Lessee complies with its obligation to provide evidence of insurance (Paragraph 8.5). Pending delivery of such evidence, Lessee shall be required to perform all of its obligations under this Lease from and after the Start Date, including the payment of Rent as defined in Paragraph 1.7 as of the Commencement Date, notwithstanding Lessor's election to withhold possession pending receipt of such evidence of insurance. Further, if Lessee is required to perform any other conditions prior to or concurrent with the Start Date, the Start Date shall occur but Lessor may elect to withhold possession until such conditions are satisfied.

4. Rent.

4.1 **Rent Defined.** All monetary obligations of Lessee to Lessor under the terms of this Lease (except for the Security Deposit) are deemed to be rent ("Rent").

4.2 **Operating Expense Increase.** N/A - See First Addendum, Article 2. Lessee shall pay to Lessor during the term hereof, in addition to the Base Rent, Lessee's Share of the amount by which all Operating Expenses for each Comparison Year exceeds the amount of all Operating Expenses for the Base Year, such excess being hereinafter referred to as the "Operating Expense Increase", in accordance with the following provisions:

(a) "Base Year" is as specified in Paragraph 1.9.

(b) "Comparison Year" is defined as each calendar year during the term of this Lease subsequent to the Base Year; provided, however, Lessee shall have no obligation to pay a share of the Operating Expense Increase applicable to the first 12 months of the Lease Term (other than such as are mandated by a governmental authority, as to which government mandated expenses Lessee shall pay Lessee's Share, notwithstanding they occur during the first twelve (12) months). Lessee's Share of the Operating Expense Increase for the first and last Comparison Years of the Lease Term shall be prorated according to that portion of such Comparison Year as to which Lessee is responsible for a share of such increase.

(c) "Operating Expenses" include all costs incurred by Lessor relating to the ownership and operation of the Project, calculated as if the Project was at least 95% occupied, including, but not limited to, the following:

(i) The operation, repair, and maintenance in neat, clean, safe, good order and condition, but not the replacement (see subparagraph (g)), of the following:

(aa) The Common Areas, including their surfaces, coverings, decorative items, carpets, drapes and window coverings, and including parking areas, loading and unloading areas, trash areas, roadways, sidewalks, walkways, stairways, parkways, driveways, landscaped areas, striping, bumpers, irrigation systems, Common Area lighting facilities, building exteriors and roofs, fences and gates;

(ab) All heating, air conditioning, plumbing, electrical systems, life safety equipment, communication systems and other equipment used in common by, or for the benefit of, lessees or occupants of the Project, including elevators and escalators; tenant directories; fire detection systems including sprinkler system maintenance and repair;

(ac) Any other service to be provided by Lessor that is elsewhere in this Lease stated to be an "Operating Expense";

(ad) The cost of the premiums for the insurance policies maintained by Lessor pursuant to paragraph 8 and any deductible portion of an insured loss concerning the Building or the Common Areas;

(ae) The amount of the Real Property Taxes payable by Lessor pursuant to paragraph 10;

(af) The cost of water, sewer, gas, electricity, and other publicly mandated services not separately metered;

(ag) Labor, salaries, and applicable fringe benefits and costs, materials, supplies and tools used in maintaining and/or cleaning the Project and accounting and management fees attributable to the operation of the Project;

(ah) The cost of any Capital Expenditure to the Building or the Project not covered under the provisions of Paragraph 2.3 provided, however, that Lessor shall allocate the cost of any such Capital Expenditure over a 12 year period and Lessee shall not be required to pay more than Lessee's Share of 1/144th of the cost of such Capital Expenditure in any given month;

(ai) Replacement of equipment or improvements that have a useful life for accounting purposes of 5 years or less;

(aj) Any item of Operating Expense that is specifically attributable to the Premises, the Building or to any other building in the Project or to the operation, repair and maintenance thereof, shall be allocated entirely to such Premises, Building, or other building. However, any such item that is not specifically attributable to the Building or to any other building or to the operation, repair and maintenance thereof, shall be equitably allocated by Lessor to all buildings in the Project.

(k) The inclusion of the improvements, facilities and services set forth in Subparagraph 4.2(c) shall not be deemed to impose an obligation upon Lessor to either have said improvements or facilities or to provide these services unless the Project already has the same. Lessor already provides the services, or Lessor has agreed elsewhere in this Lease to provide the same or come of them.

(l) Lessee's Share of Operating Expense Increase shall be payable by Lessee within 10 days after a reasonably detailed statement of actual expenses is presented to Lessee by Lessor. At Lessor's option, however, an amount may be estimated by Lessor from time to time in advance of Lessee's Share of the Operating Expense Increase for any Comparison Year, and the same shall be payable monthly during each Comparison Year of the Lease term, on the same day as the Base Rent is due hereunder. In the event that Lessee pays Lessor's estimate of Lessee's Share of Operating Expense Increase as aforesaid, Lessor shall deliver to Lessee within 60 days after the expiration of each Comparison Year a reasonably detailed statement showing Lessee's Share of the actual Operating Expense Increase incurred during such year. If Lessee's payments under this paragraph (l) during said Comparison Year exceed Lessee's Share as indicated on said statement, Lessee shall be entitled to credit the amount of such overpayment against Lessee's Share of Operating Expense Increase next falling due. If Lessee's payments under this paragraph during said Comparison Year were less than Lessee's Share as indicated on said statement, Lessee shall pay to Lessor the amount of the deficiency within 10 days after delivery by Lessor to Lessee of said statement. Lessor and Lessee shall forthwith adjust between them by cash payment any balance determined to exist with respect to that portion of the last Comparison Year for which Lessee is responsible as to Operating Expense Increases, notwithstanding that the Lease term may have terminated before the end of such Comparison Year.

(m) Operating Expenses shall not include the costs of replacement for equipment or capital components such as the roof, foundations, exterior walls or a Common Area capital improvement, such as the parking lot paving, elevators, fences that have a useful life for accounting purposes of 5 years or more unless it is of the type described in paragraph 4.2(c) (vi) in which case their cost shall be included as above provided.

(n) Operating Expenses shall not include any expense paid by any tenant directly to third parties, or as to which Lessor is otherwise reimbursed by any third party, other tenant, or by insurance proceeds.

4.3 **Payment.** Lessee shall cause payment of Rent to be received by Lessor in lawful money of the United States on or before the day on which it is due, without offset or deduction (except as specifically permitted in this Lease). Rent for any period during the term hereof which is for less than one full calendar month shall be prorated based upon the actual number of days of said month. Payment of Rent shall be made to Lessor at its address stated herein or to such other persons or place as Lessor may from time to time designate in writing. Acceptance of a payment which is less than the amount then due shall not be a waiver of Lessor's rights to the balance of such Rent, regardless of Lessor's endorsement of any check or stating, in the event that any check, draft, or other instrument of payment given by Lessee to Lessor is dishonored for any reason, Lessee agrees to pay to Lessor the sum of \$25 in addition to any Late Charge. Payments will be applied first to accrued late charges and attorney's fees, second to accrued interest, then to Base Rent and Operating Expense Increase, and any remaining amount to any other outstanding charges or costs.



© 1999 - American Industrial Real Estate Association

Page 3 of 13
REVISED



FORM OFG-1-9/99E

5. **Security Deposit.** Lessee shall deposit with Lessor upon execution hereof the Security Deposit as security for Lessee's faithful performance of its obligations under this Lease. If Lessee fails to pay Rent, or otherwise Defaults under this Lease, Lessor may use, apply or retain all or any portion of said Security Deposit for the payment of any amount due Lessor or to reimburse or compensate Lessor for any liability, expense, loss or damage which Lessor may suffer or incur by reason thereof. If Lessor uses or applies all or any portion of the Security Deposit, Lessee shall within 10 days after written request therefor, deposit monies with Lessor sufficient to restore said Security Deposit to the full amount required by this Lease. ~~If the Base Rent increases during the term of this Lease, Lessee shall, upon written request from Lessor, deposit additional moneys with Lessor so that the total amount of the Security Deposit shall at all times bear the same proportion to the increased Base Rent as the initial Security Deposit bore to the initial Base Rent.~~ Should the Agreed Use be amended to accommodate a material change in the business of Lessee or to accommodate a sublessee or assignee, Lessor shall have the right to increase the Security Deposit to the extent necessary, in Lessor's reasonable judgment, to account for any increased wear and tear that the Premises may suffer as a result thereof. If a change in control of Lessee occurs during this Lease and following such change the financial condition of Lessee is, in Lessor's reasonable judgment, significantly reduced, Lessee shall deposit such additional monies with Lessor as shall be sufficient to cause the Security Deposit to be at a commercially reasonable level based on such change in financial condition. Lessor shall not be required to keep the Security Deposit separate from its general accounts. Within 14 days after the expiration or termination of this Lease, if Lessor elects to apply the Security Deposit only to unpaid Rent, and otherwise within 30 days after the Premises have been vacated pursuant to Paragraph 7.4(c) below, Lessor shall return that portion of the Security Deposit not used or applied by Lessor. No part of the Security Deposit shall be considered to be held in trust, to bear interest or to be prepayment for any monies to be paid by Lessee under this Lease.

6. **Use.**

6.1 **Use.** Lessee shall use and occupy the Premises only for the Agreed Use, or any other legal use which is reasonably comparable thereto, and for no other purpose. Lessee shall not use or permit the use of the Premises in a manner that is unlawful, creates damage, waste or a nuisance, or that disturbs occupants or causes damage to neighboring premises or properties. Lessor shall not unreasonably withhold or delay its consent to any written request for a modification of the Agreed Use, so long as the same will not impair the structural integrity of the improvements of the Building, will not adversely affect the mechanical, electrical, HVAC, and other systems of the Building, and/or will not affect the exterior appearance of the Building. If Lessor elects to withhold consent, Lessor shall within 7 days after such request give written notification of same, which notice shall include an explanation of Lessor's objections to the change in the Agreed Use.

6.2 **Hazardous Substances**

(a) **Reportable Uses Require Consent.** The term "Hazardous Substance" as used in this Lease shall mean any product, substance, or waste whose presence, use, manufacture, disposal, transportation, or release, either by itself or in combination with other materials expected to be on the Premises, is either: (i) potentially injurious to the public health, safety or welfare, the environment or the Premises, (ii) regulated or monitored by any governmental authority, or (iii) a basis for potential liability of Lessor to any governmental agency or third party under any applicable statute or common law theory. Hazardous Substances shall include, but not be limited to, hydrocarbons, petroleum, gasoline, and/or crude oil or any products, byproducts or fractions thereof. Lessee shall not engage in any activity in or on the Premises which constitutes a Reportable Use of Hazardous Substances without the express prior written consent of Lessor and timely compliance (at Lessee's expense) with all Applicable Requirements. "Reportable Use" shall mean (i) the installation or use of any above or below ground storage tank, (ii) the generation, possession, storage, use, transportation, or disposal of a Hazardous Substance that requires a permit from, or with respect to which a report, notice, registration or business plan is required to be filed with, any governmental authority, and/or (iii) the presence at the Premises of a Hazardous Substance with respect to which any Applicable Requirements require that a notice be given to persons entering or occupying the Premises or neighboring properties. Notwithstanding the foregoing, Lessee may use any ordinary and customary materials reasonably required to be used in the normal course of the Agreed Use such as ordinary office supplies (copier toner, liquid paper, glue, etc.) and common household cleaning materials, so long as such use is in compliance with all Applicable Requirements, is not a Reportable Use, and does not expose the Premises or neighboring property to any meaningful risk of contamination or damage or expose Lessor to any liability therefor. In addition, Lessor may condition its consent to any Reportable Use upon receiving such additional assurances as Lessor reasonably deems necessary to protect itself, the public, the Premises and/or the environment against damage, contamination, injury and/or liability, including, but not limited to, the installation (and removal on or before Lease expiration or termination) of protective modifications (such as concrete encasements) and/or increasing the Security Deposit.

(b) **Duty to Inform Lessor.** If Lessee knows, or has reasonable cause to believe, that a Hazardous Substance has come to be located in, on, under or about the Premises, other than as previously consented to by Lessor, Lessee shall immediately give written notice of such fact to Lessor, and provide Lessor with a copy of any report, notice, claim or other documentation which it has concerning the presence of such Hazardous Substance.

(c) **Lessee Remediation.** Lessee shall not cause or permit any Hazardous Substance to be spilled or released in, on, under, or about the Premises (including through the plumbing or sanitary sewer system) and shall promptly, at Lessee's expense, comply with all Applicable Requirements and take all investigatory and/or remedial action reasonably recommended, whether or not formally ordered or required, for the cleanup of any contamination of, and for the maintenance, security and/or monitoring of the Premises or neighboring properties, that was caused or materially contributed to by Lessee, or pertaining to or involving any Hazardous Substance brought onto the Premises during the term of this Lease, by or for Lessee, or any third party.

(d) **Lessee Indemnification.** Lessee shall indemnify, defend and hold Lessor, its agents, employees, lenders and ground lessor, if any, harmless from and against any and all loss of rents and/or damages, liabilities, judgments, claims, expenses, penalties, and attorneys' and consultants' fees arising out of or involving any Hazardous Substance brought onto the Premises by or for Lessee, ~~or any third party (provided, however, that Lessee shall have no liability under this Lease with respect to underground migration of any Hazardous Substance under the Premises from areas outside of the Project not caused or contributed to by Lessee).~~ Lessee's obligations shall include, but not be limited to, the effects of any contamination or injury to person, property or the environment created or suffered by Lessee, and the cost of investigation, removal, remediation, restoration and/or abatement, and shall survive the expiration or termination of this Lease. No termination, cancellation or release agreement entered into by Lessor and Lessee shall release Lessee from its obligations under this Lease with respect to Hazardous Substances, unless specifically so agreed by Lessor in writing at the time of such agreement.


(e) **Lessor Indemnification.** Lessor and its successors and assigns shall indemnify, defend, reimburse and hold Lessee, its employees and lenders, harmless from and against any and all environmental damages, including the cost of remediation, which result from Hazardous Substances which existed on the Premises prior to Lessee's occupancy or which are caused by the gross negligence or willful misconduct of Lessor, its agents or employees. Lessor's obligations, as and when required by the Applicable Requirements, shall include, but not be limited to, the cost of investigation, removal, remediation, restoration and/or abatement, and shall survive the expiration or termination of this Lease.

(f) **Investigations and Remediations.** Lessor shall retain the responsibility and pay for any investigations or remediation measures required by governmental entities having jurisdiction with respect to the existence of Hazardous Substances on the Premises prior to Lessee's occupancy, ~~unless such remediation measure is required as a result of Lessee's use (including "Alterations," as defined in paragraph 7.2(a) below) of the Premises, in which event Lessee shall be responsible for such payment.~~ Lessee shall cooperate fully in any such activities at the request of Lessor, including allowing Lessor and Lessor's agents to have reasonable access to the Premises at reasonable times in order to carry out Lessor's investigative and remedial responsibilities. Lessee shall not be held responsible for any pre-existing Hazardous Material or any other Hazardous Material not caused by Lessee.

(g) **Lessor Termination Option.** If a Hazardous Substance Condition (see Paragraph 9.1(e)) occurs during the term of this Lease, unless Lessee is legally responsible under the terms of the Lease therefor (in which case Lessee shall make the investigation and remediation thereof required by the Applicable Requirements and this Lease shall continue in full force and effect, but subject to Lessor's rights under Paragraph 6.2(d) and Paragraph 13), Lessor may, at Lessor's option, either (i) investigate and remediate such Hazardous Substance Condition, if required, as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) if the estimated cost to remediate such condition exceeds 12 times the then monthly Base Rent or \$100,000, whichever is greater, give written notice to Lessee, within 30 days after receipt by Lessor of knowledge of the occurrence of such Hazardous Substance Condition, of Lessor's desire to terminate this Lease as of the date 60 days following the date of such notice. In the event Lessor elects to give a termination notice, Lessee may, within 10 days thereafter, give written notice to Lessor of Lessee's commitment to pay the amount by which the cost of the remediation of such Hazardous Substance Condition exceeds an amount equal to 12 times the then monthly Base Rent or \$100,000, whichever is greater. Lessee shall provide Lessor with said funds or satisfactory assurance thereof within 30 days following such commitment. In such event, this Lease shall continue in full force and effect, and Lessor shall proceed to make such remediation as soon as reasonably possible after the required funds are available. If Lessee does not give such notice and provide the required funds or assurance thereof within the time provided, this Lease shall terminate as of the date specified in Lessor's notice of termination.

6.3 **Lessee's Compliance with Applicable Requirements.** Except as otherwise provided in this Lease, Lessee shall, at Lessee's sole expense, fully, diligently and in a timely manner, materially comply with all Applicable Requirements arising during the Term of the Lease and due to Lessee's particular use, the requirements of any applicable fire insurance underwriter or rating bureau, and the recommendations of Lessor's engineers and/or consultants which relate in any manner to the Premises, ~~without regard to whether said requirements are now in effect or that become effective after the Start Date.~~ Lessee shall, within 10 days after receipt of Lessor's written request, provide Lessor with copies of all permits and other documents, and other information evidencing Lessee's compliance with any Applicable Requirements arising during the Term of the Lease and due to Lessee's particular use specified by Lessor, and shall immediately upon receipt, notify Lessor in writing (with copies of any documents involved) of any threatened or actual claim, notice, citation, warning, complaint or report pertaining to or involving the failure of Lessee or the Premises to comply with any such Applicable Requirements.

6.4 **Inspection; Compliance.** Lessor and Lessor's "Lender" (as defined in Paragraph 30) and consultants shall have the right to enter into Premises at any time, in the case of an emergency, and otherwise at reasonable times, for the purpose of inspecting the condition of the Premises and for




Initials

verifying compliance by Lessee with this Lease. The cost of any such inspections shall be paid by Lessor, unless a violation of Applicable Requirements, or a Hazardous Substance Condition (see paragraph 9.1e) is found to exist or be imminent, or the inspection is requested or ordered by a governmental authority. In such case, Lessee shall upon request reimburse Lessor for the cost of such inspection, so long as such inspection is reasonably related to the violation or contamination.

7. Maintenance; Repairs; Utility Installations; Trade Fixtures and Alterations.

7.1 Lessee's Obligations. Notwithstanding Lessor's obligation to keep the Premises in good condition and repair, Lessee shall be responsible for payment of the cost thereof to Lessor as additional rent for that portion of the cost of any maintenance and repair of the Premises, or any equipment (wherever located) that serves only Lessee or the Premises, to the extent such cost is attributable to causes beyond normal wear and tear. Lessee shall be responsible for the cost of painting, repairing or replacing wall coverings, and to repair or replace any improvements with the Premises. Lessor may, at its option, upon reasonable notice, elect to have Lessee perform any particular such maintenance or repairs the cost of which is otherwise Lessee's responsibility hereunder.

7.2 Lessor's Obligations. Subject to the provisions of Paragraphs 2.2 (Condition), 2.3 (Compliance), 4.2 (Operating Expenses), 6 (Use), 7.1 (Lessee's Obligations), 9 (Damage or Destruction) and 14 (Condemnation), Lessor, subject to reimbursement pursuant to Paragraph 4.2, shall keep in good order, condition and repair the foundations, exterior walls, structural condition of interior bearing walls, exterior roof, fire sprinkler system, fire alarm and/or smoke detection systems, fire hydrants, and the Common Areas. Lessee expressly waives the benefit of any statute now or hereafter in effect to the extent it is inconsistent with the terms of this Lease.

7.3 Utility Installations; Trade Fixtures; Alterations.

(a) Definitions. The term "Utility Installations" refers to all floor and window coverings, air lines, vacuum lines, power panels, electrical distribution, security and fire protection systems, communication cabling, lighting fixtures, HVAC equipment, and plumbing in or on the Premises. The term "Trade Fixtures" shall mean Lessee's machinery and equipment that can be removed without doing material damage to the Premises. The term "Alterations" shall mean any modification of the improvements, other than Utility Installations or Trade Fixtures, whether by addition or deletion. "Lessee Owned Alterations and/or Utility Installations" are defined as Alterations and/or Utility Installations made by Lessee that are not yet owned by Lessor pursuant to Paragraph 7.4(a).

(b) Consent. Lessee shall not make any Alterations or Utility Installations to the Premises without Lessor's prior written consent. Lessee may, however, make non-structural Utility Installations to the interior of the Premises (excluding the roof) without such consent but upon notice to Lessor, as long as they are not visible from the outside, do not involve puncturing, relocating or removing the roof, ceilings, floors or any existing walls, and do not affect the electrical, plumbing, HVAC, and/or life safety systems; and the cumulative cost thereof during this Lease as extended does not exceed \$2000. Notwithstanding the foregoing, Lessee shall not make or permit any roof penetrations and/or install anything on the roof without the prior written approval of Lessor. Lessor may, as a precondition to granting such approval, require Lessee to utilize a contractor chosen and/or approved by Lessor. Any Alterations or Utility Installations that Lessee shall desire to make and which require the consent of the Lessor shall be presented to Lessor in written form with detailed plans. Consent shall be deemed conditioned upon Lessee's: (i) acquiring all applicable governmental permits, (ii) furnishing Lessor with copies of both the permits and the plans and specifications prior to commencement of the work, and (iii) compliance with all conditions of said permits and other Applicable Requirements in a prompt and expeditious manner. Any Alterations or Utility Installations shall be performed in a workmanlike manner with good and sufficient materials. Lessee shall promptly upon completion furnish Lessor with as-built plans and specifications. For work which costs an amount in excess of one month's Base Rent, Lessor may condition its consent upon Lessee providing a lien and completion bond in an amount equal to 150% of the estimated cost of such Alteration or Utility Installation and/or upon Lessee's posting an additional Security Deposit with Lessor.

(c) Liens; Bonds. Lessee shall pay, when due, all claims for labor or materials furnished or alleged to have been furnished to or for Lessee at or for use on the Premises, which claims are or may be secured by any mechanic's or materialman's lien against the Premises or any interest therein. Lessee shall give Lessor not less than 10 days notice prior to the commencement of any work in, on or about the Premises, and Lessor shall have the right to post notices of non-responsibility. If Lessee shall contest the validity of any such lien, claim or demand, then Lessee shall, at its sole expense defend and protect itself, Lessor and the Premises against the same and shall pay and satisfy any such adverse judgment that may be rendered thereon before the enforcement thereof. If Lessor shall require, Lessee shall furnish a surety bond in an amount equal to 150% of the amount of such contested lien, claim or demand, indemnifying Lessor against liability for the same. If Lessor elects to participate in any such action, Lessee shall pay Lessor's attorneys' fees and costs.

7.4 Ownership; Removal; Surrender; and Restoration.

(a) Ownership. Subject to Lessor's right to require removal or elect ownership as hereinafter provided, all Alterations and Utility Installations made by Lessee shall be the property of Lessee, but considered a part of the Premises. Lessor may, at any time, elect in writing to be the owner of all or any specified part of the Lessee Owned Alterations and Utility Installations. Unless otherwise instructed per paragraph 7.4(b) hereof, all Lessee Owned Alterations and Utility Installations shall, at the expiration or termination of this Lease, become the property of Lessor and be surrendered by Lessee with the Premises.

(b) Removal. By delivery to Lessee of written notice from Lessor not earlier than 90 and not later than 30 days prior to the end of the term of this Lease, Lessor may require that any or all Lessee Owned Alterations or Utility Installations be removed by the expiration or termination of this Lease. Lessor may require the removal at any time of all or any part of any Lessee Owned Alterations or Utility Installations made without the required consent.

(c) Surrender; Restoration. Lessee shall surrender the Premises by the Expiration Date or any earlier termination date, with all of the improvements, parts and surfaces thereof clean and free of debris, and in good operating order, condition and state of repair, ordinary wear and tear excepted. "Ordinary wear and tear" shall not include any damage or deterioration that would have been prevented by good maintenance practice. Notwithstanding the foregoing, if this Lease is for 12 months or less, then Lessee shall surrender the Premises in the same condition as delivered to Lessee on the Start Date with NO allowance for ordinary wear and tear. Lessee shall repair any damage occasioned by the installation, maintenance or removal of Trade Fixtures, Lessee owned Alterations and/or Utility Installations, furnishings, and equipment as well as the removal of any storage tank installed by or for Lessee. Lessee shall also completely remove from the Premises any and all Hazardous Substances brought onto the Premises by or for Lessee --~~as any third-party except Hazardous Substances which were deposited via underground migration from areas outside of the Project~~ even if such removal would require Lessee to perform or pay for work that exceeds statutory requirements. Trade Fixtures shall remain the property of Lessee and shall be removed by Lessee. The failure by Lessee to timely vacate the Premises pursuant to this Paragraph 7.4(c) without the express written consent of Lessor shall constitute a holdover under the provisions of Paragraph 26 below.

8. Insurance; Indemnity.

8.1 Insurance Premiums. The cost of the premiums for the insurance policies maintained by Lessor pursuant to paragraph 8 are included as Operating Expenses (see paragraph 4.2 (c)(vi)). Said costs shall include increases in the premiums resulting from additional coverage related to requirements of the holder of a mortgage or deed of trust covering the Premises, Building and/or Project, increased valuation of the Premises, Building and/or Project, and/or a general premium rate increase. Said costs shall not, however, include any premium increases resulting from the nature of the occupancy of any other tenant of the Building. If the Project was not insured for the entirety of the Base Year, then the base premium shall be the lowest annual premium reasonably obtainable for the required insurance as of the Start Date, assuming the most nominal use possible of the Building and/or Project. In no event, however, shall Lessee be responsible for any portion of the premium cost attributable to liability insurance coverage in excess of \$2,000,000 procured under Paragraph 8.2(b).

8.2 Liability Insurance.

(a) Carried by Lessee. Lessee shall obtain and keep in force a Commercial General Liability policy of insurance protecting Lessee and Lessor as an additional insured against claims for bodily injury, personal injury and property damage based upon or arising out of the ownership, use, occupancy or maintenance of the Premises and all areas appurtenant thereto. Such insurance shall be on an occurrence basis providing single limit coverage in an amount not less than \$1,000,000 per occurrence with an annual aggregate of not less than \$2,000,000, an "Additional Insured-Managers or Lessors of Premises Endorsement" and contain the "Amendment of the Pollution Exclusion Endorsement" for damage caused by heat, smoke or fumes from a hostile fire. The policy shall not contain any intra-insured exclusions as between insured persons or organizations, but shall include coverage for liability assumed under this Lease as an "insured contract" for the performance of Lessee's indemnity obligations under this Lease. The limits of said insurance shall not, however, limit the liability of Lessee nor relieve Lessee of any obligation hereunder. All insurance carried by Lessee shall be primary to and not contributory with any similar insurance carried by Lessor, whose insurance shall be considered excess insurance only.

(b) Carried by Lessor. Lessor shall maintain liability insurance as described in Paragraph 8.2(a), in addition to, and not in lieu of, the insurance required to be maintained by Lessee. Lessee shall not be named as an additional insured therein.

8.3 Property Insurance - Building, Improvements and Rental Value.

(a) Building and Improvements. Lessor shall obtain and keep in force a policy or policies of insurance in the name of Lessor, with loss payable to Lessor, any ground-lessor, and to any Lender insuring loss or damage to the Building and/or Project. The amount of such insurance shall be equal to the full replacement cost of the Building and/or Project, as the same shall exist from time to time, or the amount required by any Lender, but in no event more than the commercially reasonable and available insurable value thereof. Lessee Owned Alterations and Utility Installations, Trade Fixtures, and Lessee's personal property shall be insured by Lessee under Paragraph 8.4. If the coverage is available and commercially appropriate, such policy or policies shall insure against all risks of direct physical loss or damage (except the perils of flood and/or earthquake unless required by a Lender), including coverage for debris removal and the enforcement of any Applicable Requirements requiring the upgrading, demolition, reconstruction or replacement of any portion of the Premises as the result of a covered loss. Said policy or policies shall also contain an agreed valuation provision in lieu of any insurance clause, waiver of subrogation, and inflation guard protection causing an increase in the annual property insurance coverage amount by a factor of not less than the adjusted U.S. Department of Labor Consumer Price Index for All Urban Consumers for the city nearest to where the Premises are located. If such

insurance coverage has a deductible clause, the deductible amount shall not exceed \$1,000 per occurrence.

(b) **Rental Value.** Lessor shall also obtain and keep in force a policy or policies in the name of Lessor with loss payable to Lessor and any Lender, insuring the loss of the full Rent for one year with an extended period of indemnity for an additional 180 days ("Rental Value Insurance"). Said insurance shall contain an agreed valuation provision in lieu of any coinsurance clause, and the amount of coverage shall be adjusted annually to reflect the projected Rent otherwise payable by Lessee, for the next 12 month period.

(c) **Adjacent Premises.** Lessee shall pay for any increase in the premiums for the property insurance of the Building and for the Common Areas or other buildings in the Project if said increase is caused by Lessee's acts, omissions, use or occupancy of the Premises.

(d) **Lessee's Improvements.** Since Lessor is the Insuring Party, Lessor shall not be required to insure Lessee Owned Alterations and Utility Installations unless the item in question has become the property of Lessor under the terms of this Lease.

8.4 Lessee's Property; Business Interruption Insurance

(a) **Property Damage.** Lessee shall obtain and maintain insurance coverage on all of Lessee's personal property, Trade Fixtures, and Lessee Owned Alterations and Utility Installations. Such insurance shall be full replacement cost coverage with a deductible of not to exceed \$1,000 per occurrence. The proceeds from any such insurance shall be used by Lessee for the replacement of personal property, Trade Fixtures and Lessee Owned Alterations and Utility Installations. Lessee shall provide Lessor with written evidence that such insurance is in force.

(b) **Business Interruption.** ~~Lessee shall obtain and maintain loss-of-income and extra expense insurance in amounts as will reimburse Lessee for direct or indirect loss of earnings attributable to all perils commonly insured against by prudent lessees in the business of Lessee or attributable to prevention of access to the Premises as a result of such perils. Lessee does not carry.~~

(c) **No Representation of Adequate Coverage.** Lessor makes no representation that the limits or forms of coverage of insurance specified herein are adequate to cover Lessee's property, business operations or obligations under this Lease.

8.5 **Insurance Policies.** Insurance required herein shall be by companies duly licensed or admitted to transact business in the state where the Premises are located, and maintaining during the policy term a "General Policyholders Rating" of at least B+. V, as set forth in the most current issue of "Best's Insurance Guide", or such other rating as may be required by a Lender. Lessee shall not do or permit to be done anything which invalidates the required insurance policies. Lessee shall, prior to the Start Date, deliver to Lessor certified copies of policies of such insurance or certificates evidencing the existence and amounts of the required insurance. No such policy shall be cancelable or subject to modification except after 30 days prior written notice to Lessor. Lessee shall, at least 30 days prior to the expiration of such policies, furnish Lessor with evidence of renewals or "insurance binders" evidencing renewal thereof, or Lessor may order such insurance and charge the cost thereof to Lessee, which amount shall be payable by Lessee to Lessor upon demand. Such policies shall be for a term of at least one year, or the length of the remaining term of this Lease, whichever is less. If either Party shall fail to procure and maintain the insurance required to be carried by it, the other Party may, but shall not be required to, procure and maintain the same.

8.6 **Waiver of Subrogation.** Without affecting any other rights or remedies, Lessee and Lessor each hereby release and relieve the other, and waive their entire right to recover damages against the other, for loss of or damage to its property arising out of or incident to the perils required to be insured against herein. The effect of such releases and waivers is not limited by the amount of insurance carried or required, or by any deductibles applicable hereto. The Parties agree to have their respective property damage insurance carriers waive any right to subrogation that such companies may have against Lessor or Lessee, as the case may be, so long as the insurance is not invalidated thereby.

8.7 **Indemnity.** Except for Lessor's gross negligence or willful misconduct, Lessee shall indemnify, protect, defend and hold harmless the Premises, Lessor and its agents, Lessor's master or ground lessor, partners and Lenders, from and against any and all claims, loss of rents and/or damages, liens, judgments, penalties, attorneys' fees, expenses and/or liabilities arising out of, involving, or in connection with, the use and/or occupancy of the Premises by Lessee. If any action or proceeding is brought against Lessor by reason of any of the foregoing matters, Lessee shall upon notice defend the same at Lessee's expense by counsel reasonably satisfactory to Lessor and Lessor shall cooperate with Lessee in such defense. Lessor need not have first paid any such claim in order to be defended or indemnified.

8.8 **Exemption of Lessor from Liability.** Unless caused by Lessor gross negligence or willful misconduct, Lessor shall not be liable for injury or damage to the person or goods, wares, merchandise or other property of Lessee, Lessee's employees, contractors, invitees, customers, or any other person in or about the Premises, whether such damage or injury is caused by or results from fire, steam, electricity, gas, water or rain, or from the breakage, leakage, obstruction or other defects of pipes, fire sprinklers, wires, appliances, plumbing, HVAC or lighting fixtures, or from any other cause, whether the said injury or damage results from conditions arising upon the Premises or upon other portions of the Building, or from other sources or places. Lessor shall not be liable for any damages arising from any act or neglect of any other tenant of Lessor nor from the failure of Lessor to enforce the provisions of any other lease in the Project. Notwithstanding Lessor's negligence or breach of this Lease, Lessor shall under no circumstances be liable for injury to Lessee's business or for any loss of income or profit therefrom.

9. Damage or Destruction.

9.1 Definitions.

(a) **"Premises Partial Damage"** shall mean damage or destruction to the improvements on the Premises, other than Lessee Owned Alterations and Utility Installations, which can reasonably be repaired in 3 months or less from the date of the damage or destruction, and the cost thereof does not exceed a sum equal to 6 month's Base Rent. Lessor shall notify Lessee in writing within 30 days from the date of the damage or destruction as to whether or not the damage is Partial or Total.

(b) **"Premises Total Destruction"** shall mean damage or destruction to the improvements on the Premises, other than Lessee Owned Alterations and Utility Installations and Trade Fixtures, which cannot reasonably be repaired in 3 months or less from the date of the damage or destruction and/or the cost thereof exceeds a sum equal to 6 month's Base Rent. Lessor shall notify Lessee in writing within 30 days from the date of the damage or destruction as to whether or not the damage is Partial or Total.

(c) **"Insured Loss"** shall mean damage or destruction to improvements on the Premises, other than Lessee Owned Alterations and Utility Installations and Trade Fixtures, which was caused by an event required to be covered by the insurance described in Paragraph 8.3(a), irrespective of any deductible amounts or coverage limits involved.

(d) **"Replacement Cost"** shall mean the cost to repair or rebuild the improvements owned by Lessor at the time of the occurrence to their condition existing immediately prior thereto, including demolition, debris removal and upgrading required by the operation of Applicable Requirements, and without deduction for depreciation.

(e) **"Hazardous Substance Condition"** shall mean the occurrence or discovery of a condition involving the presence of, or a contamination by, a Hazardous Substance as defined in Paragraph 6.2(a), in, on, or under the Premises which requires repair, remediation, or restoration.

9.2 **Partial Damage - Insured Loss.** If a Premises Partial Damage that is an Insured Loss occurs, then Lessor shall, at Lessor's expense, repair such damage (but not Lessee's Trade Fixtures or Lessee Owned Alterations and Utility Installations) as soon as reasonably possible and this Lease shall continue in full force and effect; provided, however, that Lessee shall, at Lessor's election, make the repair of any damage or destruction the total cost to repair of which is \$5,000 or less, and, in such event, Lessor shall make any applicable insurance proceeds available to Lessee on a reasonable basis for that purpose. Notwithstanding the foregoing, if the required insurance was not in force or the insurance proceeds are not sufficient to effect such repair, the Insuring Party shall promptly contribute the shortage in proceeds as and when required to complete said repairs. In the event, however, such shortage was due to the fact that, by reason of the unique nature of the improvements, full replacement cost insurance coverage was not commercially reasonable and available, Lessor shall have no obligation to pay for the shortage in insurance proceeds or to fully restore the unique aspects of the Premises unless Lessee provides Lessor with the funds to cover same, or adequate assurance thereof, within 10 days following receipt of written notice of such shortage and request therefor. If Lessor receives said funds or adequate assurance thereof within said 10 day period, the party responsible for making the repairs shall complete them as soon as reasonably possible and this Lease shall remain in full force and effect. If such funds or assurance are not received, Lessor may nevertheless elect by written notice to Lessee within 10 days thereafter to: (i) make such restoration and repair as is commercially reasonable with Lessor paying any shortage in proceeds, in which case this Lease shall remain in full force and effect, or (ii) have this Lease terminate 30 days thereafter. Lessee shall not be entitled to reimbursement of any funds contributed by Lessee to repair any such damage or destruction. Premises Partial Damage due to flood or earthquake shall be subject to Paragraph 9.3, notwithstanding that there may be some insurance coverage, but the net proceeds of any such insurance shall be made available for the repairs if made by either Party.

9.3 **Partial Damage - Uninsured Loss.** If a Premises Partial Damage that is not an Insured Loss occurs, unless caused by a negligent or willful act of Lessee (in which event Lessee shall make the repairs at Lessee's expense), Lessor may either: (i) repair such damage as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) terminate this Lease by giving written notice to Lessee within 30 days after receipt by Lessor of knowledge of the occurrence of such damage. Such termination shall be effective 60 days following the date of such notice. In the event Lessor elects to terminate this Lease, Lessee shall have the right within 10 days after receipt of the termination notice to give written notice to Lessor of Lessee's commitment to pay for the repair of such damage without reimbursement from Lessor. Lessee shall provide Lessor with said funds or satisfactory assurance thereof within 30 days after making such commitment. In such event this Lease shall continue in full force and effect, and Lessor shall proceed to make such repairs as soon as reasonably possible after the required funds are available. If Lessee does not make the required commitment, this Lease shall terminate as of the date specified in the termination notice.

9.4 **Total Destruction.** Notwithstanding any other provision hereof, if a Premises Total Destruction occurs, this Lease shall terminate 60 days following such Destruction. If the damage or destruction was caused by the gross negligence or willful misconduct of Lessee, Lessor shall have the right to recover Lessor's damages from Lessee, except as provided in Paragraph 8.6.

9.5 **Damage Near End of Term.** If at any time during the last 6 months of this Lease there is damage for which the cost to repair exceeds one month's Base Rent, whether or not an Insured Loss, Lessor may terminate this Lease effective 60 days following the date of occurrence of such damage by giving a written termination notice to Lessee within 30 days after the date of occurrence of such damage. Notwithstanding the foregoing, Lessee at that





time has an exercisable option to extend this Lease or to purchase the Premises, then Lessee may preserve this Lease by, (a) exercising such option and (b) providing Lessor with any shortage in insurance proceeds (or adequate assurance thereof) needed to make the repairs on or before the earlier of (i) the date which is 10 days after Lessee's receipt of Lessor's written notice purporting to terminate this Lease, or (ii) the day prior to the date upon which such option expires. If Lessee duly exercises such option during such period and provides Lessor with funds (or adequate assurance thereof) to cover any shortage in insurance proceeds, Lessor shall, at Lessor's commercially reasonable expense, repair such damage as soon as reasonably possible and this Lease shall continue in full force and effect. If Lessee fails to exercise such option and provide such funds or assurance during such period, then this Lease shall terminate on the date specified in the termination notice and Lessee's option shall be extinguished.

9.6 Abatement of Rent; Lessee's Remedies.

(a) **Abatement.** In the event of Premises Partial Damage or Premises Total Destruction or a Hazardous Substance Condition for which Lessee is not responsible under this Lease, the Rent payable by Lessee for the period required for the repair, remediation or restoration of such damage shall be abated in proportion to the degree to which Lessee's use of the Premises is impaired, ~~but not to exceed the proceeds received from the Rental-Value insurance.~~ All other obligations of Lessee hereunder shall be performed by Lessee, and Lessor shall have no liability for any such damage, destruction, remediation, repair or restoration except as provided herein.

(b) **Remedies.** If Lessor shall be obligated to repair or restore the Premises and does not commence, in a substantial and meaningful way, such repair or restoration within 90 days after such obligation shall accrue, Lessee may, at any time prior to the commencement of such repair or restoration, give written notice to Lessor and to any Lenders of which Lessee has actual notice, of Lessee's election to terminate this Lease on a date not less than 60 days following the giving of such notice. If Lessee gives such notice and such repair or restoration is not commenced within 30 days thereafter, this Lease shall terminate as of the date specified in said notice. If the repair or restoration is commenced within such 30 days, this Lease shall continue in full force and effect. "Commence" shall mean either the unconditional authorization of the preparation of the required plans, or the beginning of the actual work on the Premises, whichever first occurs.

9.7 **Termination; Advance Payments.** Upon termination of this Lease pursuant to Paragraph 6.2(g) or Paragraph 9, an equitable adjustment shall be made concerning advance Base Rent and any other advance payments made by Lessee to Lessor. Lessor shall, in addition, return to Lessee so much of Lessee's Security Deposit as has not been, or is not then required to be, used by Lessor.

9.8 **Waive Statutes.** Lessor and Lessee agree that the terms of this Lease shall govern the effect of any damage to or destruction of the Premises with respect to the termination of this Lease and hereby waive the provisions of any present or future statute to the extent inconsistent herewith.

10. Real Property Taxes

10.1 **Definitions.** As used herein, the term "Real Property Taxes" shall include any form of assessment, real estate, general, special, ordinary or extraordinary, or rental levy or tax (other than inheritance, personal income or estate taxes), improvement bond, and/or license fee imposed upon or levied against any legal or equitable interest of Lessor in the Project, Lessor's right to other income therefrom, and/or Lessor's business of leasing, by any authority having the direct or indirect power to tax and where the funds are generated with reference to the Project address and where the proceeds so generated are to be applied by the city, county or other local taxing authority of a jurisdiction within which the Project is located. "Real Property Taxes" shall also include any tax, fee, levy, assessment or charge, or any increase therein, imposed by reason of events occurring during the term of this Lease, including but not limited to, a change in the ownership of the Project or any portion thereof or a change in the improvements thereon.

10.2 **Payment of Taxes.** Except as otherwise provided in Paragraph 10.3, Lessor shall pay the Real Property Taxes applicable to the Project, and said payments shall be included in the calculation of Operating Expenses in accordance with the provisions of Paragraph 4.2.

10.3 **Additional Improvements.** Operating Expenses shall not include Real Property Taxes specified in the tax assessor's records and work sheets as being caused by additional improvements placed upon the Project by other lessees or by Lessor for the exclusive enjoyment of such other lessees. Notwithstanding Paragraph 10.2 hereof, however, pay to Lessor at the time Operating Expenses are payable under Paragraph 4.2, the entirety of any increase in Real Property Taxes if assessed solely by reason of Alterations, Trade Fixtures or Utility Installations placed upon the Premises by Lessee or at Lessee's request.

10.4 **Joint Assessment.** If the Building is not separately assessed, Real Property Taxes allocated to the Building shall be an equitable proportion of the Real Property Taxes for all of the land and improvements included within the tax parcel assessed, such proportion to be determined by Lessor from the respective valuations assigned in the assessor's work sheets or such other information as may be reasonably available. Lessor's reasonable determination thereof, in good faith, shall be conclusive.

10.5 **Personal Property Taxes.** Lessee shall pay prior to delinquency all taxes assessed against and levied upon Lessee Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all personal property of Lessee contained in the Premises. When possible, Lessee shall cause its Lessee Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all other personal property to be assessed and billed separately from the real property of Lessor. If any of Lessee's said property shall be assessed with Lessor's real property, Lessee shall pay Lessor the taxes attributable to Lessee's property within 10 days after receipt of a written statement setting forth the taxes applicable to Lessee's property.

11. Utilities and Services

11.1 **Services Provided by Lessor.** Lessor shall provide heating, ventilation, air conditioning, reasonable amounts of electricity for normal lighting and office machines, water for reasonable and normal drinking and lavatory use in connection with an office, and replacement light bulbs and/or fluorescent tubes and ballasts for standard overhead fixtures. Lessor shall also provide janitorial services to the Premises and Common Areas 5 times per week, excluding Building Holidays, or pursuant to the attached janitorial schedule, if any. Lessor shall not, however, be required to provide janitorial services to kitchens or storage areas included within the Premises.

11.2 **Services Exclusive to Lessee.** Lessee shall pay for all water, gas, heat, light, power, telephone and other utilities and services specially or exclusively supplied and/or metered exclusively to the Premises or to Lessee, together with any taxes thereon. If a service is deleted by Paragraph 11.3 and such service is not separately metered to the Premises, Lessee shall pay at Lessor's option, either Lessee's share or a reasonable proportion to be determined by Lessor of all charges for such jointly metered service. Lessor shall not charge for after-hour HVAC during the lease term or any extension thereof.

11.3 **Hours of Service.** Said services and utilities shall be provided during times set forth in Paragraph 11.2. Utilities and services required at other times shall be subject to advance request and reimbursement by Lessee to Lessor of the cost thereof.

11.4 **Excess Usage by Lessee.** Lessee shall not make connection to the utilities except by or through existing outlets and shall not install or use machinery or equipment in or about the Premises that uses excess water, lighting or power, or suffer or permit any act that causes extra burden upon the utilities or services, including but not limited to security and trash services, over standard office usage for the Project. Lessor shall require Lessee to reimburse Lessor for any excess expenses or costs that may arise out of a breach of this subparagraph by Lessee. Lessor may, in its sole discretion, install at Lessee's expense supplemental equipment and/or separate metering applicable to Lessee's excess usage or loading.

11.5 **Interruptions.** There shall be no abatement of rent and Lessor shall not be liable in any respect whatsoever for the inadequacy, stoppage, interruption or discontinuance of any utility or service due to riot, strike, labor dispute, breakdown, accident, repair or other cause beyond Lessor's reasonable control or in cooperation with governmental request or directions.

12. Assignment and Subletting

12.1 Lessor's Consent Required.

(a) Lessee shall not voluntarily or by operation of law assign, transfer, mortgage or encumber (collectively, "assign or assignment") or sublet all or any part of Lessee's interest in this Lease or in the Premises without Lessor's prior written consent.

(b) Unless Lessee is a corporation and its stock is publicly traded on a national stock exchange, a change in the control of Lessee shall constitute an assignment requiring consent. The transfer, ~~on a cumulative basis, as a singular event, of 25% 50% or more of the voting control of Lessee~~ shall constitute a change in control for this purpose.

(c) The involvement of Lessee or its assets in any transaction, or series of transactions (by way of merger, sale, acquisition, financing, transfer, leveraged buyout or otherwise), whether or not a formal assignment or hypothecation of this Lease or Lessee's assets occurs, which results or will result in a reduction of the Net Worth of Lessee by an amount greater than 25% of such Net Worth as it was represented at the time of the execution of this Lease or at the time of the most recent assignment to which Lessor has consented, or as it exists immediately prior to said transaction or transactions constituting such reduction, whichever was or is greater, shall be considered an assignment of this Lease to which Lessor may withhold its consent. "Net Worth of Lessee" shall mean the net worth of Lessee (excluding any guarantors) established under generally accepted accounting principles.

(d) An assignment or subletting without consent shall, at Lessor's option, be a Default curable after notice per Paragraph 13.1(c), or a noncurable Breach without the necessity of any notice and grace period. If Lessor elects to treat such unapproved assignment or subletting as a noncurable Breach, Lessor may either: (i) terminate this Lease, or (ii) upon 30 days written notice, increase the monthly Base Rent to 110% of the Base Rent then in effect. Further, in the event of such Breach and rental adjustment, (i) the purchase price of any option to purchase the Premises held by Lessee shall be subject to similar adjustment to 110% of the price previously in effect, and (ii) all fixed and non-fixed rental adjustments scheduled during the remainder of the Lease term shall be increased to 110% of the scheduled adjusted rent.

(e) Lessee's remedy for any breach of Paragraph 12.1 by Lessor shall be limited to compensatory damages and/or injunctive relief.

12.2 Terms and Conditions Applicable to Assignment and Subletting.

(a) Regardless of Lessor's consent, no assignment or subletting shall: (i) be effective without the express written assumption by such assignee or sublessee of the obligations of Lessee under this Lease, (ii) release Lessee of any obligations hereunder, or (iii) alter the primary liability of Lessee for the payment of Rent or for the performance of any other obligations to be performed by Lessee.

(b) Lessor may accept Rent or performance of Lessee's obligations from any person other than Lessee pending approval or disapproval of an assignment. Neither a delay in the approval or disapproval of such assignment nor the acceptance of Rent or performance shall constitute a waiver or

estoppel of Lessor's right to exercise its remedies for Lessee's Default or Breach.

(c) Lessor's consent to any assignment or subletting shall not constitute a consent to any subsequent assignment or subletting.

(d) In the event of any Default or Breach by Lessee, Lessor may proceed directly against Lessee, any Guarantors or anyone else responsible for the performance of Lessee's obligations under this Lease, including any assignee or sublessee, without first exhausting Lessor's remedies against any other person or entity responsible therefore to Lessor, or any security held by Lessor.

(e) Each request for consent to an assignment or subletting shall be in writing, accompanied by information relevant to Lessor's determination as to the financial and operational responsibility and appropriateness of the proposed assignee or sublessee, including but not limited to the intended use and/or required modification of the Premises, if any. Lessee agrees to provide Lessor with such other or additional information and/or documentation as may be reasonably requested. (See also Paragraph 36.)

(f) Any assignee of, or sublessee under, this Lease shall, by reason of accepting such assignment or entering into such sublease, be deemed to have assumed and agreed to conform and comply with each and every term, covenant, condition and obligation herein to be observed or performed by Lessee during the term of said assignment or sublease, other than such obligations as are contrary to or inconsistent with provisions of an assignment or sublease to which Lessor has specifically consented to in writing.

(g) Lessor's consent to any assignment or subletting shall not transfer to the assignee or sublessee any Option granted to the original Lessee by this Lease unless such transfer is specifically consented to by Lessor in writing. (See Paragraph 39.2.)

12.3 **Additional Terms and Conditions Applicable to Subletting.** The following terms and conditions shall apply to any subletting by Lessee of all or any part of the Premises and shall be deemed included in all subleases under this Lease whether or not expressly incorporated therein:

(a) As further defined in First Addendum, Article 8, Lessee hereby assigns and transfers to Lessor all of Lessee's interest in all Rent payable on any sublease, and Lessor may collect such Rent and apply same toward Lessee's obligations under this Lease; provided, however, that until a Breach shall occur in the performance of Lessee's obligations, Lessee may collect said Rent and share Rent with Lessor as defined in First Addendum. Lessor shall not, by reason of the foregoing or any assignment of such sublease, nor by reason of the collection of Rent, be deemed liable to the sublessee for any failure of Lessee to perform and comply with any of Lessee's obligations to such sublessee. Lessee hereby irrevocably authorizes and directs any such sublessee, upon receipt of a written notice from Lessor stating that a Breach exists in the performance of Lessee's obligations under this Lease, to pay to Lessor all Rent due and to become due under the sublease. Sublessee shall rely upon any such notice from Lessor and shall pay all Rents to Lessor without any obligation or right to inquire as to whether such Breach exists, notwithstanding any claim from Lessee to the contrary.

(b) In the event of a Breach by Lessee, Lessor may, at its option, require sublessee to atone to Lessor, in which event Lessor shall undertake the obligations of the sublessor under such sublease from the time of the exercise of said option to the expiration of such sublease; provided, however, Lessor shall not be liable for any prepaid rents or security deposit paid by such sublessee to such sublessor or for any prior Defaults or Breaches of such sublessor.

(c) Any matter requiring the consent of the sublessor under a sublease shall also require the consent of Lessor.

(d) No sublessee shall further assign or sublet all or any part of the Premises without Lessor's prior written consent which shall not be unreasonably withheld.

(e) Lessor shall deliver a copy of any notice of Default or Breach by Lessee to the sublessee, who shall have the right to cure the Default of Lessee within the grace period, if any, specified in such notice. The sublessee shall have a right of reimbursement and offset from and against Lessee for any such Defaults cured by the sublessee.

13. Default; Breach; Remedies

13.1 **Default; Breach.** A "Default" is defined as a failure by the Lessee to comply with or perform any of the terms, covenants, conditions or Rules and Regulations under this Lease. A "Breach" is defined as the occurrence of one or more of the following Defaults, and the failure of Lessee to cure such Default within any applicable grace period:

(a) The abandonment of the Premises; or the vacating of the Premises without providing a commercially reasonable level of security, or where the coverage of the property insurance described in Paragraph 8.3 is jeopardized as a result thereof, or without providing reasonable assurances to minimize potential vandalism;

(b) The failure of Lessee to make any payment of Rent or any Security Deposit required to be made by Lessee hereunder, whether to Lessor or to a third party, when due, to provide reasonable evidence of insurance or surety bond, or to fulfill any obligation under this Lease which endangers or threatens life or property, where such failure continues for a period of 3 business days following written notice to Lessee;

(c) The failure by Lessee to provide (i) reasonable written evidence of compliance with Applicable Requirements, (ii) the service contracts, (iii) the rescission of an unauthorized assignment or subletting, (iv) an Estoppel Certificate, (v) a requested subordination, (vi) evidence concerning any guaranty and/or Guarantor, (vii) any document requested under Paragraph 41 (easements), or (viii) any other documentation or information which Lessor may reasonably require of Lessee under the terms of this Lease, where any such failure continues for a period of 10 days following written notice to Lessee;

(d) A Default by Lessee as to the terms, covenants, conditions or provisions of this Lease, or of the rules adopted under Paragraph 2.9 hereof, other than those described in subparagraphs 13.1(a), (b) or (c), above, where such Default continues for a period of 30 days after written notice; provided, however, that if the nature of Lessee's Default is such that more than 30 days are reasonably required for its cure, then it shall not be deemed to be a Breach if Lessee commences such cure within said 30 day period and thereafter diligently prosecutes such cure to completion.

(e) The occurrence of any of the following events: (i) the making of any general arrangement or assignment for the benefit of creditors; (ii) becoming a "debtor" as defined in 11 U.S.C. § 101 or any successor statute thereto (unless, in the case of a petition filed against Lessee, the same is dismissed within 60 days); (iii) the appointment of a trustee or receiver to take possession of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where possession is not restored to Lessee within 30 days; or (iv) the attachment, execution or other judicial seizure of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where such seizure is not discharged within 30 days; provided, however, in the event that any provision of this subparagraph (e) is contrary to any applicable law, such provision shall be of no force or effect, and not affect the validity of the remaining provisions.

(f) The discovery that any financial statement of Lessee or of any Guarantor given to Lessor was materially false.

(g) If the performance of Lessee's obligations under this Lease is guaranteed: (i) the death of a Guarantor, (ii) the termination of a Guarantor's liability with respect to this Lease other than in accordance with the terms of such guaranty, (iii) a Guarantor's becoming insolvent or the subject of a bankruptcy filing, (iv) a Guarantor's refusal to honor the guaranty, or (v) a Guarantor's breach of its guaranty obligation on an anticipatory basis, and Lessee's failure, within 60 days following written notice of any such event, to provide written alternative assurance or security which, when coupled with the then-existing resources of Lessee, equals or exceeds the combined financial resources of Lessee and the Guarantors that existed at the time of execution of this Lease.

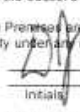
13.2 **Remedies.** If Lessee fails to perform any of its affirmative duties or obligations, within 10 days after written notice (or in case of an emergency, without notice), Lessor may, at its option, perform such duty or obligation on Lessee's behalf, including but not limited to the obtaining of reasonably required bonds, insurance policies, or governmental licenses, permits or approvals. The costs and expenses of any such performance by Lessor shall be due and payable by Lessee upon receipt of invoice therefor. If any check given to Lessor by Lessee shall not be honored by the bank upon which it is drawn, Lessor, at its option, may require all future payments to be made by Lessee to be by cashier's check. In the event of a Breach, Lessor may, with or without further notice or demand, and without limiting Lessor in the exercise of any right or remedy which Lessor may have by reason of such Breach:

(a) Terminate Lessee's right to possession of the Premises by any lawful means, in which case this Lease shall terminate and Lessee shall immediately surrender possession to Lessor. In such event Lessor shall be entitled to recover from Lessee: (i) the unpaid Rent which had been earned at the time of termination; (ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that the Lessee proves could have been reasonably avoided; (iii) the worth at the time of award of the amount by which the unpaid rent for the balance of the term after the time of award exceeds the amount of such rental loss that the Lessee proves could be reasonably avoided; and (iv) any other amount necessary to compensate Lessor for all the detriment proximately caused by the Lessee's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, including but not limited to the cost of recovering possession of the Premises, expenses of reletting, including necessary renovation and alteration of the Premises, reasonable attorneys' fees, and that portion of any leasing commission paid by Lessor in connection with this Lease applicable to the unexpired term of this Lease. The worth at the time of award of the amount referred to in provision (iii) of the immediately preceding sentence shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of the District within which the Premises are located at the time of award plus one percent. Efforts by Lessor to mitigate damages caused by Lessee's Breach of this Lease shall not waive Lessor's right to recover damages under Paragraph 12. If termination of this Lease is obtained through the provisional remedy of unlawful detainer, Lessor shall have the right to recover in such proceeding any unpaid Rent and damages as are recoverable therein; or Lessor may reserve the right to recover all or any part thereof in a separate suit. If a notice and grace period required under Paragraph 13.1 was not previously given, a notice to pay rent or quit, or to perform or quit given to Lessee under the unlawful detainer statute shall also constitute the notice required by Paragraph 13.1. In such case, the applicable grace period required by Paragraph 13.1 and the unlawful detainer statute shall run concurrently, and the failure of Lessee to cure the Default within the greater of the two such grace periods shall constitute both an unlawful detainer and a Breach of this Lease entitling Lessor to the remedies provided for in this Lease and/or by said statute.

(b) Continue the Lease and Lessee's right to possession and recover the Rent as it becomes due, in which event Lessee may sublet or assign, subject only to reasonable limitations. Acts of maintenance, efforts to relet, and/or the appointment of a receiver to protect the Lessor's interests, shall not constitute a termination of the Lessee's right to possession.

(c) Pursue any other remedy now or hereafter available under the laws or judicial decisions of the state wherein the Premises are located. The expiration or termination of this Lease and/or the termination of Lessee's right to possession shall not relieve Lessee from liability under any indemnity




Initials

provisions of this Lease as to matters occurring or accruing during the term hereof or by reason of Lessee's occupancy of the Premises.

13.3—Inducement Recapture. Any agreement for free or abated rent or other charges, or for the giving or paying by Lessor to or for Lessee of any cash or other bonus, inducement or consideration for Lessee's entering into this Lease, all of which concessions are hereinafter referred to as "Inducement Provisions", shall be deemed conditioned upon Lessee's full and faithful performance of all of the terms, covenants and conditions of this Lease. Upon Breach of this Lease by Lessee, any such Inducement Provision shall automatically be deemed deleted from this Lease and of no further force or effect, and any rent, other charge, bonus, inducement or consideration theretofore abated, given or paid by Lessor under such an Inducement Provision shall be immediately due and payable by Lessee to Lessor, notwithstanding any subsequent cure of said Breach by Lessee. The acceptance by Lessor of rent or the cure of the Breach which initiated the operation of this paragraph shall not be deemed a waiver by Lessor of the provisions of this paragraph unless specifically so stated in writing by Lessor at the time of such acceptance.

13.4 Late Charges. Lessee hereby acknowledges that late payment by Lessee of Rent will cause Lessor to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges, and late charges which may be imposed upon Lessor by any Lender. Accordingly, if any Rent shall not be received by Lessor within 5 days after such amount shall be due, then, without any requirement for notice to Lessee, Lessee shall pay to Lessor a one-time late charge equal to 10% of each such overdue amount or \$100, whichever is greater. The parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Lessor will incur by reason of such late payment. Acceptance of such late charge by Lessor shall in no event constitute a waiver of Lessee's Default or Breach with respect to such overdue amount, nor prevent the exercise of any of the other rights and remedies granted hereunder. In the event that a late charge is payable hereunder, whether or not collected, for 3 consecutive installments of Base Rent, then notwithstanding any provision of this Lease to the contrary, Base Rent shall, at Lessor's option, become due and payable quarterly in advance.

13.5 Interest. Any monetary payment due Lessor hereunder, other than late charges, not received by Lessor, when due as to scheduled payments (such as Base Rent) or within 30 days following the date on which it was due for nonscheduled payment, shall bear interest from the date when due, as to scheduled payments, or the 31st day after it was due as to nonscheduled payments. The interest ("Interest") charged shall be computed at the rate of 10% per annum but shall not exceed the maximum rate allowed by law. Interest is payable in addition to the potential late charge provided for in Paragraph 13.4.

13.6 Breach by Lessor.

(a) **Notice of Breach.** Lessor shall not be deemed in breach of this Lease unless Lessor fails within a reasonable time to perform an obligation required to be performed by Lessor. For purposes of this Paragraph, a reasonable time shall in no event be less than 30 days after receipt by Lessor, and any Lender whose name and address shall have been furnished Lessee in writing for such purpose, of written notice specifying wherein such obligation of Lessor has not been performed, provided, however, that if the nature of Lessor's obligation is such that more than 30 days are reasonably required for its performance, then Lessor shall not be in breach if performance is commenced within such 30 day period and thereafter diligently pursued to completion. Notwithstanding the foregoing, if there is imminent danger of injury to person or property, Lessor shall cure such default immediately.

(b) **Performance by Lessee on Behalf of Lessor.** In the event that neither Lessor nor Lender cures said breach within 30 days after receipt of said notice, or if having commenced said cure they do not diligently pursue it to completion, then Lessee may elect to cure said breach at Lessee's expense and offset from Rent the actual and reasonable cost to perform such cure, provided however, that such offset shall not exceed an amount equal to the greater of one month's Base Rent or the Security Deposit, reserving Lessee's right to seek reimbursement from Lessor. Lessee shall document the cost of said cure and supply said documentation to Lessor.

14. Condemnation. If the Premises or any portion thereof are taken under the power of eminent domain or sold under the threat of the exercise of said power (collectively "Condemnation"), this Lease shall terminate as to the part taken as of the date the condemning authority takes title or possession, whichever first occurs. If more than 10% of the rentable floor area of the Premises, or more than 25% of Lessee's Reserved Parking Spaces, if any, are taken by Condemnation, Lessee may, at Lessee's option, to be exercised in writing within 10 days after Lessor shall have given Lessee written notice of such taking (or in the absence of such notice, within 10 days after the condemning authority shall have taken possession) terminate this Lease as of the date the condemning authority takes such possession. If Lessee does not terminate this Lease in accordance with the foregoing, this Lease shall remain in full force and effect as to the portion of the Premises remaining, except that the Base Rent shall be reduced in proportion to the reduction in utility of the Premises caused by such Condemnation. Condemnation awards and/or payments shall be the property of Lessor, whether such award shall be made as compensation for diminution in value of the leasehold, the value of the part taken, or for severance damages; provided, however, that Lessee shall be entitled to any compensation for Lessee's relocation expenses, loss of business goodwill and/or Trade Fixtures, without regard to whether or not this Lease is terminated pursuant to the provisions of this Paragraph. All Alterations and Utility Installations made to the Premises by Lessee, for purposes of Condemnation only, shall be considered the property of the Lessee and Lessee shall be entitled to any and all compensation which is payable therefor. In the event that this Lease is not terminated by reason of the Condemnation, Lessor shall repair any damage to the Premises caused by such Condemnation.

15. Brokerage Fees.

15.1—Additional Commission. In addition to the payments owed pursuant to Paragraph 1.10 above, and unless Lessor and the Brokers otherwise agree in writing, Lessor agrees that: (a) if Lessee exercises any Option; (b) if Lessee acquires from Lessor any rights to the Premises or other premises owned by Lessor and located within the Project; (c) if Lessee remains in possession of the Premises, with the consent of Lessor, after the expiration of the Lease; or (d) if Base Rent is increased, whether by agreement or operation of an escalation clause herein, then, Lessor shall pay Brokers a fee in accordance with the schedule of the Brokers in effect at the time of the execution of this Lease.

15.2 Assumption of Obligations. Any buyer or transferee of Lessor's interest in this Lease shall be deemed to have assumed Lessor's obligation hereunder. Brokers shall be third party beneficiaries of the provisions of Paragraphs 1.10, 15, 22 and 31. If Lessor fails to pay to Brokers any amounts due as and for brokerage fees pertaining to this Lease when due, then such amounts shall accrue interest. In addition, if Lessor fails to pay any amounts to Lessee's Broker when due, Lessee's Broker may send written notice to Lessor and Lessee of such failure and if Lessor fails to pay such amounts within 10 days after said notice, Lessee shall pay said monies to its Broker and offset such amounts against Rent. In addition, Lessee's Broker shall be deemed to be a third party beneficiary of any commission agreement entered into by and/or between Lessor and Lessor's Broker for the limited purpose of collecting any brokerage fee owed.

15.3 Representations and Indemnities of Broker Relationships. Lessee and Lessor each represent and warrant to the other that it has had no dealings with any person, firm, broker or finder (other than the Brokers, if any) in connection with this Lease, and that no one other than said named Brokers is entitled to any commission or finder's fee in connection herewith. Lessee and Lessor do each hereby agree to indemnify, protect, defend and hold the other harmless from and against liability for compensation or charges which may be claimed by any such unnamed broker, finder or other similar party by reason of any dealings or actions of the indemnifying Party, including any costs, expenses, attorneys' fees reasonably incurred with respect thereto.

16. Estoppel Certificates.

(a) Each Party (as "Responding Party") shall within 10 days after written notice from the other Party (the "Requesting Party") execute, acknowledge and deliver to the Requesting Party a statement in writing in form similar to the then most current "Estoppel Certificate" form published by the American Industrial Real Estate Association, plus such additional information, confirmation and/or statements as may be reasonably requested by the Requesting Party.

(b) If the Responding Party shall fail to execute or deliver the Estoppel Certificate within such 10 day period, the Requesting Party may execute an Estoppel Certificate stating that: (i) the Lease is in full force and effect without modification except as may be represented by the Requesting Party, (ii) there are no uncured defaults in the Requesting Party's performance, and (iii) if Lessor is the Requesting Party, not more than one month's rent has been paid in advance. Prospective purchasers and encumbrancers may rely upon the Requesting Party's Estoppel Certificate, and the Responding Party shall be estopped from denying the truth of the facts contained in said Certificate.

(c) If Lessor desires to finance, refinance, or sell the Premises, or any part thereof, Lessee and all Guarantors shall deliver to any potential lender or purchaser designated by Lessor such financial statements as may be reasonably required by such lender or purchaser, including but not limited to Lessee's financial statements for the past 3 years. All such financial statements shall be received by Lessor and such lender or purchaser in confidence and shall be used only for the purposes herein set forth.

17. Definition of Lessor. The term "Lessor" as used herein shall mean the owner or owners at the time in question of the fee title to the Premises, or, if this is a sublease, of the Lessee's interest in the prior lease. In the event of a transfer of Lessor's title or interest in the Premises or this Lease, Lessor shall deliver to the transferee or assignee (in cash or by credit) any unused Security Deposit held by Lessor. Except as provided in Paragraph 15, upon such transfer or assignment and delivery of the Security Deposit, as aforesaid, the prior Lessor shall be relieved of all liability with respect to the obligations and/or covenants under this Lease thereafter to be performed by the Lessor. Subject to the foregoing, the obligations and/or covenants in this Lease to be performed by the Lessor shall be binding only upon the Lessor as hereinabove defined.

18. Severability. The invalidity of any provision of this Lease, as determined by a court of competent jurisdiction, shall in no way affect the validity of any other provision hereof.

19. Days. Unless otherwise specifically indicated to the contrary, the word "days" as used in this Lease shall mean and refer to calendar days.

20. Limitation on Liability. The obligations of Lessor under this Lease shall not constitute personal obligations of Lessor or its partners, members, directors, officers or shareholders, and Lessee shall look to the Project, and to no other assets of Lessor, for the satisfaction of any liability of Lessor with respect to this Lease, and shall not seek recourse against Lessor's partners, members, directors, officers or shareholders, or any of their personal assets for such satisfaction.

21. Time of Essence. Time is of the essence with respect to the performance of all obligations to be performed or observed by the Parties under this Lease.

© 1999 - American Industrial Real Estate Association

Page 9 of 13
REVISED

FORM OFG-1-9/99E

22. **No Prior or Other Agreements; Broker Disclaimer.** This Lease contains all agreements between the Parties with respect to any matter mentioned herein, and no other prior or contemporaneous agreement or understanding shall be effective. Lessor and Lessee each represents and warrants to the Brokers that it has made, and is relying solely upon, its own investigation as to the nature, quality, character and financial responsibility of the other Party to this Lease and as to the use, nature, quality and character of the Premises. Brokers have no responsibility with respect thereto or with respect to any default or breach hereof by either Party. The liability (including court costs and attorneys' fees) of any Broker with respect to negotiation, execution, delivery or performance by either Lessor or Lessee under this Lease or any amendment or modification hereto shall be limited to an amount up to the fee received by such Broker pursuant to this Lease; provided, however, that the foregoing limitation on each Broker's liability shall not be applicable to any gross negligence or willful misconduct of such Broker.

23. **Notices.**

23.1 **Notice Requirements.** All notices required or permitted by this Lease or applicable law shall be in writing and may be delivered in person (by hand or by courier) or may be sent by regular, certified or registered mail or U.S. Postal Service Express Mail, with postage prepaid, or by facsimile transmission, and shall be deemed sufficiently given if served in a manner specified in this Paragraph 23. The addresses noted adjacent to a Party's signature on this Lease shall be that Party's address for delivery or mailing of notices. Either Party may by written notice to the other specify a different address for notice, except that upon Lessee's taking possession of the Premises, the Premises shall constitute Lessee's address for notice. A copy of all notices to Lessor shall be concurrently transmitted to such party or parties at such addresses as Lessor may from time to time hereafter designate in writing.

23.2 **Date of Notice.** Any notice sent by registered or certified mail, return receipt requested, shall be deemed given on the date of delivery shown on the receipt card, or if no delivery date is shown, the postmark thereon. If sent by regular mail the notice shall be deemed given 48 hours after the same is addressed as required herein and mailed with postage prepaid. Notices delivered by United States Express Mail or overnight courier that guarantee next day delivery shall be deemed given 24 hours after delivery of the same to the Postal Service or courier. Notices transmitted by facsimile transmission or similar means shall be deemed delivered upon telephone confirmation of receipt (confirmation report from fax machine is sufficient), provided a copy is also delivered via delivery or mail. If notice is received on a Saturday, Sunday or legal holiday, it shall be deemed received on the next business day.

24. **Waivers.** No waiver by Lessor of the Default or Breach of any term, covenant or condition hereof by Lessee, shall be deemed a waiver of any other term, covenant or condition hereof, or of any subsequent Default or Breach by Lessee of the same or of any other term, covenant or condition hereof. Lessor's consent to, or approval of, any act shall not be deemed to render unnecessary the obtaining of Lessor's consent to, or approval of, any subsequent or similar act by Lessee, or be construed as the basis of an estoppel to enforce the provision or provisions of this Lease requiring such consent. The acceptance of Rent by Lessor shall not be a waiver of any Default or Breach by Lessee. Any payment by Lessee may be accepted by Lessor on account of moneys or damages due Lessor, notwithstanding any qualifying statements or conditions made by Lessee in connection therewith, which such statements and/or conditions shall be of no force or effect whatsoever unless specifically agreed to in writing by Lessor at or before the time of deposit of such payment.

25. **Disclosures Regarding The Nature of a Real Estate Agency Relationship.**

(a) When entering into a discussion with a real estate agent regarding a real estate transaction, a Lessor or Lessee should from the outset understand what type of agency relationship or representation it has with the agent or agents in the transaction. Lessor and Lessee acknowledge being advised by the Brokers in this transaction, as follows:

(i) **Lessor's Agent.** A Lessor's agent under a listing agreement with the Lessor acts as the agent for the Lessor only. A Lessor's agent or subagent has the following affirmative obligations: To the Lessor: a. Diligent exercise of reasonable skills and care in performance of the agent's duties. b. A duty of honest and fair dealing and good faith. c. A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the Parties. An agent is not obligated to reveal to either Party any confidential information obtained from the other Party which does not involve the affirmative duties set forth above.

(ii) **Lessee's Agent.** An agent can agree to act as agent for the Lessee only. In these situations, the agent is not the Lessor's agent, even if by agreement the agent may receive compensation for services rendered, either in full or in part from the Lessor. An agent acting only for a Lessee has the following affirmative obligations: To the Lessee: a. Diligent exercise of reasonable skills and care in performance of the agent's duties. b. A duty of honest and fair dealing and good faith. c. A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the Parties. An agent is not obligated to reveal to either Party any confidential information obtained from the other Party which does not involve the affirmative duties set forth above.

(iii) **Agent Representing Both Lessor and Lessee.** A real estate agent, either acting directly or through one or more associate licensees, can legally be the agent of both the Lessor and the Lessee in a transaction, but only with the knowledge and consent of both the Lessor and the Lessee. In a dual agency situation, the agent has the following affirmative obligations to both the Lessor and the Lessee: a. A fiduciary duty of utmost care, integrity, honesty and loyalty in the dealings with either Lessor or the Lessee. b. Other duties to the Lessor and the Lessee as stated above in subparagraphs (i) or (ii). In representing both Lessor and Lessee, the agent may not without the express permission of the respective Party, disclose to the other Party that the Lessor will accept rent in an amount less than that indicated in the listing or that the Lessee is willing to pay a higher rent than that offered. The above duties of the agent in a real estate transaction do not relieve a Lessor or Lessee from the responsibility to protect their own interests. Lessor and Lessee should carefully read all agreements to assure that they adequately express their understanding of the transaction. A real estate agent is a person qualified to advise about real estate. If legal or tax advice is desired, consult a competent professional.

(b) Brokers have no responsibility with respect to any default or breach hereof by either Party. The liability (including court costs and attorneys' fees), of any Broker with respect to any breach of duty, error or omission relating to this Lease shall not exceed the fee received by such Broker pursuant to this Lease; provided, however, that the foregoing limitation on each Broker's liability shall not be applicable to any gross negligence or willful misconduct of such Broker.

(c) Buyer and Seller agree to identify to Brokers as "Confidential" any communication or information given Brokers that is considered by such Party to be confidential.

26. **No Right To Holdover.** Lessee has no right to retain possession of the Premises or any part thereof beyond the expiration or termination of this Lease. In the event that Lessee holds over, then the Base Rent shall be increased to 150% of the Base Rent applicable immediately preceding the expiration or termination. Nothing contained herein shall be construed as consent by Lessor to any holding over by Lessee.

27. **Cumulative Remedies.** No remedy or election hereunder shall be deemed exclusive but shall, wherever possible, be cumulative with all other remedies at law or in equity.

28. **Covenants and Conditions; Construction of Agreement.** All provisions of this Lease to be observed or performed by Lessee are both covenants and conditions. In construing this Lease, all headings and titles are for the convenience of the Parties only and shall not be considered a part of this Lease. Whenever required by the context, the singular shall include the plural and vice versa. This Lease shall not be construed as if prepared by one of the Parties, but rather according to its fair meaning as a whole, as if both Parties had prepared it.

29. **Binding Effect; Choice of Law.** This Lease shall be binding upon the Parties, their personal representatives, successors and assigns and be governed by the laws of the State in which the Premises are located. Any litigation between the Parties hereto concerning this Lease shall be initiated in the county in which the Premises are located.

30. **Subordination; Attornment; Non-Disturbance**

30.1 **Subordination.** This Lease and any Option granted hereby shall be subject and subordinate to any ground lease, mortgage, deed of trust, or other hypothecation or security device (collectively, "**Security Device**"), now or hereafter placed upon the Premises, to any and all advances made on the security thereof, and to all renewals, modifications, and extensions thereof. Lessee agrees that the holders of any such Security Devices (in this Lease together referred to as "**Lender**") shall have no liability or obligation to perform any of the obligations of Lessor under this Lease. Any Lender may elect to have this Lease and/or any Option granted hereby superior to the lien of its Security Device by giving written notice thereof to Lessee, whereupon this Lease and such Options shall be deemed prior to such Security Device, notwithstanding the relative dates of the documentation or recordation thereof.

30.2 **Attornment.** In the event that Lessor transfers title to the Premises, or the Premises are acquired by another upon the foreclosure or termination of a Security Device to which this Lease is subordinated (i) Lessee shall, subject to the nondisturbance provisions of Paragraph 30.3, attorn to such new owner, and upon request, enter into a new lease, containing all of the terms and provisions of this Lease, with such new owner for the remainder of the term hereof, or, at the election of such new owner, this Lease shall automatically become a new Lease between Lessee and such new owner, upon all of the terms and conditions hereof, for the remainder of the term hereof; and (ii) Lessor shall thereafter be relieved of any further obligations hereunder and such new owner shall assume all of Lessor's obligations hereunder, except that such new owner shall not: (a) be liable for any act or omission of any prior lessor or with respect to events occurring prior to acquisition of ownership; (b) be subject to any offsets or defenses which Lessee might have against any prior lessor; (c) be bound by prepayment of more than one month's rent, or (d) be liable for the return of any security deposit paid to any prior lessor, unless received by new owner.

30.3 **Non-Disturbance.** With respect to Security Devices entered into by Lessor after the execution of this Lease, Lessee's subordination of this Lease shall be subject to receiving a commercially reasonable non-disturbance agreement (a "**Non-Disturbance Agreement**") from the Lender which Non-Disturbance Agreement provides that Lessee's possession of the Premises, and this Lease, including any options to extend the term hereof, will not be disturbed so long as Lessee is not in Breach hereof and attorns to the record owner of the Premises. Further, within 60 days after the execution of this Lease, Lessor shall use its commercially reasonable efforts to obtain a Non-Disturbance Agreement from the holder of any pre-existing Security Device which is secured by the Premises. In the event that Lessor is unable to provide the Non-Disturbance Agreement within said 60 days, then Lessee may, at Lessee's option, directly contact Lender and attempt to negotiate for the execution and delivery of a Non-Disturbance Agreement.

30.4 **Self-Executing.** The agreements contained in this Paragraph 30 shall be effective without the execution of any further documents;

provided, however, that, upon written request from Lessor or a Lender in connection with a sale, financing or refinancing of the Premises, Lessee and Lessor shall execute such further writings as may be reasonably required to separately document any subordination, attornment and/or Non-Disturbance Agreement provided for herein.

31. **Attorneys' Fees.** If any Party or Broker brings an action or proceeding involving the Premises whether founded in tort, contract or equity, or to declare rights hereunder, the Prevailing Party (as hereafter defined) in any such proceeding, action, or appeal thereon, shall be entitled to reasonable attorneys' fees. Such fees may be awarded in the same suit or recovered in a separate suit, whether or not such action or proceeding is pursued to decision or judgment. The term, "Prevailing Party" shall include, without limitation, a Party or Broker who substantially obtains or defeats the relief sought, as the case may be, whether by compromise, settlement, judgment, or the abandonment by the other Party or Broker of its claim or defense. The attorneys' fees award shall not be computed in accordance with any court fee schedule, but shall be such as to fully reimburse all attorneys' fees reasonably incurred. In addition, Lessor shall be entitled to attorneys' fees, costs and expenses incurred in the preparation and service of notices of Default and consultations in connection therewith, whether or not a legal action is subsequently commenced in connection with such Default or resulting Breach (\$200 is a reasonable minimum per occurrence for such services and consultation).

32. **Lessor's Access; Showing Premises; Repairs.** Lessor and Lessor's agents shall have the right to enter the Premises at any time, in the case of an emergency, and otherwise at reasonable times for the purpose of showing the same to prospective purchasers, lenders, or tenants, and making such alterations, repairs, improvements or additions to the Premises as Lessor may deem necessary or desirable and the erecting, using and maintaining of utilities, services, pipes and conduits through the Premises and/or other premises as long as there is no material adverse effect to Lessee's use of the Premises. All such activities shall be without abatement of rent or liability to Lessee. Lessor may at any time place on the Premises any ordinary "For Sale" signs and Lessor may during the last 6 months of the term hereof place on the Premises any ordinary "For Lease" signs. In addition, Lessor shall have the right to retain keys to the Premises and to unlock all doors in or upon the Premises other than to files, vaults and safes, and in the case of emergency to enter the Premises by any reasonably appropriate means, and any such entry shall not be deemed a forcible or unlawful entry or detainer of the Premises or an eviction. Lessee waives any charges for damages or injuries or interference with Lessee's property or business in connection therewith.

33. **Auctions.** Lessee shall not conduct, nor permit to be conducted, any auction upon the Premises without Lessor's prior written consent. Lessor shall not be obligated to exercise any standard of reasonableness in determining whether to permit an auction.

34. **Signs.** Lessee shall not place any sign upon the Project without Lessor's prior written consent.

35. **Termination; Merger.** Unless specifically stated otherwise in writing by Lessor, the voluntary or other surrender of this Lease by Lessee, the mutual termination or cancellation hereof, or a termination hereof by Lessor for Breach by Lessee, shall automatically terminate any sublease or lesser estate in the Premises; provided, however, that Lessor may elect to continue any one or all existing subtenancies. Lessor's failure within 10 days following any such event to elect to the contrary by written notice to the holder of any such lesser interest, shall constitute Lessor's election to have such event constitute the termination of such interest.

36. **Consents.** Except as otherwise provided herein, wherever in this Lease the consent of a Party is required to an act by or for the other Party, such consent shall not be unreasonably withheld or delayed. Lessor's actual reasonable costs and expenses (including but not limited to architects', attorneys', engineers' and other consultants' fees) incurred in the consideration of, or response to, a request by Lessee for any Lessor consent, including but not limited to consents to an assignment, a subletting or the presence or use of a Hazardous Substance, shall be paid by Lessee upon receipt of an invoice and supporting documentation therefor. Lessor's consent to any act, assignment or subletting shall not constitute an acknowledgment that no Default or Breach by Lessee of this Lease exists, nor shall such consent be deemed a waiver of any then existing Default or Breach, except as may be otherwise specifically stated in writing by Lessor at the time of such consent. The failure to specify herein any particular condition to Lessor's consent shall not preclude the imposition by Lessor at the time of consent of such further or other conditions as are then reasonable with reference to the particular matter for which consent is being given. In the event that either Party disagrees with any determination made by the other hereunder and reasonably requests the reasons for such determination, the determining party shall furnish its reasons in writing and in reasonable detail within 10 business days following such request.

37. Guarantors.

37.1 **Execution.** The Guarantors, if any, shall each execute a guaranty in the form most recently published by the American Industrial Real Estate Association.

37.2 **Default.** It shall constitute a Default of the Lessee if any Guarantor fails or refuses, upon request to provide: (a) evidence of the execution of the guaranty including the authority of the party signing on Guarantor's behalf to obligate Guarantor, and in the case of a corporate Guarantor, a certified copy of a resolution of its board of directors authorizing the making of such guaranty; (b) current financial statements; (c) an Estoppel Certificate; or (d) written confirmation that the guaranty is still in effect.

38. **Quiet Possession.** Subject to payment by Lessee of the Rent and performance of all of the covenants, conditions and provisions on Lessee's part to be observed and performed under this Lease, Lessee shall have quiet possession and quiet enjoyment of the Premises during the term hereof.

39. **Options.** If Lessee is granted an Option, as defined below, then the following provisions shall apply.

39.1 **Definition.** "Option" shall mean: (a) the right to extend the term of or renew this Lease or to extend or renew any lease that Lessee has on other property of Lessor; (b) the right of first refusal or first offer to lease either the Premises or other property of Lessor; (c) the right to purchase or the right of first refusal to purchase the Premises or other property of Lessor.

39.2 **Options Personal To Original Lessee.** Any Option granted to Lessee in this Lease is personal to the original Lessee, and cannot be assigned or exercised by anyone other than said original Lessee and only while the original Lessee is in full possession of the Premises and, if requested by Lessor, with Lessee certifying that Lessee has no intention of thereafter assigning or subletting.

39.3 **Multiple Options.** In the event that Lessee has any multiple Options to extend or renew this Lease, a later Option cannot be exercised unless the prior Options have been validly exercised.

39.4 Effect of Default on Options.

(a) Lessee shall have no right to exercise an Option: (i) during the period commencing with the giving of any notice of Default and continuing until said Default is cured, (ii) during the period of time any Rent is unpaid (without regard to whether notice thereof is given Lessee), (iii) during the time Lessee is in Breach of this Lease, or (iv) in the event that Lessee has been given 3 or more notices of separate Default, whether or not the Defaults are cured, during the 12 month period immediately preceding the exercise of the Option.

(b) The period of time within which an Option may be exercised shall not be extended or enlarged by reason of Lessee's inability to exercise an Option because of the provisions of Paragraph 39.4(a).

(c) An Option shall terminate and be of no further force or effect, notwithstanding Lessee's due and timely exercise of the Option, if, after such exercise and prior to the commencement of the extended term or completion of the purchase, (i) Lessee fails to pay Rent for a period of 30 days after such Rent becomes due (without any necessity of Lessor to give notice thereof), or (ii) if Lessee commits a Breach of this Lease.

40. **Security Measures.** Lessee hereby acknowledges that the Rent payable to Lessor hereunder does not include the cost of guard service or other security measures, and that Lessor shall have no obligation whatsoever to provide same. Lessee assumes all responsibility for the protection of the Premises, Lessee, its agents and invitees and their property from the acts of third parties. In the event, however, that Lessor should elect to provide security services, then the cost thereof shall be an Operating Expense.

41. Reservations.

(a) Lessor reserves the right: (i) to grant, without the consent or joinder of Lessee, such easements, rights and dedications that Lessor deems necessary, (ii) to cause the recordation of parcel maps and restrictions, (iii) to create and/or install new utility raceways, so long as such easements, rights, dedications, maps, restrictions, and utility raceways do not unreasonably interfere with the use of the Premises by Lessee. Lessor may also: change the name, address or title of the Building or Project upon at least 90 days prior written notice; provide and install, at Lessee's expense, Building standard graphics on the door of the Premises and such portions of the Common Areas as Lessor shall reasonably deem appropriate; grant to any lessee the exclusive right to conduct any business as long as such exclusive right does not conflict with any rights expressly given herein; and to place such signs, notices or displays as Lessor reasonably deems necessary or advisable upon the roof, exterior of the Building or the Project or on pole signs in the Common Areas. Lessee agrees to sign any documents reasonably requested by Lessor to effectuate such rights. The obstruction of Lessee's view, air, or light by any structure erected in the vicinity of the Building, whether by Lessor or third parties, shall in no way affect this Lease or impose any liability upon Lessor.

(b) Lessor also reserves the right to move Lessee to other space of comparable size in the Building or Project. Lessor must provide at least 45 prior written notice of such move, and the new space must contain improvements of comparable quality to those contained within the Premises. Lessor shall pay the reasonable out-of-pocket costs that Lessee incurs with regard to such relocation, including the expenses of moving and necessary statutory revision costs, in no event, however, shall Lessor be required to pay an amount in excess of two months' Base Rent. Lessee may not be relocated more than once during the term of this Lease.

(c) Lessee shall not: (i) use a representation (photographic or otherwise) of the Building or Project or their name(s) in connection with Lessee's business, or (ii) suffer or permit anyone, except in emergency, to go upon the roof of the Building.

42. **Performance Under Protest.** If at any time a dispute shall arise as to any amount or sum of money to be paid by one Party to the other under the provisions hereof, the Party against whom the obligation to pay the money is asserted shall have the right to make payment "under protest" and such payment shall not be regarded as a voluntary payment and there shall survive the right on the part of said Party to institute suit for recovery of such sum. If it shall be adjudged that there was no legal obligation on the part of said Party to pay such sum or any part thereof, said Party shall be entitled to recover such sum or so much thereof as it was not legally required to pay.

43. Authority.

(a) If either Party hereto is a corporation, trust, limited liability company, partnership, or similar entity, each individual executing this Lease on behalf of such entity represents and warrants that he or she is duly authorized to execute and deliver this Lease on its behalf. Each party shall, within 30 days after request, deliver to the other party satisfactory evidence of such authority.

© 1999 - American Industrial Real Estate Association

Page 11 of 13
REVISED

FORM OFG-1.9/99E

(b) If this Lease is executed by more than one person or entity as "Lessee", each such person or entity shall be jointly and severally liable hereunder. It is agreed that any one of the named Lessees shall be empowered to execute any amendment to this Lease, or other document ancillary thereto and bind all of the named Lessees, and Lessor may rely on the same as if all of the named Lessees had executed such document.

44. **Conflict.** Any conflict between the printed provisions of this Lease and the typewritten or handwritten provisions shall be controlled by the typewritten or handwritten provisions.

45. **Offer.** Preparation of this Lease by either party or their agent and submission of same to the other Party shall not be deemed an offer to lease to the other Party. This Lease is not intended to be binding until executed and delivered by all Parties hereto.

46. **Amendments.** This Lease may be modified only in writing, signed by the Parties in interest at the time of the modification. As long as they do not materially change Lessee's obligations hereunder, Lessee agrees to make such reasonable nonmonetary modifications to this Lease as may be reasonably required by a Lender in connection with the obtaining of normal financing or refinancing of the Premises.

47. **Multiple Parties.** If more than one person or entity is named herein as either Lessor or Lessee, such multiple Parties shall have joint and several responsibility to comply with the terms of this Lease.

48. **Waiver of Jury Trial.** THE PARTIES HEREBY WAIVE THEIR RESPECTIVE RIGHTS TO TRIAL BY JURY IN ANY ACTION OR PROCEEDING INVOLVING THE PROPERTY OR ARISING OUT OF THIS AGREEMENT.

49. **Mediation and Arbitration of Disputes.** An Addendum requiring the Mediation and/or the Arbitration of all disputes between the Parties and/or Brokers arising out of this Lease ☐ is ☒ is not attached to this Lease.

50. **Americans with Disabilities Act.** In the event that as a result of Lessee's use, or intended use, of the Premises the Americans with Disabilities Act or any similar law requires modifications or the construction or installation of improvements in or to the Premises, Building, Project and/or Common Areas, the Parties agree that such modifications, construction or improvements shall be made at: ☐ Lessor's expense ☒ Lessee's expense.

LESSOR AND LESSEE HAVE CAREFULLY READ AND REVIEWED THIS LEASE AND EACH TERM AND PROVISION CONTAINED HEREIN, AND BY THE EXECUTION OF THIS LEASE SHOW THEIR INFORMED AND VOLUNTARY CONSENT THERETO. THE PARTIES HEREBY AGREE THAT, AT THE TIME THIS LEASE IS EXECUTED, THE TERMS OF THIS LEASE ARE COMMERCIALY REASONABLE AND EFFECTUATE THE INTENT AND PURPOSE OF LESSOR AND LESSEE WITH RESPECT TO THE PREMISES.

ATTENTION: NO REPRESENTATION OR RECOMMENDATION IS MADE BY THE AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION OR BY ANY BROKER AS TO THE LEGAL SUFFICIENCY, LEGAL EFFECT, OR TAX CONSEQUENCES OF THIS LEASE OR THE TRANSACTION TO WHICH IT RELATES. THE PARTIES ARE URGED TO:

1. SEEK ADVICE OF COUNSEL AS TO THE LEGAL AND TAX CONSEQUENCES OF THIS LEASE.
2. RETAIN APPROPRIATE CONSULTANTS TO REVIEW AND INVESTIGATE THE CONDITION OF THE PREMISES. SAID INVESTIGATION SHOULD INCLUDE BUT NOT BE LIMITED TO: THE POSSIBLE PRESENCE OF HAZARDOUS SUBSTANCES, THE ZONING AND SIZE OF THE PREMISES, THE STRUCTURAL INTEGRITY, THE CONDITION OF THE ROOF AND OPERATING SYSTEMS, COMPLIANCE WITH THE AMERICANS WITH DISABILITIES ACT AND THE SUITABILITY OF THE PREMISES FOR LESSEE'S INTENDED USE.

WARNING: IF THE PREMISES ARE LOCATED IN A STATE OTHER THAN CALIFORNIA, CERTAIN PROVISIONS OF THE LEASE MAY NEED TO BE REVISED TO COMPLY WITH THE LAWS OF THE STATE IN WHICH THE PREMISES ARE LOCATED.

The parties hereto have executed this Lease at the place and on the dates specified above their respective signatures.

Executed at: _____
on: _____

By LESSOR:
Jack Rominger, Tommie Plemons and Dale
Denson

By: 
Name Printed: Jack Rominger
Title: Owner

By: 
Name Printed: Tommie Plemons
Title: Owner

By: _____
Name Printed: Dale Denson
Title: Owner
Address: c/o Dalton Realty
510 Waverley Street
Palo Alto, CA 94301

(650) 321-1711 / (650) 327-2383
Telephone / Facsimile
Federal ID No. _____

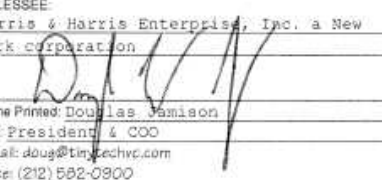
LESSOR'S
BROKER: _____

Attn: _____
Address: _____

Telephone / Facsimile No. _____

Executed at: _____
on: _____

By LESSEE:
Harris & Harris Enterprises, Inc. a New
York corporation

By: 
Name Printed: Douglas Jamison
Title: President & COO
E-mail: doug@tinytechvc.com
Office: (212) 582-0900

By: _____
Name Printed: _____
Title: _____

Palo Alto Tenant Contact:
Michael Janse (E-mail: mike@tinytechvc.com)
Cell: (850) 815-8079
Alternative Address: 111 W. 57th Street, Suite 1100
New York, NY 10019

Telephone / Facsimile
Federal ID No. _____

LESSEE'S
BROKER: _____

Attn: _____
Address: _____

Telephone / Facsimile No. _____

These forms are often modified to meet changing requirements of law and needs of the industry. Always write or call to make sure you are utilizing the most current form: American Industrial Real Estate Association, 700 South Flower Street, Suite 600, Los Angeles, CA 90017. (213) 687-8777.

©Copyright 1999 By American Industrial Real Estate Association.
All rights reserved.

EXHIBIT C

DETERMINATION OF FAIR MARKET RENTAL RATE

As used herein, the term "Fair Market Rental Rate" (FMV) shall mean the base full service monthly rental for space of comparable size and location to the Premises and in buildings similar in quality to the Building in the Palo Alto area, taking into account any additional rental and all other payments or escalations then being charged and allowances being given in the Palo Alto area for such comparable space over a comparable term and conversion to full service monthly rental. The Fair Market Rental Rate shall be determined by Lessor and provided to Lessee within fifteen (15) days of receipt of Lessee's written notice to exercise their option. If Lessee disputes Lessor's determination of the Fair Market Rental Rate, Lessee shall so notify Lessor within ten (10) days following Lessor's notice to Lessee of Lessor's determination and, in such case, the Prevailing Market Rate (FMV) shall be determined as follows:

- (a) Within ten (10) days following Lessor's notice to Lessee of the Fair Market Rental Rate (FMV), Lessor and Lessee shall meet or connect via conference calls no less than two (2) times, at a mutually agreeable time and if applicable place, to attempt to agree upon the Fair Market Rental Rate (FMV).
- (b) If within this ten (10) day period thereafter Lessor and Lessee cannot reach agreement as to the Fair Market Rental Rate (FMV), they shall each select one Commercial Real Estate Agent (CREA) with a minimum of five (5) years leasing office space experience in the Palo Alto area, to determine the Fair Market Rental Rate (FMV). Each such CREA shall arrive at a determination of the Fair Market Rental Rate (FMV) and submit his or her conclusions to Lessor and Lessee within twenty (20) days after the expiration of the ten (10) day consultation period described in (a) above (but in no event later than the commencement of the 3rd month prior to the end of the lease term).
- (c) If only one CREA is submitted within the requisite time period, it shall be deemed to be the Fair Market Rental Rate (FMV). If both CREA's are submitted within such time period, and if the two CREA's so submitted differ by less than ten (10) percent of the higher of the two, the average of the two shall be the Fair Market Rental Rate (FMV). If the two CREA's differ by more than ten (10) percent of the higher of the two, then the two CREA's shall immediately select a third CREA who will within fifteen (15) days of his or her selection make a determination of the Fair Market Rental Rate (FMV) and submit such determination to Lessor and Lessee (but in no event later than the commencement of the 2nd month prior to the end of the lease term). This third CREA will then be averaged with the closer of the two previous CREA's and the result shall be the Fair Market Rental Rate (FMV).
- (d) Each party shall pay the cost of the CREA selected by such party and one-half of the cost of the third CREA plus one-half of any other costs incurred in the determination.

Initials
Initials





FIRST ADDENDUM

FIRST ADDENDUM TO THAT CERTAIN LEASE DATED JULY 1, 2008 BY AND BETWEEN JACK ROMINGER, TOMMIE PLEMONS AND DALE DENSON AS LESSOR AND HARRIS & HARRIS ENTERPRISE, INC., A NY CORPORATION AS LESSEE FOR APPROXIMATELY 2,290 RENTABLE SQUARE FEET LOCATED AT 420 FLORENCE STREET, SUITE 200, PALO ALTO, CALIFORNIA 94301

1. Commencement Date:

The initial term of this Lease ("Term") shall be five (5) year. The lease shall commence two (2) weeks following Lessor completion of Tenant Improvement work, with the commencement date no earlier than August 1, 2008 and no later than August 15, 2008.

2. Base Rate (Full Service):

<u>Months</u>	<u>Monthly Full Service Rent</u>
01 - 12	\$10,305.00

Effective the 13th month of the lease term and annually thereafter, the Base Rent shall increase according to the SF/SJ Consumer Price Index, but not less than 3% or more than 7% per year.

3. Early Access:

Lessee shall have access to the Premises upon execution of the formal lease agreement and Lessor's completion of said Tenant Improvements for the purpose of installing furniture, fixtures, voice and data communications systems, and any other improvements or equipment necessary for the conduct of Lessee's business. Said Early Access shall be at no cost to Lessee. Lessee may have access during Lessor construction period if Lessor agrees such early access shall not unreasonably interfere with Lessor work.

4. Delivery Condition:

In addition to the Tenant Improvements defined herein, Lessor shall deliver the Premises "as is" with the HVAC, electrical, lighting, plumbing, mechanical, life safety, fire protection, roof, roof membrane, and building systems in good working order. Upon Lessor's receipt of Lessee's written notification, within the first thirty (30) days of Lessee occupancy of the Premises, Lessor shall repair any punch list items as soon as possible.

5. Tenant Improvements:

Lessor shall provide the Lessee with the following improvements within thirty (30) days of the lease execution date:



F I R S T A D D E N D U M

A. Paint & Interior Walls: Lessor has painted the Premises, however, Lessor shall provide touch up paint as needed, paint or replace the window shutters located in the front office and remove the half-wall in the interior core of the Premises as outlined on the attached Exhibit A.

B. Carpet: Lessor shall provide new carpet according to building standard in the Premises, excluding the hallway. The carpet color shall be mutually agreed upon by the Lessee and Lessor within five (5) business days of lease execution.

C. Lighting & Electrical: Lessor shall replace all burnt out condensed fluorescent tube lighting with light bulbs that match, both in color and form, to the existing working light bulbs.

Lessor shall replace the recessed cans (if a replacement can be found that does not involve changing the existing ceiling wall to house a new alternative fixture) and replace lights with an updated can and white light for the purpose of providing brighter lighting. Lessor and Lessee shall review the options. All plastic light diffusers shall be cleaned or replaced as needed.

D. Windows: Lessor shall clean the interior and exterior of the exterior windows. The cleaning of the exterior of the windows shall be done once exterior of the building is painted scheduled for completion in the next 60 – 90 days.

6. Conference Room:

Lessor, at Lessor's sole cost and expense, has provided a furnished conference room on the first floor for all the building occupants' non-exclusive use and is included in the building definition "Common Area". Lessee's of the building sign up to use the conference room on a first come first available basis.

7. Signage:

Lessor, at Lessor's expense, shall provide building standard directory in the main lobby of the building. Lessee, at its sole cost and expense, shall be responsible for suite signage, subject to reasonable approval from Lessor. Any signage on the suite entry door shall be removed by Lessee, at Lessee's cost, at the end of the term.

8. Assignment/Sublease:

Pursuant to paragraph 12 of the Lease, in the event a Sublease is approved, Lessor and Lessee shall split 50% to Lessor and 50% to Lessee any Base Rent in excess of Lessee's current Base Rent paid ("Excess Rent"), less the cost of a real estate broker fee associated with the Sublease/assignment in this Section 8, if applicable. Lessor shall have the right to recapture the Premises if Lessee Subleases more than 50% of the Premises.

Notwithstanding, Lessor acknowledges Lessee may sublease up to two (2) offices for general office use without Lessor approval, but with written notification to Lessor. All remaining terms of the Lease, other than sharing Excess Rent as defined in this Section 8, shall be applicable.

F I R S T A D D E N D U M

9. Access to Premises:

Notwithstanding Paragraph 12 of the general rules and regulations entered into as of the same date hereof, Lessee shall have 24 hour/7 day per week access to the Premises.

10. Option to Extend:

As further defined in the lease, Lessee shall notify Lessor in writing no sooner than seven (7) months and no later than five (5) months prior to the Expiration Date of the Lease of their intent to exercise the option or the option shall be null and void. The option shall be according to the same terms and conditions as the underlying lease except the option shall be at Fair Market Value (FMV) for current office space in downtown Palo Alto, but not less than the last month rent paid.

Determination of FMV is as defined in Exhibit C.

11. Article 50:

Notwithstanding the foregoing Article 50 of the Lease, Lessee shall not be liable for any ADA compliance related to the Tenant Improvements set forth on Article 5 of the First Addendum herein which are to be performed by Landlord.

12. After hours:

The parties acknowledge all tenants of the building cooperate to lock the front door after 5:00 PM weekdays and all day on weekends and holidays.

13. Effect of Addendum:

All terms with initial capital letters used herein as defined terms shall have the meanings ascribed to them in the Lease unless specifically defined herein. In the event of any inconsistency between this Addendum and the Lease, the terms of this Addendum shall prevail. As used herein, the term "Lease" shall mean the Lease, this Addendum and all riders, exhibits, rules, regulations, referred in the Lease or this Addendum.

Acknowledged and Agreed To:

Lessor's Initials



Lessee's Initials



5 A.

Lessee shall be permitted, at Lessee's cost, to repaint the walls, trim, doors and shutters to a color mutually agreed upon by Lessor and Lessee, which shall be in good taste and complimentary to the Premises.

Lessee shall be permitted, at Lessee's cost, to replace the existing light switches and plates, and electrical outlets and plates with white colored ones that will be mutually agreed upon by Lessor and Lessee.

RULES AND REGULATIONS FOR STANDARD OFFICE LEASE



Dated July 1, 2008

By and Between Jack Rominger, Tommie Plemons and Dale Denson as Lessor and Harris & Harris Enterprise, Inc., a New York corporation as Lessee for the Premises located at 420 Florence Street, Suite 200, Palo Alto, California.

GENERAL RULES

1. Lessee shall not suffer or permit the obstruction of any Common Areas, including driveways, walkways and stairways.
2. Lessor reserves the right to refuse access to any persons Lessor in good faith judges to be a threat to the safety and reputation of the Project and its occupants.
3. Lessee shall not make or permit any noise or odors that annoy or interfere with other lessees or persons having business within the Project.
4. Lessee shall not keep animals or birds within the Project, and shall not bring bicycles, motorcycles or other vehicles into areas not designated as authorized for same.
5. Lessee shall not make, suffer or permit litter except in appropriate receptacles for that purpose.
6. Lessee shall not alter any lock or install new or additional locks or bolts.
7. Lessee shall be responsible for the inappropriate use of any toilet rooms, plumbing or other utilities. No foreign substances of any kind are to be inserted therein.
8. Lessee shall not deface the walls, partitions or other surfaces of the Premises or Project.
9. Lessee shall not suffer or permit anything in or around the Premises or Building that causes excessive vibration or floor loading in any part of the Project.
10. Furniture, significant freight and equipment shall be moved into or out of the building only with the Lessor's knowledge and consent, and subject to such reasonable limitations, techniques and timing, as may be designated by Lessor. Lessee shall be responsible for any damage to the Office Building Project arising from any such activity.
11. Lessee shall not employ any service or contractor for services or work to be performed in the Building, except as approved by Lessor.
12. Lessor reserves the right to close and lock the Building on Saturdays, Sundays and Building Holidays, and on other days between the hours of 6 P.M. and 8 A.M. of the following day. If Lessee uses the Premises during such periods, Lessee shall be responsible for securely locking any doors it may have opened for entry.
13. Lessee shall return all keys at the termination of its tenancy and shall be responsible for the cost of replacing any keys that are lost.
14. No window coverings, shades or awnings shall be installed or used by Lessee.
15. No Lessee, employee or invitee shall go upon the roof of the Building.
16. Lessee shall not suffer or permit smoking or carrying of lighted cigars or cigarettes in areas reasonably designated by Lessor or by applicable governmental agencies as non-smoking areas.
17. Lessee shall not use any method of heating or air conditioning other than as provided by Lessor.
18. Lessee shall not install, maintain or operate any vending machines upon the Premises without Lessor's written consent.
19. The Premises shall not be used for lodging or manufacturing, cooking or food preparation.
20. Lessee shall comply with all safety, fire protection and evacuation regulations established by Lessor or any applicable governmental agency.
21. Lessor reserves the right to waive any one of these rules or regulations, and/or as to any particular Lessee, and any such waiver shall not constitute a waiver of any other rule or regulation or any subsequent application thereof to such Lessee.
22. Lessee assumes all risks from theft or vandalism and agrees to keep its Premises locked as may be required.
23. Lessor reserves the right to make such other reasonable rules and regulations as it may from time to time deem necessary for the appropriate operation and safety of the Project and its occupants. Lessee agrees to abide by these and such rules and regulations.

PARKING RULES

1. Parking areas shall be used only for parking by vehicles no longer than full-size, passenger automobiles herein called "Permitted Size Vehicles." Vehicles other than Permitted Size Vehicles are herein referred to as "Over-sized Vehicles."
2. Lessee shall not permit or allow any vehicles that are "Over-sized Vehicles."
3. Lessee shall not permit or allow any vehicles that are "Over-sized Vehicles" to be loaded, unloaded, or parked in areas other than those designated by Lessor for such activities.
4. Parking stickers or identification devices shall be the property of Lessor and be returned to Lessor by the holder thereof upon termination of the holder's parking privileges. Lessee will pay such replacement charge as is reasonably established by Lessor for the loss of such devices.
5. Lessor reserves the right to refuse the sale of monthly identification devices to any person or entity that willfully refuses to comply with the applicable rules, regulations, laws and/or agreements.
6. Lessor reserves the right to relocate all or a part of parking spaces from floor-to-floor, within one floor, and/or to reasonably adjacent off-site location(s), and to reasonably allocate them between compact and standard size spaces, as long as the same complies with applicable laws, ordinances and regulations.
7. Users of the parking area will obey all posted signs and park only in the areas designated for vehicle parking.
8. Unless otherwise instructed, every person using the parking area is required to park and lock his own vehicle. Lessor will not be responsible for any damage to vehicles, injury to persons or loss of property, all of which risks are assumed by the party using the parking area.
9. Validation, if established, will be permissible only by such method or methods as Lessor and/or its licensee may establish at rates generally applicable to visitor parking.
10. The maintenance, washing, waxing or cleaning of vehicles in the parking structure or Common Areas is prohibited.
11. Lessee shall be responsible for seeing that all of its employees, agents and invitees comply with the applicable parking rules, regulations, laws and agreements.
12. Lessor reserves the right to modify these rules and/or adopt such other reasonable and non-discriminatory rules and regulations as it may deem necessary for the proper operation of the parking area.
13. Such parking use as is herein provided is intended merely as a license only and no bailment is intended or shall be created hereby.

© 1999 - American Industrial Real Estate Association

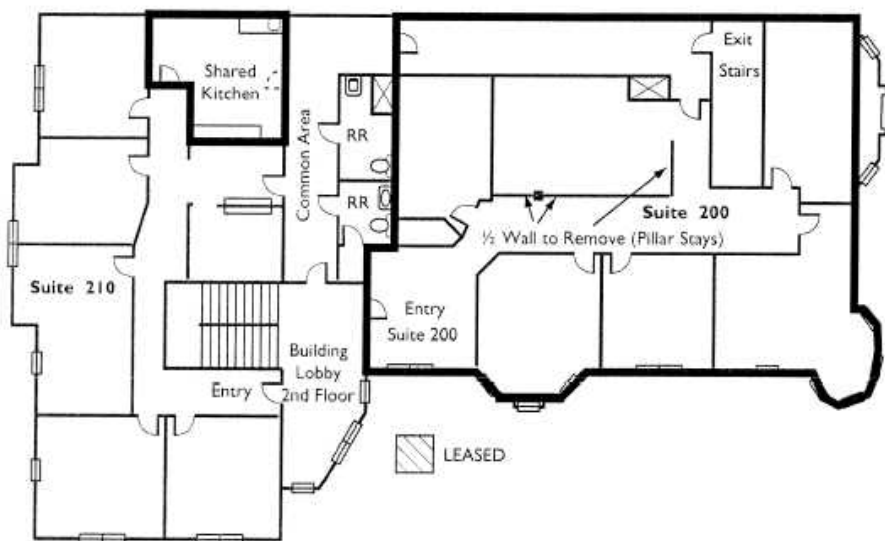
Page 1 of 1
REVISED

Initials

FORM OFG-1.9/99E



STANDARD OFFICE LEASE
FLOOR PLAN



[Signature]
DATE

PAGE 1 OF 1

[Signature]
INITIALS

(b) If this Lease is executed by more than one person or entity as "Lessee", each such person or entity shall be jointly and severally liable hereunder. It is agreed that any one of the named Lessees shall be empowered to execute any amendment to this Lease, or other document ancillary thereto and bind all of the named Lessees, and Lessor may rely on the same as if all of the named Lessees had executed such document.

44. **Conflict.** Any conflict between the printed provisions of this Lease and the typewritten or handwritten provisions shall be controlled by the typewritten or handwritten provisions.

45. **Offer.** Preparation of this Lease by either party or their agent and submission of same to the other Party shall not be deemed an offer to lease to the other Party. This Lease is not intended to be binding until executed and delivered by all Parties hereto.

46. **Amendments.** This Lease may be modified only in writing, signed by the Parties in interest at the time of the modification. As long as they do not materially change Lessee's obligations hereunder, Lessee agrees to make such reasonable nonmonetary modifications to this Lease as may be reasonably required by a Lender in connection with the obtaining of normal financing or refinancing of the Premises.

47. **Multiple Parties.** If more than one person or entity is named herein as either Lessor or Lessee, such multiple Parties shall have joint and several responsibility to comply with the terms of this Lease.

48. **Waiver of Jury Trial.** THE PARTIES HEREBY WAIVE THEIR RESPECTIVE RIGHTS TO TRIAL BY JURY IN ANY ACTION OR PROCEEDING INVOLVING THE PROPERTY OR ARISING OUT OF THIS AGREEMENT.

49. **Mediation and Arbitration of Disputes.** An Addendum requiring the Mediation and/or the Arbitration of all disputes between the Parties and/or Brokers arising out of this Lease ☐ is ☒ is not attached to this Lease.

50. **Americans with Disabilities Act.** In the event that as a result of Lessee's use, or intended use, of the Premises the Americans with Disabilities Act or any similar law requires modifications or the construction or installation of improvements in or to the Premises, Building, Project and/or Common Areas, the Parties agree that such modifications, construction or improvements shall be made at: ☐ Lessor's expense ☒ Lessee's expense.

LESSOR AND LESSEE HAVE CAREFULLY READ AND REVIEWED THIS LEASE AND EACH TERM AND PROVISION CONTAINED HEREIN, AND BY THE EXECUTION OF THIS LEASE SHOW THEIR INFORMED AND VOLUNTARY CONSENT THERETO. THE PARTIES HEREBY AGREE THAT, AT THE TIME THIS LEASE IS EXECUTED, THE TERMS OF THIS LEASE ARE COMMERCIALY REASONABLE AND EFFECTUATE THE INTENT AND PURPOSE OF LESSOR AND LESSEE WITH RESPECT TO THE PREMISES.

ATTENTION: NO REPRESENTATION OR RECOMMENDATION IS MADE BY THE AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION OR BY ANY BROKER AS TO THE LEGAL SUFFICIENCY, LEGAL EFFECT, OR TAX CONSEQUENCES OF THIS LEASE OR THE TRANSACTION TO WHICH IT RELATES. THE PARTIES ARE URGED TO:

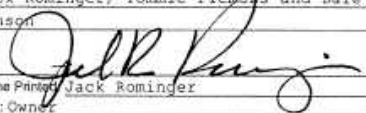
1. SEEK ADVICE OF COUNSEL AS TO THE LEGAL AND TAX CONSEQUENCES OF THIS LEASE.
2. RETAIN APPROPRIATE CONSULTANTS TO REVIEW AND INVESTIGATE THE CONDITION OF THE PREMISES. SAID INVESTIGATION SHOULD INCLUDE BUT NOT BE LIMITED TO: THE POSSIBLE PRESENCE OF HAZARDOUS SUBSTANCES, THE ZONING AND SIZE OF THE PREMISES, THE STRUCTURAL INTEGRITY, THE CONDITION OF THE ROOF AND OPERATING SYSTEMS, COMPLIANCE WITH THE AMERICANS WITH DISABILITIES ACT AND THE SUITABILITY OF THE PREMISES FOR LESSEE'S INTENDED USE.

WARNING: IF THE PREMISES ARE LOCATED IN A STATE OTHER THAN CALIFORNIA, CERTAIN PROVISIONS OF THE LEASE MAY NEED TO BE REVISED TO COMPLY WITH THE LAWS OF THE STATE IN WHICH THE PREMISES ARE LOCATED.

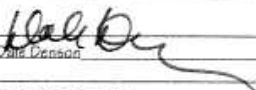
The parties hereto have executed this Lease at the place and on the dates specified above their respective signatures.

Executed at: _____
on: _____

By LESSOR:
Jack Rominger, Tommie Plemons and Dale
Denson

By: 
Name Printed: Jack Rominger
Title: Owner


Name Printed: Tommie Plemons
Title: Owner

By: 
Name Printed: Dale Denson
Title: Owner
Address: c/o Dalton Realty
510 Waverley Street
Palo Alto, CA 94301

(650) 321-1711 / (650) 327-2383
Telephone / Facsimile
Federal ID No. _____


LESSOR'S
BROKER: _____

Attn: _____
Address: _____

Telephone / Facsimile No. _____

Executed at: _____
on: _____

By LESSEE:
Harris & Harris Enterprise, Inc. a New
York corporation

By: 
Name Printed: Douglas Jamison
Title: President & COO
E-mail: doug@tinytechvc.com
Office: (212) 582-0900

By: _____
Name Printed: _____
Title: _____

Palo Alto Tenant Contact:
Michael Janse (E-mail: mike@tinytechvc.com)
Cell: (650) 615-8079
Alternative Address: 111 W. 57th Street, Suite 1100
New York, NY 10019

Telephone / Facsimile
Federal ID No. _____

LESSEE'S
BROKER: _____

Attn: _____
Address: _____

Telephone / Facsimile No. _____

These forms are often modified to meet changing requirements of law and needs of the industry. Always write or call to make sure you are utilizing the most current form: American Industrial Real Estate Association, 700 South Flower Street, Suite 600, Los Angeles, CA 90017. (213) 687-8777.

©Copyright 1999 By American Industrial Real Estate Association.
All rights reserved.

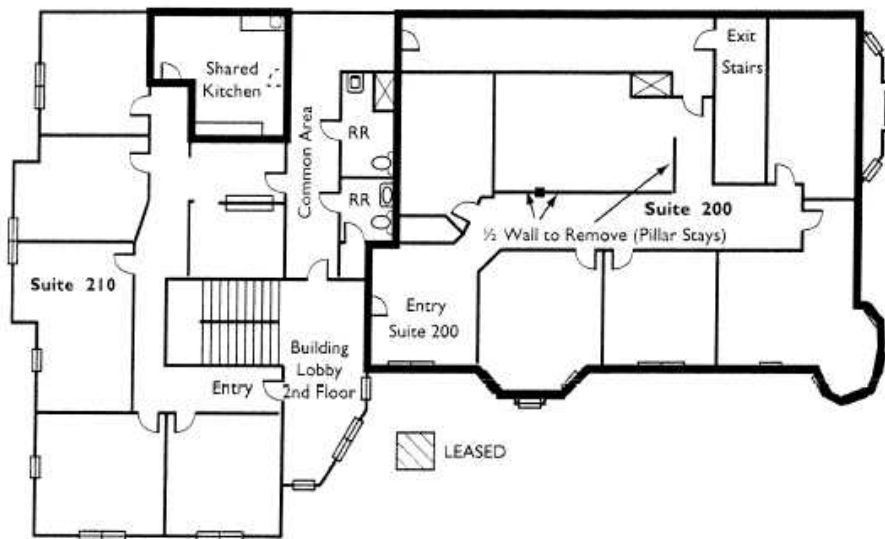

© 1999 - American Industrial Real Estate Association

Page 12 of 13
REVISED


Initial
FORM OFG-1-9/99E



STANDARD OFFICE LEASE
FLOOR PLAN





ONCOR INTERNATIONAL

S E C O N D A D D E N D U M

SECOND ADDENDUM TO THAT CERTAIN LEASE AND FIRST ADDENDUM DATED JULY 1, 2008 BY AND BETWEEN JACK ROMINGER, TOMMIE PLEMONS AND DALE DENSON AS LESSOR AND HARRIS & HARRIS ENTERPRISE, INC., A DELAWARE CORPORATION AS LESSEE FOR APPROXIMATELY 2,290 RENTABLE SQUARE FEET LOCATED AT 420 FLORENCE STREET, SUITE 200, PALO ALTO, CALIFORNIA 94301

1. Lessee Name Change:

The Parties hereto acknowledge the Lessee entity for the Lease was assigned from Harris & Harris Enterprise, Inc., a Delaware Corporation to Harris & Harris Group, Inc., a NY Corporation effective July 1, 2008.

Lessee Address:

Harris & Harris Group, Inc.
111 West 57th Street, Suite 1100
New York, NY 10019
(212) 582-0900 x 10 - Phone
(212) 582-9563 - Fax
Admin@TinyTechVC.com - E-mail

2. Effect of Addendum:

All terms with initial capital letters used herein as defined terms shall have the meanings ascribed to them in the Lease unless specifically defined herein. In the event of any inconsistency between this Addendum and the Lease, the terms of this Addendum shall prevail. As used herein, the term "Lease" shall mean the Lease, this Addendum and all riders, exhibits, rules, regulations, referred in the Lease or this Addendum.

Acknowledged and Agreed To:

Lessor's Initials

DRK
JRP

Date: *11-5-08*

Lessee's Initials

ETH

Date: *11-5-08*

245 LYTTON AVENUE, SUITE 150, PALO ALTO, CA 94301 • (650) 322-2600 FAX (650) 321-0719

Certification of Chief Executive Officer
Pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a)

I, Charles E. Harris, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q 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/ Charles E. Harris

Name: Charles E. Harris

Title: Chief Executive Officer

Date: November 7, 2008

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 Quarterly Report on Form 10-Q 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: November 7, 2008

**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 Quarterly Report on Form 10-Q of Harris & Harris Group, Inc. (the "Company") for the quarter ended September 30, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Charles E. Harris, 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/ Charles E. Harris

Name: Charles E. Harris

Title: Chief Executive Officer

Date: November 7, 2008

/s/ Daniel B. Wolfe

Name: Daniel B. Wolfe

Title: Chief Financial Officer

Date: November 7, 2008