MEXICAN ECONOMIC DEVELOPMENT INC
Form F-3ASR
April 09, 2013
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As filed with the Securities and Exchange Commission on April 8, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM F-3

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

FOMENTO ECONÓMICO MEXICANO, S.A.B. DE C.V.

(Exact name of registrant as specified in its charter)

Mexican Economic Development, Inc.

(Translation of registrant s name into English)

United Mexican States

(State or other jurisdiction of incorporation or organization)

Not Applicable

(I.R.S. Employer Identification Number)

General Anaya No. 601 Pte.

Colonia Bella Vista

Monterrey, NL 64410 Mexico

Telephone: (52-81) 8328-6000

(Address and telephone number of registrant s principal executive offices)

Puglisi & Associates

850 Library Avenue, Suite 204

Newark, Delaware 19711

Telephone: (302) 738-6680

(Name, address and telephone number of agent for service)

Copies to:

Duane McLaughlin

Cleary Gottlieb Steen & Hamilton LLP

One Liberty Plaza

New York, New York 10006

(212) 225-2000

Approximate date of commencement of proposed sale to the public: From time to time after this registration statement becomes effective.

If only securities being registered on this Form are to be offered pursuant to dividend or interest reinvestment plans, please check the following box: ¨

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box: x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: ¨

If this Form is a registration statement pursuant to General Instruction I.C. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box: x

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.C. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box: ¨

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price Per Unit	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
Debt securities			See Note (1)	
Warrants				
Guarantees of debt securities				

(1) The registrant is registering an indeterminate amount of securities for offer and sale from time to time at indeterminate offering prices. In reliance on Rules 456(b) and 457(r) under the Securities Act of 1933, as amended, the registrant is deferring payment of all of the registration fee relating to the registration of securities.

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PROSPECTUS

FOMENTO ECONÓMICO MEXICANO, S.A.B. DE C.V.

DEBT SECURITIES

WARRANTS

GUARANTEES

We may from time to time offer debt securities, warrants to purchase debt securities or guarantees of debt securities issued by others. This prospectus describes some of the general terms that may apply to these securities and the general manner in which they may be offered. When we offer securities, the specific terms of the securities, the offering price and the specific manner in which they may be offered, will be described in supplements to this prospectus.

Investment in the securities involves risks. See Risk Factors beginning on page 4 of this prospectus.

Neither the U.S. Securities and Exchange Commission (the SEC) nor any state securities commission has approved or disapproved of these securities or determined if this prospectus or any accompanying prospectus supplement is truthful or complete. Any representation to the contrary is a criminal offense.

THE SECURITIES HAVE NOT BEEN AND WILL NOT BE REGISTERED WITH THE NATIONAL SECURITIES REGISTRY (*REGISTRO NACIONAL DE VALORES*) MAINTAINED BY THE MEXICAN NATIONAL BANKING AND SECURITIES COMMISSION (*COMISIÓN NACIONAL BANCARIA Y DE VALORES, OR CNBV*), AND MAY NOT BE OFFERED OR SOLD PUBLICLY IN MEXICO, EXCEPT THAT THE SECURITIES MAY BE OFFERED AND SOLD IN MEXICO, PURSUANT TO THE PRIVATE PLACEMENT EXEMPTION SET FORTH IN ARTICLE 8 OF THE MEXICAN SECURITIES MARKET LAW (*LEY DEL MERCADO DE VALORES*), TO INSTITUTIONAL AND QUALIFIED INVESTORS. UPON THE ISSUANCE OF ANY SECURITIES, WE WILL NOTIFY THE CNBV OF THE ISSUANCE, INCLUDING THE PRINCIPAL CHARACTERISTICS OF THE SECURITIES AND THE OFFERING OF THE SECURITIES OUTSIDE MEXICO. SUCH NOTICE WILL BE DELIVERED TO THE CNBV TO COMPLY WITH A LEGAL REQUIREMENT AND FOR INFORMATION PURPOSES ONLY, AND THE DELIVERY TO AND THE RECEIPT BY THE CNBV OF SUCH NOTICE, DOES NOT CONSTITUTE OR IMPLY ANY CERTIFICATION AS TO THE INVESTMENT QUALITY OF THE SECURITIES OR OF OUR SOLVENCY, LIQUIDITY OR CREDIT QUALITY OR THE ACCURACY OR COMPLETENESS OF THE INFORMATION SET FORTH IN THIS PROSPECTUS. THE INFORMATION CONTAINED IN THIS PROSPECTUS IS THE EXCLUSIVE RESPONSIBILITY OF THE ISSUER AND HAS NOT BEEN REVIEWED OR AUTHORIZED BY THE CNBV.

April 8, 2013

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We are responsible for the information contained in this prospectus, any accompanying prospectus supplement and the documents incorporated by reference herein and therein. We have not authorized any person to give you any other information, and we take no responsibility for any other information that others may give you. This document may only be used where it is legal to sell these securities. You should not assume that the information contained in this prospectus, any accompanying prospectus supplement and the documents incorporated by reference are accurate as of any date other than their respective dates. Our business, financial condition, results of operations and prospects may have changed since those dates. We are not making an offer of these securities in any state where the offer is not permitted.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the SEC using a shelf registration process. Under this shelf process, Fomento Económico Mexicano, S.A.B. de C.V. may from time to time offer debt securities, warrants to purchase debt securities or guarantees of debt securities issued by others.

As used in this prospectus, FEMSA, we, our and us refer to Fomento Económico Mexicano, S.A.B. de C.V. and its consolidated subsidiaries, unless the context otherwise requires or unless otherwise specified.

This prospectus only provides a general description of the securities that we may offer. Each time we offer securities, we will prepare a prospectus supplement containing specific information about the particular offering and the terms of those securities. We may also add, update or change other information contained in this prospectus by means of a prospectus supplement or by incorporating by reference information we file with the SEC. The registration statement that we filed with the SEC includes exhibits that provide more detail on the matters discussed in this prospectus. Before you invest in any securities offered by this prospectus, you should read this prospectus, any related prospectus supplement and the related exhibits filed with the SEC, together with the additional information described under the headings Where You Can Find More Information and Incorporation of Certain Documents by Reference.

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FORWARD-LOOKING STATEMENTS

Some of the information contained or incorporated by reference in this prospectus may contain words, such as believe, expect and anticipate and similar expressions that identify forward-looking statements. Use of these words reflects our views about future events and financial performance. Actual results could differ materially from those projected in these forward-looking statements as a result of various factors that may be beyond our control, including but not limited to:

- effects on our company from changes in our relationship with or among our affiliated companies;
- movements in the prices of raw materials;
- changes in customer demand;
- competition; and
- significant developments in Mexico or international economic or political conditions or changes in the regulatory environment applicable to us, including foreign investment and antitrust regulations.

Forward-looking statements involve inherent risks and uncertainties. Accordingly, we caution readers not to place undue reliance on these forward-looking statements. In any event, these statements speak only as of their respective dates, and we undertake no obligation to update or revise any of them, whether as a result of new information, future events or otherwise.

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FEMSA

FEMSA is a leading company that participates in the beverage industry through Coca-Cola FEMSA, S.A.B. de C.V., which we refer to as Coca-Cola FEMSA, the largest franchise bottler of *Coca-Cola* products in the world; in the retail industry through FEMSA Comercio, S.A. de C.V., which we refer to as FEMSA Comercio, operating OXXO, the largest and fastest-growing chain of small-format stores in Latin America; and in the beer industry, through its ownership of the second largest equity stake in Heineken, one of the world s leading brewers with operations in 178 countries. As of December 31, 2012, FEMSA had total revenues of Ps. 238,309 million.

Fomento Económico Mexicano, S.A.B. de C.V. is a *sociedad anónima bursátil de capital variable* (a listed variable capital stock corporation) organized under the laws of Mexico with its principal executive offices at General Anaya No. 601 Pte., Colonia Bella Vista, Monterrey, Nuevo León 64410, México. Our telephone number at this location is (52-818) 328-6000.

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RISK FACTORS

We have set forth risk factors in our most recent annual report on Form 20-F, which is incorporated by reference in this prospectus. We have also set forth below certain additional risk factors that relate specifically to securities we may offer using this prospectus. We may include further risk factors in more recent reports on Form 6-K incorporated in this prospectus by reference, or in a prospectus supplement. You should carefully consider all these risk factors in addition to the other information presented or incorporated by reference in this prospectus.

Risks Relating to Debt Securities

There may not be a liquid trading market

If an active market for our debt securities does not develop, the price of our debt securities and the ability of a holder of debt securities to find a ready buyer will be adversely affected. As a result, we cannot assure you as to the liquidity of any trading market for our debt securities.

Creditors of our subsidiaries will have priority over the holders of our debt securities in claims to assets of our subsidiaries

The debt securities will be obligations of FEMSA and not of any of our subsidiaries. We conduct substantially all of our business and hold substantially all of our assets through our subsidiaries. Claims of creditors of our subsidiaries, including trade creditors, holders of bonds and banks and other lenders, will have priority over the holders of debt securities of FEMSA in claims to assets of our subsidiaries, and claims of creditors against subsidiaries will have priority over the holders of debt securities in claims to assets of our subsidiaries. In addition, our ability to meet our obligations, including under our debt securities, will depend, in significant part, on our receipt of cash dividends, advances and other payments from our subsidiaries.

Judgments of Mexican courts enforcing our obligations under the debt securities would be payable only in Mexican pesos

If proceedings were brought in Mexico seeking to enforce in Mexico our obligations in respect of debt securities, we would be required to discharge our obligations in Mexico solely in Mexican pesos and not in U.S. dollars or any other foreign currency. Under the *Ley Monetaria de los Estados Unidos Mexicanos* (the Mexican Monetary Law), an obligation denominated in a currency other than Mexican pesos that is payable in Mexico, whether as a result of the enforcement of a judgment or pursuant to an agreement, may be satisfied in Mexican pesos at the rate of exchange in effect on the date of payment. This rate is currently determined by *Banco de México* and published in the *Diario Oficial de la Federación* (the Official Gazette of the Federation). As a result, any amount paid by us in Mexican pesos to holders of debt securities may not be readily convertible into the amount of U.S. dollars or other currency that we are obligated to pay under the applicable indenture or that, if converted, such amounts may not be sufficient to purchase U.S. dollars equal to the amount of principal, interest, and additional interest due under the debt securities. In addition, our obligation to indemnify these holders against exchange losses may be unenforceable in Mexico.

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Investors may experience difficulties in enforcing civil liabilities against us or our directors, officers and controlling persons.

FEMSA is organized under the laws of Mexico, and most of our directors, officers and controlling persons reside outside the United States. In addition, all or a substantial portion of our assets and the assets of our directors, officers and controlling persons are located outside the United States. As a result, it may not be possible for investors to effect service of process within the United States on such persons or to enforce judgments against them, including in any action based on civil liabilities under the U.S. federal securities laws. Based on the opinion of Carlos Eduardo Aldrete Ancira, our general counsel, the enforceability against these persons in Mexico in actions for enforcement of judgments of U.S. courts of liabilities predicated solely upon the U.S. federal securities laws will be subject to certain requirements provided for in the Mexican Federal Civil Procedure Code and any applicable treaties. Some of the requirements may include personal service of process and that the judgments of U.S. courts are not contrary to Mexican public policy.

The enforceability of our obligations under the debt securities would be affected in the event of bankruptcy

Under Mexico s *Ley de Concursos Mercantiles* (Law on Mercantile Reorganization), if we were declared bankrupt or in *concurso mercantil* (bankruptcy reorganization), our obligations under our debt securities:

- would be converted into Mexican pesos and then from Mexican pesos into inflation-adjusted units, or *Unidades de Inversión*;
- would not be adjusted to take into account any depreciation of the Mexican peso against the U.S. dollar or other currency occurring after such declaration;
- would cease to accrue interest;
- would be satisfied at the time claims of all our creditors are satisfied;
- would be subject to the outcome of, and priorities recognized in, the relevant proceedings; and
- would be subject to certain statutory preferences, including tax, social security and labor claims and claims of secured creditors.

The collection of interest on interest may not be enforceable in Mexico

Mexican law does not permit the collection of interest on interest and, as a result, the accrual of default interest, if any, on past due ordinary interest accrued in respect of the notes may be unenforceable in Mexico.

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Developments in other countries may affect prices for the debt securities and adversely affect our ability to raise additional financing.

The market value of securities of Mexican companies is, to varying degrees, influenced by economic and securities market conditions in other emerging market countries. Although economic conditions are different in each country, investors reaction to developments in one country can have effects on the securities of issuers in other countries, including Mexico. We cannot assure you that events elsewhere, especially in emerging markets, will not adversely affect the market value of our securities.

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RATIO OF EARNINGS TO FIXED CHARGES

The table below presents our consolidated ratios of earnings to fixed charges for each of the periods indicated.

Fomento Económico Mexicano, S.A.B. de C.V. and Subsidiaries

Computation of Ratio of Earnings to Fixed Charges

Amounts in Millions of Mexican Pesos, Except Ratios

IFRS	**2012**	**2011**
Earnings available for fixed charges:		
Income before income taxes and share of the profit of associates and joint ventures accounted for using the equity method	Ps. 27,530	Ps. 23,552
Distributed income from equity investees	1,697	1,661
Plus:		
Fixed charges	3,463	3,249
Amortization of capitalized interest	14	3
Less:		
Capitalized interest	38	185
Non-controlling interest		
	Ps. 32,666	Ps. 28,280
Fixed Charges:		
Interest expense, net	2,506	2,302
Capitalized interest	38	185
Estimate of the interest within rental expense	919	762
Total fixed charges	Ps. 3,463	Ps. 3,249
Ratio of earnings to fixed charges	**9.43**	**8.70**

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USE OF PROCEEDS

Unless otherwise disclosed in connection with a particular offering of securities, we intend to use the net proceeds from the sale of the securities for general corporate purposes.

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DESCRIPTION OF DEBT SECURITIES

Unless otherwise specified in the applicable prospectus supplement, our debt securities will be issued under a base indenture, dated as of April 8, 2013 (the base indenture), and supplemental indentures relating to particular series of debt securities (collectively, the indenture). The indenture is an agreement between us and The Bank of New York Mellon, as trustee.

Our debt securities will not be guaranteed by any of our subsidiaries.

The following section summarizes the material terms that are common to all series of debt securities issued by FEMSA, and to the indenture under which such securities are issued, unless otherwise indicated in this section or in the prospectus supplement relating to a particular series. We will describe the particular terms of each series of debt securities offered in a supplement to this prospectus.

Because this section is a summary, it does not describe every aspect of the debt securities and the indenture. This summary is subject to and qualified in its entirety by reference to all the provisions of the indenture, including the definition of various terms used in the indenture. For example, we describe the meanings for only the more important terms that have been given special meanings in the indenture. We also include references in parentheses to some sections of the base indenture.

The indenture and the documents relating to each series of debt securities contain the full legal text of the matters summarized in this section. We have filed a copy of the base indenture with the SEC as an exhibit to the registration statement of which this prospectus forms a part. We will file a copy of the supplemental indentures relating to particular series of debt securities with the SEC. Upon request, we will provide you with a copy of the indenture. See Where You Can Find More Information for information concerning how to obtain a copy.

In this section, references to we, us and our are to Fomento Económico Mexicano, S.A.B. de C.V. only and do not include our subsidiaries or affiliates. References to holders mean those who have debt securities registered in their names on the books that we or the trustee maintain for this purpose, and not those who own beneficial interests in debt securities issued in book-entry form through The Depository Trust Company or in debt securities registered in street name. Owners of beneficial interests in debt securities should refer to Form of Debt Securities, Clearing and Settlement.

The debt securities will be issued in one or more series. The following discussion of provisions of the debt securities, including, among others, the discussion of provisions described under Redemption of Debt Securities, Defaults, Remedies and Waiver of Defaults, Modification and Waiver and Defeasance, applies to individual series of debt securities.

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General

Indenture

Unless otherwise specified in the applicable prospectus supplement, the debt securities will be issued under an indenture, dated as of April 8, 2013, as supplemented from time to time. The indenture is an agreement between us and The Bank of New York Mellon, as trustee. The trustee has the following two main roles:

First, the trustee can enforce your rights against us if we default in respect of the debt securities. There are some limitations on the extent to which the trustee acts on your behalf, which we describe under Defaults, Remedies and Waiver of Defaults.

Second, the trustee performs administrative duties for us, such as making interest payments and sending notices to holders of debt securities.

Ranking of the Debt Securities

We are a holding company and our principal assets are shares that we hold in our subsidiaries. Our debt securities will be senior unsecured obligations and, as such, will not be secured by any of our assets or properties or any assets or properties of any of our subsidiaries. As a result, by owning the debt securities, you will be one of our unsecured creditors. The debt securities will not be subordinated or senior to any of our other unsecured and unsubordinated obligations. In the event of a bankruptcy or liquidation proceeding against us, the debt securities would rank equally in right of payment with all our other unsecured and unsubordinated obligations.

The debt securities will be effectively subordinated to any secured obligations we may incur in the future and to all of the existing and future obligations of our subsidiaries. Claims of creditors of our subsidiaries, including trade creditors and bank and other lenders, will have priority over the holders of the debt securities in claims to assets of our subsidiaries.

Stated Maturity and Maturity

The day on which the principal amount of the debt securities is scheduled to become due is called the stated maturity of the principal. The principal may become due before the stated maturity by reason of redemption or acceleration after a default. The day on which the principal actually becomes due, whether at the stated maturity or earlier, is called the maturity of the principal.

We also use the terms stated maturity and maturity to refer to the dates when interest payments become due. For example, we may refer to a regular interest payment date when an installment of interest is scheduled to become due as the stated maturity of that installment. When we refer to the stated maturity or the maturity of the debt securities without specifying a particular payment, we mean the stated maturity or maturity, as the case may be, of the principal.

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Rate of Interest of the Debt Securities

The debt securities will bear interest at a fixed or floating rate. If the debt securities bear interest at a floating rate, the floating interest rate formula will be based on one or more base rates plus or minus a fixed amount or multiplied by a specified percentage.

Form and Denominations

The debt securities will be issued only in fully registered book-entry form without coupons and in denominations of U.S. $150,000 and integral multiples of U.S. $2,000 in excess thereof, unless otherwise specified in the applicable prospectus supplement. *(Section 302)*

Except in limited circumstances, the debt securities will be issued in the form of global debt securities. See Form of Debt Securities, Clearing and Settlement.

Further Issues

Unless otherwise specified in the applicable prospectus supplement, we reserve the right, from time to time without the consent of holders of a particular series of the debt securities, to issue additional debt securities on terms and conditions substantially identical to those of such series of the debt securities (except as to denomination and as may otherwise be provided in any applicable prospectus supplement). *(Section 301)*

Payment Provisions

Payments on the Debt Securities

We will pay interest on the debt securities on the interest payment dates stated in the applicable prospectus supplement and at maturity. Each payment of interest due on an interest payment date or at maturity will include interest accrued from and including the last date to which interest has been paid or made available for payment, or from the issue date, if none has been paid or made available for payment, to but excluding the relevant payment date.

For interest due on a debt security on an interest payment date, we will pay the interest to the holder in whose name the debt security is registered at the close of business on the regular record date relating to the interest payment date. For interest due, but not punctually paid or duly provided for, on any interest payment date, we will pay the interest to the person or entity entitled to receive the principal of the debt security. *(Section 306)*

For principal due on a debt security at maturity, we will pay the amount to the holder of the debt security against surrender of the debt security at the proper place of payment. *(Section 1001)*

Unless otherwise specified in the applicable prospectus supplement, we will compute interest on debt securities bearing interest at a fixed rate on the basis of a 360-day year of twelve 30-day months.

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The regular record dates relating to the interest payment dates for any debt security will be set forth in the applicable prospectus supplement.

Payments on Global Debt Securities. For debt securities issued in global form, we will make payments on the debt securities in accordance with the applicable procedures of the depositary as in effect from time to time. *(Section 1002)* Under those procedures, we will make payments through the trustee or a paying agent directly to the depositary, or its nominee, as the registered holder of the global debt security and not to any indirect holders who own beneficial interests in a global debt security. An indirect holder s right to receive those payments will be governed by the rules and practices of the depositary and its participants.

Payments on Certificated Debt Securities. For debt securities issued in certificated form, we will pay interest that is due on an interest payment date by check mailed on the interest payment date to the holder at the holder s address shown on the register maintained by the security registrar as of the close of business on the regular record date (Section 202). In addition, if we issue debt securities in certificated form, holders of debt securities in certificated form will be able to receive payment on their debt securities at the office or agency of the Company maintained in New York City or any other place as we may set forth in the applicable prospectus supplement. *(Section 1002)*

Payment When Offices Are Closed

If any payment is due on a debt security on a day that is not a business day, we will make the payment on the day that is the next business day. Payments postponed to the next business day in this situation will be treated under the indenture or the supplemental indenture as if they were made on the original due date. Postponement of this kind will not result in a default under the debt securities, the indenture or the supplemental indenture. If interest on the debt securities is calculated on the basis of a 360-day year of twelve 30-day months, no interest will accrue on the postponed amount from the original due date to the next day that is a business day.

Business day means each Monday, Tuesday, Wednesday, Thursday and Friday that is (a) not a day on which banking institutions in New York City or Mexico City generally are authorized or obligated by law, regulation or executive order, as applicable, to close and (b) in the case of debt securities issued in certificated form, a day on which banks and financial institutions are generally open for business in the location of each office of a paying agent, but only with respect to a payment to be made at the office of such paying agent. *(Section 101)*

Paying Agents

If we issue debt securities in certificated form, we may appoint one or more financial institutions to act as our paying agents, at whose designated offices the debt securities may be surrendered for payment at their maturity. We may add, replace or terminate paying agents from time to time; *provided* that if any debt securities are issued in certificated form, so long as such debt securities are outstanding, we will maintain a paying agent in New York City. We may also choose to act as our own paying agent. Initially, we have appointed the trustee, at its corporate trust office in New York City, as a paying agent.

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Unclaimed Payments

All money paid by us to the trustee or any paying agent that remains unclaimed at the end of two years after the amount is due to a holder will be repaid to us. After that two-year period, the holder may look only to us for payment and not to the trustee, any paying agent or anyone else. *(Section 1003)*

Payment of Additional Interest

We are required by Mexican law to deduct Mexican withholding taxes from payments of interest (or amounts deemed interest) to holders of debt securities who are not residents of Mexico for tax purposes as described under Taxation Mexican Tax Considerations.

Subject to the limitations and exceptions described below, we will pay to holders of the debt securities all additional interest that may be necessary so that every net payment of interest or principal or premium to the holder will not be less than the amount provided for in the debt securities. By net payment, we mean the amount that we or our paying agent will pay the holder after we deduct or withhold an amount for or on account of any present or future taxes, duties, assessments or other governmental charges imposed or levied with respect to that payment (or the payment of such additional interest) by a Mexican taxing authority or the taxing authority of any other country under whose laws we or any successor of us (assuming the obligations of the debt securities, the indenture and any applicable supplemental indenture following a merger, consolidation or transfer, lease or conveyance of substantially all of our assets and properties) are organized at the time of payment, except for the United States (each, a Taxing Jurisdiction).

Our obligation to pay additional interest is, however, subject to several important exceptions. We will not pay additional interest to or on behalf of any holder or beneficial owner, or to the trustee, for or on account of any of the following:

any taxes, duties, assessments or other governmental charges imposed solely because at any time there is or was a connection between the holder and the Taxing Jurisdiction (other than the mere receipt of a payment or the ownership or holding of a debt security or the enforcement of rights with respect to a debt security);

any estate, inheritance, gift, sales, transfer, personal property or other similar tax, assessment or other governmental charge imposed with respect to the debt securities;

any taxes, duties, assessments or other governmental charges imposed solely because the holder or any other person fails to comply with any certification, identification or other reporting requirement concerning the nationality, residence, identity or connection with the Taxing Jurisdiction of the holder or any beneficial owner of the debt security if compliance is required by law, regulation or by an applicable income tax treaty to which such Taxing Jurisdiction is a party and which is effective, as a precondition to exemption from, or reduction in the rate of, the tax, assessment or other governmental charge and we have given the holders at least 30 calendar days notice prior to the first payment date with respect to which such certification, identification or reporting requirement is required to the effect that holders will be required to provide such information and identification;

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any tax, duty, assessment or other governmental charge payable otherwise than by deduction or withholding from payments on the debt securities;

any taxes, duties, assessments or other governmental charges with respect to a debt security presented for payment more than 15 days after the date on which the payment became due and payable or the date on which payment thereof is duly provided for and notice thereof given to holders, whichever occurs later, except to the extent that the holders of such debt security would have been entitled to such additional interest on presenting such debt security for payment on any date during such 15-day period;

any payment on a debt security to a holder that is a fiduciary or partnership or a person other than the sole beneficial owner of any such payment, to the extent that a beneficiary or settlor with respect to such fiduciary, a member of such a partnership or the beneficial owner of the payment would not have been entitled to the additional interest had the beneficiary, settlor, member or beneficial owner been the holder of such debt security;

any taxes, duties, assessments or other governmental charges that are imposed on a payment to an individual and are required to be made pursuant to European Council Directive 2003/48/EC on the taxation of savings income or any other directive implementing the conclusions of the ECOFIN Council meetings of November 26 and 27, 2000, December 13, 2001, and January 21, 2003, or any law or agreement implementing or complying with, or introduced in order to conform to, such a directive; and

any combination of the items in the bullet points above. *(Section 1008)*

The limitations on our obligations to pay additional interest described in the third bullet point above will not apply if the provision of information, documentation or other evidence described in the applicable bullet point would be materially more onerous, in form, in procedure or in the substance of information disclosed, to a holder or beneficial owner of a debt security, taking into account any relevant differences between U.S. and Mexican law, regulation or administrative practice, or the laws, regulations or administrative practices of any other Taxing Jurisdiction, than comparable information or other reporting requirements imposed under U.S. tax law (including the United States/Mexico Income Tax Treaty), regulations (including proposed regulations) and administrative practice. *(Section 1008(a))*

Applicable Mexican regulations currently allow us to withhold at a reduced rate, provided that we comply with certain information reporting requirements. Accordingly, the limitations on our obligations to pay additional interest described in the third bullet point above also will not apply with respect to any Mexican withholding taxes unless (a) the provision of the information, documentation or other evidence described in the applicable bullet point is expressly required by the applicable Mexican regulations, (b) we cannot obtain the information, documentation or other evidence necessary to comply with the applicable Mexican regulations on our own through reasonable diligence and (c) we otherwise would meet the requirements for application of the applicable Mexican regulations.

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In addition, the limitation described in the third bullet point above does not require that any person that is not a resident of Mexico for tax purposes, including any non-Mexican pension fund, retirement fund or financial institution, register with the *Secretaría de Hacienda y Crédito Público* (the Ministry of Finance and Public Credit, or the SHCP) or with the *Servicio de Administración Tributaria* (the Tax Administration Service or SAT) to establish eligibility for an exemption from, or a reduction of, Mexican withholding tax.

We will remit the full amount of any taxes withheld to the applicable taxing authorities in accordance with the applicable law of the Taxing Jurisdiction. We will also provide the trustee with documentation (which may consist of copies of such documentation) reasonably satisfactory to the trustee evidencing the payment of taxes in respect of which we have paid any additional interest. We will provide copies of such documentation to the holders of the debt securities or the relevant paying agent upon request. *(Section 1008(a))*

In the event that additional interest actually paid with respect to the debt securities pursuant to the preceding paragraphs is based on rates of deduction or withholding of taxes in excess of the appropriate rate applicable to the holder of such debt securities, and as a result thereof such holder is entitled to make a claim for a refund or credit of such excess from the authority imposing such withholding tax, then such holder shall, by accepting such debt securities, be deemed to have assigned and transferred all right, title and interest to any such claim for a refund or credit of such excess to us. However, by making such assignment, the holder makes no representation or warranty that we will be entitled to receive such claim for a refund or credit and incurs no other obligation with respect thereto. *(Section 1008(d))*

Any reference in this prospectus, the base indenture, any applicable supplemental indenture or the debt securities to principal, premium, if any, interest or any other amount payable in respect of the debt securities by us will be deemed also to refer to any additional interest that may be payable with respect to that amount under the obligations referred to therein. *(Section 1008(e))*

Redemption of Debt Securities

We will not be permitted to redeem the debt securities before their stated maturity, except as set forth below. The debt securities will not be entitled to the benefit of any sinking fund meaning that we will not deposit money on a regular basis into any separate account to repay your debt securities. In addition, you will not be entitled to require us to repurchase your debt securities from you before the stated maturity. *(Section 1101(a))*

Optional Redemption

If so indicated in the applicable prospectus supplement, we will be entitled, at our option, to redeem some or all of the outstanding debt securities from time to time at the redemption price set forth in the applicable prospectus supplement. If the debt securities are redeemable only on or after a specified date or upon the satisfaction of additional conditions, the prospectus supplement will specify the date or describe the conditions. In each case we will also pay you accrued and unpaid interest, if any, to the redemption date. Debt securities, or any portion thereof called for redemption, will stop bearing interest on and after the redemption date, unless the redemption payment of such debt security is not paid to you upon surrender. *(Sections 301, 1101 and 1104)*

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Redemption for Taxation Reasons

If either:

> as a result of any amendment to, or change in, the laws (or any rules or regulations thereunder) of Mexico, or any amendment to or change in an official interpretation or application of such laws, rules or regulations, which amendment to or change of such laws, rules or regulations becomes effective on or after the date of this offering memorandum, we would be obligated on the next succeeding interest payment date, after taking such measures as we may consider reasonable to avoid this requirement, to pay additional interest in excess of that attributable to a withholding tax rate of 4.9% with respect to the debt securities (see Payment of Additional Interest and Taxation Mexican Tax Considerations); or
>
> in the event that we or any successor of us (assuming the obligations of the debt securities and the indenture following a merger, consolidation or transfer, lease or conveyance of substantially all of our assets and properties) are organized under the laws of any Taxing Jurisdiction other than Mexico (the date on which we or a successor become subject to any such Taxing Jurisdiction, the Succession Date), and as a result of any amendment to, or change in, the laws (or any rules or regulations thereunder) of such Taxing Jurisdiction, or any political subdivision or taxing authority thereof or therein affecting taxation, any amendment to or change in an official interpretation or application of such laws, rules or regulations, which amendment to or change of such laws, rules or regulations becomes effective after the Succession Date, we would be obligated on the next succeeding interest payment date, after taking such measures as we may consider reasonable to avoid this requirement, to pay additional interest in excess of that attributable to any withholding tax rate imposed by such Taxing Jurisdiction as of the Succession Date with respect to the debt securities,

then we may, at our option, redeem the debt securities, in whole but not in part, at any time on giving not less than 30 nor more than 60 days notice, at a redemption price equal to 100% of the outstanding principal amount of the debt securities being redeemed, plus accrued and unpaid interest and any additional interest due thereon up to but not including the date of redemption; provided, however, that (1) no notice of redemption for tax reasons may be given earlier than 90 days prior to the earliest date on which we would be obligated to pay this additional interest if a payment on the debt securities were then due and (2) at the time such notice of redemption is given such obligation to pay such additional interest remains in effect. *(Section 1101(c))*

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Prior to the giving of any notice of redemption for taxation reasons, we will deliver to the trustee:

- a certificate signed by one of our duly authorized representatives stating that we are entitled to effect the redemption and setting forth a statement of facts showing that the conditions precedent to our right of redemption for taxation reasons have occurred; and

- an opinion of legal counsel (which may be our in-house counsel) of recognized standing to the effect that we have or will become obligated to pay such additional interest as a result of such change or amendment. *(Section 1101(d))*

This notice, after it is delivered to the holders, will be irrevocable. *(Section 1102)*

Covenants

The following covenants will apply to us and our subsidiaries for so long as any debt security remains outstanding. These covenants restrict our ability and the ability of our subsidiaries to enter into certain transactions. However, these covenants do not limit our ability to incur indebtedness or require us to comply with financial ratios or to maintain specified levels of net worth or liquidity. In addition, these covenants and the indenture generally do not limit the ability of our principal shareholders to reduce their ownership interest in us.

Limitation on Liens

We may not, and we may not allow any of our significant subsidiaries to, create, incur, issue or assume any liens on our property to secure debt where the debt secured by such liens would exceed an aggregate amount equal to the greater of (1) U.S. $2,800.00 million and (2) 16% of our Consolidated Net Tangible Assets less, in each case, the aggregate amount of attributable debt of us and our significant subsidiaries pursuant to the first bullet point under Limitation on Sales and Leasebacks, unless we secure the debt securities equally with, or prior to, the debt secured by such liens. This restriction will not, however, apply to the following:

- liens on property acquired and existing on the date the property was acquired or arising after such acquisition pursuant to contractual commitments entered into prior to such acquisition and not in contemplation of such acquisition;

- liens on any property securing debt incurred or assumed for the purpose of financing its purchase price or the cost of its construction, improvement or repair; *provided* that such lien attaches to the property within 12 months of its acquisition or the completion of its construction, improvement or repair and does not attach to any other property;

- liens existing on any property of any subsidiary prior to the time that the subsidiary became a subsidiary of ours or liens arising after that time under contractual commitments entered into prior to and not in contemplation of that event;

liens on any property securing debt owed by a subsidiary of ours to us or to another of our subsidiaries;

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liens existing on the date the debt securities are issued;

liens resulting from the deposit of funds or evidence of debt in trust for the purpose of defeasing our debt or the debt of any of our subsidiaries;

any (i) liens for taxes, assessments and other governmental charges and (ii) attachment or judgment liens, in each case, the payment of which is being contested in good faith by appropriate proceedings for which such reserves or other appropriate provision, if any, as may be required by International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS) shall have been made;

liens on accounts receivable, inventory, or bottles and cases to secure working capital or revolving credit debt incurred in the ordinary course of business;

liens resulting from a direct or indirect pledge of any or all of our shares in Heineken N.V. or Heineken Holdings N.V. or any holding company the principal assets of which consist of such shares;

any liens on real estate related to retail or commercial locations operated by us or our subsidiaries that is contributed to a trust (a Real Estate Trust); and

liens arising out of the refinancing, extension, renewal or refunding of any debt described above, provided that the aggregate principal amount of such debt is not increased and such lien does not extend to any additional property. *(Section 1006)*

Consolidated Net Tangible Assets means at any time the total assets (stated net of properly deductible items, to the extent not already deducted in the computation of total assets) appearing on our consolidated balance sheet less all goodwill and intangible assets appearing on such balance sheet, all determined on a consolidated basis at such time in accordance with IFRS. *(Section 101)*

For purposes of this covenant, the covenant set forth under Limitation on Sale and Leaseback Transactions and the events of default set forth under Default, Remedies and Waiver of Default Events of Default, significant subsidiary means any of our subsidiaries that meets the definition of significant subsidiary under Regulation S-X as promulgated by the SEC. As of December 31, 2012, our significant subsidiaries consisted of Coca-Cola FEMSA, S.A.B. de C.V., FEMSA Comercio, S.A. de C.V. and CB Equity LLP. *(Section 101)*

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Limitation on Sales and Leasebacks

We may not, and we may not allow any of our significant subsidiaries to, enter into any sale and leaseback transaction without effectively providing that the debt securities will be secured equally and ratably with or prior to the sale and leaseback transaction, unless:

- the aggregate amount of attributable debt of us and our significant subsidiaries pursuant to this bullet point would not exceed an aggregate amount equal to the greater of (1) U.S. $2,800.00 million or (2) 16% of our Consolidated Net Tangible Assets less, in each case, any secured indebtedness permitted under Limitation on Liens that does not secure the debt securities equally with, or prior to, the debt secured by such liens;

- we or one of our subsidiaries, within 12 months of the sale and leaseback transaction, retire debt not owed to us or any of our subsidiaries that is not subordinated to the debt securities or invest in equipment, plant facilities or other fixed assets used in the operations of us or any of our subsidiaries, in an aggregate amount equal to the greater of (1) the net proceeds of the sale or transfer of the property or other assets that are the subject of the sale and leaseback transaction and (2) the fair market value of the property leased (Section *1007*); or

- the transaction involves the lease by us or our subsidiaries of real estate contributed to a Real Estate Trust.

Notwithstanding the foregoing, we and/or our subsidiaries may enter into sale and leaseback transactions that solely refinance, extend, renew or refund sale and leaseback transactions permitted under the bullet points above and the restriction described in the preceding paragraph will not apply to such sale and leaseback transactions.

Sale and leaseback transaction means a transaction or arrangement between us or one of our subsidiaries and a bank, insurance company or other lender or investor where we or our subsidiary leases property for an initial term of three years or more that was or will be sold by us or our significant subsidiary to that lender or investor for a sale price of U.S. $5 million (or its equivalent in other currencies) or more. (Section *101*)

Attributable debt means, with respect to any sale and leaseback transaction, the lesser of (1) the fair market value of the asset subject to such transaction and (2) the present value, discounted at a rate per annum equal to the discount rate of a capital lease obligation with a like term in accordance with IFRS, of the obligations of the lessee for net rental payments (excluding amounts on account of maintenance and repairs, insurance, taxes, assessments and similar charges and contingent rents) during the term of the lease. (Section *101*)

Provision of Information

We will furnish the trustee with copies of our annual report and the information, documents and other reports that we are required to file with the SEC pursuant to Section 13 or 15(d) of the U.S. Securities Exchange Act of 193 but unissued preferred stock, which may affect the likelihood of a change of control in our company.

Our Board of Directors has the authority, without further action by the stockholders, to issue 10,000,000 shares of preferred stock on such terms and with such rights, preferences and designations as our Board of Directors may determine. Such terms may include restricting dividends on our common stock, dilution of the voting power of our common stock or impairing the liquidation rights of the holders of our common stock. Issuance of such preferred stock, depending on the rights, preferences and designations thereof, may have the effect of delaying, deterring or preventing a change in control. In addition, certain "anti-takeover" provisions in Delaware law may restrict the ability of our stockholders to authorize a merger, business combination or change of control.

Our stock price may be volatile.

The market price of our common stock is likely to be highly volatile and could fluctuate widely in price in response to various factors, many of which are beyond our control, including the following:

our ability to successfully enforce and/or defend our Remote Power Patent;

our ability to enter into favorable license agreements with third parties withrespect to our Remote Power Patent;

our ability to achieve material revenue and profits;

our ability to raise capital when needed;

sales of our common stock;

our ability to execute our business plan;

technology changes;

legislative, regulatory and competitive developments; and

economic and other external factors.

In addition, the securities markets have from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. These market fluctuations may also materially and adversely affect the market price of our common stock.

Additional stock offerings may dilute current stockholders.

We may need to issue additional shares of our capital stock or securities convertible or exercisable for shares of our capital stock, including preferred stock, options or warrants. The issuance of additional capital stock may dilute the ownership of our current stockholders.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains certain forward-looking statements that are statements that include information based upon beliefs of our management, as well as assumptions made by, and information available to, our management. Statements containing terms such as “believes,” “expects,” “anticipates,” “intends” or similar words are intended to identify forward-looking statements.

Our management, based upon assumptions it considers reasonable, has compiled these forward-looking statements. Such statements reflect our current views with respect to future events. These statements involve known and unknown risks and uncertainties that may cause our actual results in future periods to differ materially from what is currently anticipated. We make cautionary statements in certain sections of this prospectus, including under “Risk Factors.” You should read these cautionary statements as being applicable to all related forward-looking statements wherever they appear in this prospectus, the materials referred to in this prospectus or the materials incorporated by reference into this prospectus.

You are cautioned that no forward-looking statement is a guarantee of future performance and you should not place undue reliance on any forward-looking statement. Such statements speak only as of the date of this prospectus and we are not undertaking any obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date of this prospectus or to reflect the occurrence of unanticipated events.

PRICE RANGE OF OUR COMMON STOCK

Our common stock currently trades on the OTC Bulletin Board under the symbol NSSI. The following table sets forth, for the periods indicated, the range of the high and low closing bid prices for our common stock as reported by the Pink Sheets LLC quotation service. Such prices reflect inter-dealer quotations, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

SIX MONTHS ENDED JUNE 30, 2008	HIGH	LOW
Second Quarter	$1.29	$0.85
First Quarter	$1.50	$1.14

YEAR ENDED DECEMBER 31, 2007	HIGH	LOW
Fourth Quarter	$2.05	$1.33
Third Quarter	$1.60	$1.44
Second Quarter	$2.04	$1.55
First Quarter	$1.75	$1.35

YEAR ENDED DECEMBER 31, 2006	HIGH	LOW
Fourth Quarter	$1.65	$1.06
Third Quarter	$1.37	$1.00
Second Quarter	$1.42	$1.02
First Quarter	$1.48	$0.93

On September 17, 2008, the closing price for our common stock as reported on the OTC Bulletin Board was $0.94 per share. The number of record holders of our common stock was 96 as of September 17, 2008.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our common stock and do not intend to declare or pay cash or other dividends in the foreseeable future. The Board of Directors currently expects to retain future earnings, if any, for use in the operation and expansion of its business. The declaration and payment of any future dividends will be at the discretion of the Board of Directors and will depend upon a variety of factors, including future earnings, if any, operations, capital requirements, our general financial condition, the preferences of any series of preferred stock, our general business conditions and future contractual restrictions on payment of dividends, if any.

EQUITY COMPENSATION PLAN INFORMATION

The following table summarizes share and exercise price information about our equity compensation plans as of December 31, 2007.

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (1)	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (1))
Equity compensation plans approved by security holders	3,902,370	$.95	0(1)
Equity compensation plans not approved by security holders	0	—	—
Total	3,902,370	$.95	0(1)

(1) Our 1996 Amended and Restated Stock Option Plan provides for the issuance of options to purchase up to 4,000,000 shares of our common stock. As of March 2006, no additional options could be issued under the plan in accordance with its terms.

BUSINESS

Overview

Our principal business is the acquisition, development, licensing and protection of our intellectual property. We presently own six patents issued by the U.S. Patent Office that relate to various telecommunications and data networking technologies (the "Patent Portfolio") and include, among other things, patents covering the control of power delivery over local area networks ("LANs") for the purpose of remotely powering network devices over Ethernet ("PoE") networks and systems and methods for the transmission of audio, video and data over LANS in order to achieve higher quality of service (QoS). Our strategy is to pursue licensing and strategic business alliances with companies in industries that manufacture and sell products that make use of the technologies underlying our Patent Portfolio as well as with other users of the technologies who benefit directly from the technologies including corporate, educational and governmental entities.

To date, our efforts with respect to our Patent Portfolio have focused on licensing our patent (U.S. Patent No. 6,218,930) covering the control of power delivery over Ethernet cables (the "Remote Power Patent"). In August, 2007, as part of a settlement agreement relating to our litigation with D-Link, we entered into a license agreement with D-Link pertaining to our Remote Power Patent (See "Legal Proceedings - D-Link Litigation"). In February 2008, we commenced patent infringement litigation against several major data networking equipment manufacturers including Cisco Systems, Inc. and 7 other defendants (See "Legal Proceedings - Pending Litigation Against Major Data Networking Equipment Manufacturers"). On August 13, 2008, as part of our new agreement with Microsemi Corp - Analog Mixed Signal Group Ltd. ("Microsemi Analog"), Microsemi Corporation ("Microsemi"), the parent company of Microsemi Analog, entered into a License agreement with us with respect to our Remote Power Patent (See "Business - Licensing Program").

At least for the next twelve months, we do not presently anticipate licensing efforts for our other patents besides our Remote Power Patent. We may seek to acquire additional patents in the future.

The Patents

Our Patent Portfolio consist of the following patents:

U.S. Patent No. 6,218,930: Apparatus and method for remotely powering access equipment over a 10/100 switched Ethernet network;

U.S. Patent No. 6,577,631: Communication switching module for the transmission and control of audio, video, and computer data over a single network fabric;

U.S. Patent No. 6,574,242: Method for the transmission and control of audio, video, and computer data over a single network fabric;

U.S. Patent No. 6,570,890: Method for the transmission and control of audio, video, and computer data over a single network fabric using Ethernet packets;

U.S. Patent No. 6,539,011: Method for initializing and allocating bandwidth in a permanent virtual connection for the transmission and control of audio, video, and computer data over a single network fabric; and

U.S. Patent No. 6,215,789: Local area network for the transmission and control of audio, video, and computer data.

In August 2008, we were issued European Patent No. 1086556 titled "Integrated Voice and Data Communications over a Local Area Network" which covers the same technology as covered by our U.S. QoS family of patents. The Patent has issued in France, Germany and Spain and is in the process of being issued in the United Kingdom and Ireland. We have also been notified that the Canadian Intellectual Property Office has issued a Notice of Allowance for this patent and we anticipate its issuance in Canada prior to the end of this year.

Our future success is largely dependent upon our proprietary technologies, our ability to protect our intellectual property rights and consummate license agreements with respect to our Patent Portfolio. The complexity of patent and common law, combined with our limited resources, create risk that our efforts to protect our patents may not be successful. We cannot be assured that our patents will be upheld, or that third parties will not invalidate our patents. We face uncertainty as to the outcome of our litigation commenced in February 2008 against several major data networking equipment manufacturers pertaining to our Remote Power Patent. (See Risk Factors "We face uncertainty as to the outcome of litigation with major data networking equipment manufacturers").

The patent application for our Remote Power Patent was filed on March 11, 1999 and the patent was granted by the U.S. Office of Patent and Trademark on April 21, 2001. The patent expires on March 11, 2020.

We were incorporated under the laws of the State of Delaware in July 1990. Our offices are located at 445 Park Avenue, Suite 1028, New York, New York 10022 and our telephone number is (212) 829-5770.

Market Overview – Remote Power Patent

Our licensing efforts are currently focused on our Remote Power Patent. Our Remote Power Patent (U.S. Patent No. 6,218,930) relates to several technologies which describe a methodology for controlling the delivery of power to certain devices over an Ethernet network.

The Institute of Electrical and Electronic Engineers (IEEE) is a non-profit, technical professional association of more than 370,000 individual members in approximately 160 countries. The Standards Association of the IEEE is responsible for the creation of global industry standards for a broad range of technology industries. In 1999, at the urging of several industry vendors, the IEEE formed a task force to facilitate the adoption of a standardized methodology for the delivery of remote power over Ethernet networks which would insure interoperability among vendors of switches and terminal devices. On June 13, 2003 the IEEE Standards Association approved the 802.3af Power over Ethernet standard (the "Standard"), which covers technologies deployed in delivering power over Ethernet networks. The Standard provides for the Power Sourcing

Equipment (PSE) to be deployed in switches or as standalone midspan hubs to provide power to remote devices such as wireless access points, IP phones and network-based cameras. The technology is commonly referred to as Power over Ethernet ("PoE"). We believe that our Remote Power Patent covers several of the key technologies covered by the Standard.

Ethernet is the leading local area networking technology in use today. PoE technology allows for the delivery of power over Ethernet cables rather than by separate power cords. As a result, a variety of network devices, including IP telephones, wireless LAN Access Points, web-based network security cameras, data collection terminals and other network devices, are able to receive power over existing data cables without the need to modify the existing infrastructure to facilitate the provision of power for such devices through traditional AC outlets. Advantages such as lower installation costs, remote management capabilities, lower maintenance costs, centralized power backup, and flexibility of device location as well as the advent of worldwide power compatibility, create the possibility of PoE becoming widely adopted in networks throughout the world.

PoE provides numerous benefits including quantifiable returns on investment. The cost of hiring electricians to pull power cables to remote locations used for access points or security cameras can rival or exceed the cost of the devices. Another key benefit is the need for Voice over IP power reliability in the face of power failures. Using PoE enables data center power supply systems to ensure on going power – a function that would be difficult and expensive to implement if each phone required AC outlets.

These and other advantages such as remote management capabilities, lower maintenance costs, and flexibility of device location have led to forecasts that PoE will be widely adopted in networks throughout the world. The benefits of PoE are compelling as evidenced by the introduction of products by such leading vendors such as Cisco Systems, Foundry Networks, Extreme Networks, 3Com, Siemens, Nortel Networks and Avaya, as well as many others.

The ability to supply power to end-devices over Ethernet networks can be applied to other end-devices, such as advanced security cameras, RFID card readers, laptop computers, personal digital assistants and portable digital music players. As the desire to connect more end-devices to the Ethernet network grows, we believe that PoE technology will become more widely used as a method to power these end-devices.

Additional Patents

We also own five (5) additional patents, besides our Remote Power Patent, covering various methodologies that provide for allocating bandwidth and establishing Quality of Service for delay sensitive data, such as voice, on packet data networks. Quality of Service issues become important when data networks carry packets that contain audio and video which may require priority over data packets traveling over the same network. Covered within these patents are also technologies that establish bi-directional communications control channels between network-connected devices in order to support advanced applications on traditional data networks. We believe that potential licensees of the technologies contained in these patents would be vendors deploying applications that require the low latency transport of delay sensitive data such as video over data networks.

Network-1 Strategy

Our strategy is to capitalize on our Patent Portfolio by entering into licensing arrangements with third parties including manufacturers and users that utilize our Patent Portfolio's proprietary technologies as well as any additional proprietary technologies covered by patents which may be acquired by us in the future. We will also seek to enter into licensing arrangements with users of the proprietary technologies, including corporate, educational and governmental entities in those cases where the patent rights extend to the users of the technologies contained in manufactured products.

We do not anticipate manufacturing products utilizing our Patent Portfolio or any of the proprietary technologies contained in our Patent Portfolio. Accordingly, we do not anticipate establishing a manufacturing, sales or marketing infrastructure. Consequently, we believe that our capital requirements will be less than the capital requirements for companies with such infrastructure requirements.

In connection with our activities relating to the protection of our Patent Portfolio, it may be necessary to assert patent infringement claims against third parties that we believe are infringing our Patent Portfolio, as is the case with our litigation against several major data networking equipment manufacturers ("Legal Proceedings – Pending Litigation Against Major Data Networking Equipment Manufacturers") and as we previously asserted against D-Link (See "Legal Proceedings - D-Link Litigation").

Licensing

In February 2004, we commenced licensing efforts with respect to our Remote Power Patent. We believe that potential licensees include, among others, Wireless Local Area Networking (WLAN) equipment manufacturers, Local Area Networking (LAN) equipment manufacturers, Voice Over IP Telephony (VOIP) equipment manufacturers, and Network Camera manufacturers. In addition, we believe that additional potential licensees include users of the equipment embodying the PoE technology covered by our Remote Power Patent, including corporate, educational and federal, state and local government users, as we believe that they are significant beneficiaries of the technologies covered by our Remote Power Patent.

ThinkFire Agreement

On November 30, 2004, we entered into a Master Services Agreement (the "Agreement") with ThinkFire Services USA, Ltd. ("ThinkFire") pursuant to which ThinkFire has been granted the exclusive (except for direct efforts by us and related companies) worldwide rights to negotiate license agreements for our Remote Power Patent with respect to certain potential licensees agreed to between the parties. Either we or ThinkFire may terminate the Agreement upon 60 days notice for any reason or upon 30 days notice in the event of a material breach. We have agreed to pay ThinkFire a fee not to exceed 20% of the royalty payments received from license agreements consummated by ThinkFire on our behalf after we recover our expenses.

Licensing Program

As of August 31, 2008, we had transmitted letters to approximately 250 companies offering licenses to our Remote Power Patent. In addition, in September 2005 we initiated an industry-wide Power Up Licensing program that offered licenses for our Remote Power Patent to "early adopters" that included royalty rates and related fees at a discount from our standard royalty rates and fees for a limited time period. The Power Up licensing program continued until May 2007. No licenses were granted under the Power Up licensing program.

On June 25, 2008 we announced the introduction of a Special Licensing Program for our Remote Power Patent. Our Special Licensing Program is of limited duration (through December 31, 2008) and is being implemented on an industry-wide basis to offer discounted running royalty rates and exceptions to our standard licensing terms and conditions for our Remote Power Patent to vendors of finished products that comply with the PoE Standard, including equipment defined in the PoE Standard as Power Sourcing Equipment (PSE) and Powered Devices (PD). The Special Licensing Program is available to all vendors of PoE equipment including those companies that are defendants in our pending patent litigation against several major data equipment manufacturers and who enter into a license agreement with us within 120 days of a scheduling order being entered in the case. Our agreement with Microsemi Corp. - Analog Mixed Signal Group Ltd. ("Microsemi"), dated June 17, 2008, among other things, enables Microsemi to assist its customers' evaluation of our Remote Power Patent and the terms being made available to vendors of PoE equipment pursuant to our Special Licensing Program.

Microsemi License

On August 13, 2008, as part of our agreement with Microsemi Corp-Analog Mixed Signal Group Ltd. ("Microsemi-Analog"), previously PowerDsine Ltd, entered into in June 2008, Microsemi Corporation ("Microsemi"), the parent company of Microsemi-Analog, entered into a license agreement with us with respect to our Remote Power Patent. The license agreement provides that Microsemi is obligated to pay us quarterly royalty payments of 2% of the sales price for certain of its Midspan PoE products for the full term of our Remote Power Patent (March 2020).

D-Link License

In August 2007, we agreed to final licensing terms with D-Link Corporation and D-Link Systems (collectively, "D-Link") as part of a settlement agreement of our patent infringement litigation against D-Link in the United States District Court for the Eastern District of Texas, Tyler Division for infringement of our Remote Power Patent (See "Legal Proceedings - D-Link Litigation").

The license terms include the agreement by D-Link to license our Remote Power Patent for its full term which expires in March 2020, and the payment of monthly royalty payments (beginning as of May 26, 2007) based upon a running royalty rate of 3.25% of the net sales of D-Link branded Power over Ethernet products, including those products which comply with the IEEE 802.3af and 802.3at Standards. The royalty rate is subject to adjustment beginning the second quarter of 2008 to a royalty rate consistent with other similarly situated licensees of our Remote Power Patent that may vary according to units and volumes of licensed products sold. In addition, D-Link paid us an upfront payment upon signing of the license agreement of $100,000. The products covered by the settlement include D-Link Power over Ethernet enabled switches, wireless access points, and network security cameras, among others.

Legal Representation

In February 2008, we entered into an agreement with Dovel & Luner, LLP pursuant to which such firm provides legal services to us with respect to our litigation commenced in February 2008 against several major data networking equipment manufacturers, pending in the United States District Court for the Eastern District of Texas, Tyler Division, for infringement of our Remote Power Patent (See "Legal Proceedings"). The terms of our agreement with Dovel & Luner, LLP provide for fees of a maximum aggregate cash payment of $1.5 million plus a contingency fee of up to 24% depending upon when an outcome is achieved.

With respect to our litigation against D-Link, which was settled in May 2007, we utilized the services of Blank Rome, LLP, on a full contingency basis and also the services of Potter Mitton, P.C. (Tyler, Texas) on an hourly basis to serve as local counsel. In accordance with our contingency fee agreement with Blank Rome LLP, we will pay legal fees to Blank Rome LLP equal to 25% of the royalty revenue received by us from our license agreement with D-Link after we recover our expenses related to the litigation.

Competition

The telecommunications and data networking licensing market is characterized by intense competition and rapidly changing business conditions, customer requirements and technologies. Our current and potential competitors have longer operating histories, greater name recognition and possess substantially greater financial, technical, marketing and other competitive resources than us. Although we believe that we have enforceable patents relating to telecommunications and data networking, there can be no assurance that our Patent Portfolio will be upheld or that third parties will not invalidate any or all of the patents in our Patent Portfolio. In addition, our current and potential competitors may develop technologies that may be more effective than our proprietary technologies or that would render our technologies less marketable or obsolete. We may not be able to compete successfully.

In addition, other companies may develop competing technologies that offer better or less expensive alternatives to PoE and the other technologies covered by our Patent Portfolio. Several companies have notified the IEEE that they may have patents and proprietary technologies that are covered by the Standard. In the event any of those companies asserts claims relating to our patents, the licensing royalties available to us may be limited. Moreover, technological advances or entirely different approaches developed by one or more of our competitors or adopted by various standards groups could render our Remote Power Patent obsolete, less marketable or unenforceable.

Description of Property

We currently lease office space in New York City at a cost of $3,400 per month under a lease which expires in June 2009.

Employees and Consultants

As of the date of this prospectus, we had one full-time employee, no part-time employees and three consultants.

LEGAL PROCEEDINGS

Pending Litigation Against Major Data Networking Equipment Manufacturers

In February 2008, we commenced litigation against several major data networking equipment manufacturers in the United States District Court for the Eastern District of Texas, Tyler Division, for infringement of our Remote Power Patent. The defendants in the lawsuit include Cisco Systems, Inc., Cisco Linksys, LLC, Enterasys Networks, Inc., 3COM Corporation, Inc., Extreme Networks, Inc., Foundry Networks, Inc., Netgear, Inc. and Adtran, Inc. We seek injunctive relief and monetary damages for infringement based upon reasonable royalties as well as treble damages for the defendant's continued willful infringement of our Remote Power Patent. In their answers to the complaint, the defendants asserted that they do not infringe any valid claim of our Remote Power Patent, and further asserted that, based on several different theories, the patent claims are invalid or unenforceable. In addition to these defenses, the defendants also asserted counterclaims for, among other things, non-infringement, invalidity, and unenforceability of our Remote Power Patent. In the event that the Court determines that our Remote Power Patent is not valid or enforceable, and/or that the defendants do not infringe, any such determination would have a material adverse effect on our company.

D-Link Litigation

On August 10, 2005, we commenced patent litigation against D-Link Corporation and D-Link Systems, Incorporated (collectively, D-Link) in the United States District Court for the Eastern District of Texas, Tyler division (Civil Action No. 6:05W291), for infringement of our Remote Power Patent (U.S. Patent No. 6,218,930). Our complaint sought, among other things, a judgment that our Remote Power Patent is enforceable and has been infringed by the defendants. We also sought a permanent injunction restraining the defendants from continued infringement, or active inducement of infringement by others, of our Remote Power Patent. On February 27, 2006, the D-Link defendants filed answers and asserted counterclaims. In their answers, the D-Link defendants asserted that they did not infringe any valid claim of our Remote Power Patent, and further asserted that the asserted patent claims are invalid and/or unenforceable. In addition to these defenses, the D-Link defendants also asserted counterclaims for, among other things, non-infringement, invalidity and unenforceability of our Remote Power Patent.

On April 25, 2007, we agreed to a settlement of our patent infringement litigation against D-Link. Under the terms of the settlement which were finalized in August 2007, D-Link entered into a license agreement for our Remote Power Patent, the terms of which include monthly royalty payments of 3.25% of the net sales of D-Link branded Power over Ethernet products, including those products which comply with the IEEE 802.3af and 802.3at Standards, for the full term of the Remote Power Patent, which expires in March 2020. The royalty rate is subject to adjustment to a rate consistent with other similarly situated licensees of the Remote Power Patent based on units of shipments of licensed products. In addition, D-Link paid us $100,000 upon signing of the settlement agreement.

PowerDsine Settlement

On November 16, 2005, we entered into a Settlement Agreement with PowerDsine, Inc. and PowerDsine Ltd. (collectively, "PowerDsine") which dismissed, with prejudice, patent litigation brought by PowerDsine against us in March 2004 in the United States District Court for the Southern District of New York that sought a declaratory judgment that our Remote Power Patent (U.S. Patent No. 6,218,930) was invalid and not infringed by PowerDsine and/or its customers.

Under the terms of the Settlement Agreement, we agreed that we will not initiate litigation against PowerDsine for its sale of Power over Ethernet (PoE) integrated circuits. In addition, we agreed that we will not seek damages for infringement from customers that incorporate PowerDsine integrated circuit products in PoE capable Ethernet switches manufactured on or before April 30, 2006. PowerDsine agreed that it would not initiate, assist or cooperate in any legal action relating to our Remote Power Patent. We also agreed that we will not initiate litigation against PowerDsine or its customers for infringement of our Remote Power Patent arising from the manufacture and sale of PowerDsine Midspan products for three years following the dismissal date. No licenses to use the technologies covered by our Remote Power Patent were granted to PowerDsine or its customers under the terms of the November 2005 settlement. The Settlement Agreement further provides that PowerDsine is obligated to provide each of its customers with written notice of the settlement, which notice shall disclose that no license for our Remote Power Patent has been provided to PowerDsine's customers and that in order to combine, modify or integrate any PowerDsine product with or into any other device or software, PowerDsine's customers may need to receive patent license(s) for such third party patents which is the customer's responsibility.

In June 2008 we entered into a new agreement with Microsemi Corp-Analog Mixed Signal Group Ltd (previously PowerDsine Ltd), a subsidiary of Microsemi Corporation (Nasdaq: MSCC) a leading manufacturer of high performance analog mixed-signal integrated circuits and high reliability semiconductors, which, among other things, amended the prior settlement agreement entered into between the parties in November 2005. Under the new agreement, on June 25, 2008 we announced the commencement of an industry-wide Special Licensing Program for our Remote Power Patent to vendors of PoE equipment. The Special Licensing Program is of limited duration (through December 31, 2008) and is being implemented on an industry-wide basis to offer discounted running royalty rates and exceptions to our standard licensing terms and conditions for our Remote Power Patent to PoE vendors who are "early adopters" and enter into license agreements without delay to avoid litigation and higher royalties. The new agreement enables Microsemi to assist in its customer's evaluation of the Remote Power Patent and the terms being made available to vendors of PoE equipment pursuant to our new Special Licensing Program, an activity that was previously prohibited by the 2005 Settlement Agreement with PowerDsine. In addition, pursuant to the terms of the new agreement, on August 13, 2008 Microsemi Corporation entered into a license agreement under the Special Licensing Program for our Remote Power Patent with respect to certain of its Midspan PoE products pursuant to which Microsemi is obligated to pay us quarterly royalty payments of 2% of the sales price of certain of its Midspan products.

USE OF PROCEEDS

We will not receive any proceeds from the sale of the shares of our common stock by the selling stockholders. All proceeds from the sale of such shares will be for the accounts of the selling stockholders. We will receive proceeds from the exercise of all warrants and options held by the selling stockholders and exercised by the payment of cash. Cash proceeds that we may receive upon exercise of the warrants and options will be used for working capital purposes.

SELLING STOCKHOLDERS

The following table set forth the names of the selling stockholders who may sell their shares under this prospectus from time to time. The selling stockholders are not obligated to sell any of the shares offered by this prospectus. The number of shares sold by each selling stockholder may depend on a number of factors, such as the market price of our common stock.

We are registering 9,655,949 shares of our common stock for resale by the selling stockholders. We agreed to file a registration statement under the Securities Act of 1933, as amended (the "Securities Act") with the Securities and Exchange Commission, of which this prospectus is a part, with respect to the resale of:

- 2,166,667 shares of common stock and 1,666,667 shares of common stock issuable upon exercise of warrants issued to investors in our private offering completed on April 16, 2007;
- 360,000 shares of common stock issuable upon exercise of warrants issued to the placement agents with respect to the private offering completed on April 16, 2007;
- 1,116,250 shares of our common stock issuable upon exercise of warrants issued in our private offering completed in December 2004 and January 2005; and
- 3,046,365 shares of our common stock and 1,300,000 shares of our common stock issuable upon exercise of warrants and options owned by our Chairman and Chief Executive Officer and related parties.

The number of shares of our common stock shown in the following table as being offered by the selling stockholders do not include such presently indeterminate number of additional shares of our common stock that may be issuable as a result of stock splits, stock dividends and similar transactions. Pursuant to Rule 416 under the Securities Act, however, such shares are included in the Registration Statement of which this prospectus is a part.

The selling stockholders may sell any or all of their shares listed below from time to time. Accordingly, we cannot estimate how many shares the selling stockholders will own upon consummation of any such sales. Also, the selling stockholders may have sold, transferred or otherwise disposed of all or a portion of their shares since the date on which the information was provided in transactions exempt from the registration requirements of the Securities Act.

Of the selling stockholders listed in the table below, Eric Singer, Hilary Bergman, Brad Reifler, Jack Brimberg, Theodore J. Marolda, Jay Tomlinson and Steven Heinemann are believed by us to be affiliates of broker-dealers, who purchased the shares in the ordinary course of business and at the time of the purchase of the securities to be resold, such selling stockholders did not have any agreements or understandings, directly or indirectly, with any person to distribute the securities.

None of the selling stockholders has had a material relationship with us within the past three years other than as a result of the ownership of our securities except: (i) Corey M. Horowitz is our Chairman and Chief Executive Officer, (ii) Mr. Horowitz and Laurent Ohana serve on our board of directors, (iii) Robert Graifman is a former director, (iv) Brad Reifler is affiliated with Pali Capital, Inc., a placement agent with respect to our April 2007 private offering, (v) Eric Singer, Hilary Bergman and Matthew Pilkington were affiliated with Pali Capital, Inc. at the time of our April 2007 private offering and (v) Jack Brimberg, Theodore J. Marolda and Jay Tomlinson are affiliated with Brimberg & Co., L.P., also a placement agent with respect to our April 2007 private offering.

Name	Number of Shares Beneficially Owned Prior to Offering(1)	Number of Shares Being Offered	Number of Shares Beneficially Owned After Offering(1)(2)	Percentage of Outstanding Common Stock After Offering(1)
Corey M. Horowitz	10,073,185(3)	4,346,365(4)	5,726,820	19.2%
CMH Capital Management Corp.	3,767,800(5)	3,767,800(5)	0	0%
Donna Slavitt	67,471	67,471	0	0%
Logan Zev Horowitz 1999 Trust	55,000(6)	55,000(6)	0	0%
Dylan Max Horowitz 1999 Trust	55,000(6)	55,000(6)	0	0%
Corey M. Horowitz Custodian for Zachary Jordon Horowitz	55,000(6)	55,000(6)	0	0%
Horowitz Partners	2,291(7)	2,291(7)	0	0%
Hound Partners, LLC	3,279,916(8)	3,250,500(9)	29,916	*
Hound Partners Offshore Fund, L.P.	1,737,802(10)	1,707,886(11)	29,916	*
Hound Partners, L.P.	1,542,114(12)	1,542,114(12)	0	0%
Graham Partners, L.P.	500,000(13)	166,667(14)	333,333	1.0%
Aurelian Partners, L.P.	611,300(15)	166,667(16)	444,633	1.8%

Name	Number of Shares Beneficially Owned Prior to Offering(1)	Number of Shares Being Offered	Number of Shares Beneficially Owned After Offering(1)(2)	Percentage of Outstanding Common Stock After Offering(1)
Brian T. Horey SEP-IRA, Charles Schwab & Co. Custodian	100,000(17)	33,333(18)	66,667	*
Zaykowski Limited Partners, L.P.	33,333(19)	33,333(19)	0	0%
Zaykowski Qualified Partners, L.P.	33,333(20)	33,333(20)	0	0%
Lewis Opportunity Fund, L.P.	70,833(21)	70,833(21)	0	0%
LAM Opportunity Fund, LTD	12,500(22)	12,500(22)	0	0%
Theodore J. Marolda	83,578(23)	54,000(24)	29,578	*
Jack Brimberg	37,500(25)	37,500(25)	0	0%
Jay Tomlinson	16,500(26)	16,500(26)	0	0%
Matthew Pilkington	17,560(27)	7,560(28)	10,000	*
Emigrant Capital Corporation	1,312,500(29)	187,500(30)	1,125,000	4.7%
Eric Singer	1,184,840(31)	543,840(32)	641,000	2.7%
Singer Opportunity Fund, L.P.	720,225(33)	268,125(34)	425,100	1.9%
Singer Fund, L.P.	249,775(35)	106,875(36)	142,900	*
David M. Seldin	474,000(37)	65,000(38)	409,000	2.1%
Robert Graifman	382,277(39)	75,000(40)	307,277	1.6%
Gilbert S. Stein	175,000(41)	25,000(42)	150,000	*
John R. Hart	75,000(43)	25,000(44)	50,000	*
Granite Bridge Fund, L.P.	131,250(45)	56,250(46)	75,000	*
CGA Resources, LLC	87,500(47)	12,500(48)	75,000	*
Barry S. Friedberg	87,500(49)	12,500(50)	75,000	*
Dasa Sada, LLC	87,500(51)	12,500(52)	75,000	*
Steven Ackerman	165,500(53)	12,500(54)	153,000	*

Francis May	43,750(55)	6,250(56)	37,500	*
Matthew Balk	7,500(57)	7,500(57)	0	0%
Kenneth L. Walters	17,500(58)	2,500(59)	15,000	*

Name	Number of Shares Beneficially Owned Prior to Offering(1)	Number of Shares Being Offered	Number of Shares Beneficially Owned After Offering(1)(2)	Percentage of Outstanding Common Stock After Offering(1)
Jeb Investment Ltd.	165,450(60)	23,750(61)	141,700	*
Jeb Partners, L.P.	155,050(62)	23,750(63)	131,300	*
Manchester Explorer Limited Partnership	115,200(64)	15,000(65)	100,200	*
Steven D. Heineman	1,699,252(66)	91,667(67)	1,607,585	6.6%
Brian Eng	112,500(68)	12,500(69)	100,000	*
Brad Reifler	50,925(70)	43,425(71)	7,500	*
Steven Goldfarb	8,750(72)	3,750(73)	5,000	*
Hilary Bergman	50,925(74)	43,425(75)	7,500	*
Samuel Solomon	15,000(76)	2,500(77)	12,500	*
Jeffrey Finkle	45,000(78)	45,000(78)	0	0%
Edward Sussi	5,000(79)	5,000(79)	0	0%
Alan Friedman	5,000(80)	5,000(80)	0	0%
Alan Weiner	43,750(81)	18,750(82)	25,000	*
Laurent Ohana	195,833(83)	50,000(84)	145,833	*

* Less than 1%

(1) Except as otherwise indicated, the address for each beneficial owner is c/o Network-1 Security Solutions, Inc., 445 Park Avenue, Suite 1028, New York, New York 10022.

(2) Unless otherwise indicated, we believe that all persons named in the above table have sole voting and investment power with respect to all shares of common stock beneficially owned by them. A person is deemed to be the beneficial owner of securities that can be acquired by such person within 60 days from the date hereof upon the exercise of options, warrants or convertible securities. Each beneficial owner's percentage ownership is determined by assuming that options, warrants and convertible securities held by such person (but not those held by any other person) and which are exercisable or convertible within 60 days have been exercised and converted. Assumes a base of 24,135,557 shares of common stock outstanding.

(3) Includes (i) 343,803 shares of common stock held by Mr. Horowitz, (ii) 5,726,820 shares of common stock subject to currently exercisable stock options held by Mr. Horowitz, (iii) 2,467,800 shares of common stock held by CMH Capital Management Corp. ("CMH"), (iv) 550,000 shares of common stock subject to currently exercisable warrants held by CMH, (v) 750,000 shares of common stock subject to currently exercisable options held by CMH, (vi) 67,471 shares of common stock owned by Donna Slavitt, the wife of Mr. Horowitz, (vii) an aggregate of 165,000 shares of common stock held by two trusts and a custodian account for the benefit of Mr. Horowitz's three children and (viii) 2,291 shares of common stock held by Horowitz Partners, a general partnership of which Mr. Horowitz is a partner. Does not include options to purchase 104,375 shares of common stock which are not currently exercisable. The address of CMH Capital Management Corp. is 445 Park Avenue, New York, New York 10022.

(4) Includes (i) 343,803 shares of common stock held by Mr. Horowitz, (ii) 2,467,800 shares of common stock held by CMH, (iii) 550,000 shares of common stock subject to currently exercisable warrants held by CMH, (iv) 750,000 shares of common stock subject to currently exercisable options held by CMH, (v) 67,471 shares of common stock owned by Donna Slavitt, the wife of Mr. Horowitz, (vi) an aggregate of 165,000 shares of common stock held by two trusts and a custodian account for the benefit of Mr. Horowitz's three children and (vii) 2,291 shares of common stock held by Horowitz Partners, a general partnership of which Mr. Horowitz is a partner.

(5) Includes (i) 2,467,800 shares of common stock, (ii) 550,000 shares of common stock subject to currently exercisable warrants and (iii) 750,000 shares of common stock subject to currently exercisable options. Corey M. Horowitz, by virtue of being the sole officer and shareholder of CMH Capital Management Corp., has sole power to vote and dispose of the shares of common stock owned by CMH.

(6) Gary Horowitz, by virtue of being the trustee of the Logan Zev Horowitz 1999 Trust and the Dylan Max Horowitz 1999 Trust, has sole power to vote and dispose of the shares of common stock owned by each of the trusts. Corey M. Horowitz, by virtue of being custodian for Zachary Jordan Horowitz, has the sole power to vote and dispose of such shares.

(7) Corey M. Horowitz, Gary Horowitz, Cindy Horowitz and Syd Horowitz, by virtue of being a general partner of Horowitz Partners, may each be deemed to have shared power to vote and dispose of the shares owned by Horowitz Partners.

(8) Includes (i) 1,057,215 shares of common stock and 484,899 shares of common stock subject to currently exercisable warrants held by Hound Partners, LP and (ii) 1,139,368 shares of common stock and 598,434 shares of common stock subject to currently exercisable warrants held by Hound Partners Offshore Fund, LP. Jonathan Auerbach is the managing member of Hound Performance, LLC and Hound Partners, LLC. Hound Performance, LLC is the general partner of Hound Partners, LP and Hound Partners Offshore Fund, L.P. Hound Partners, LLC is the investment manager of Hound Partners, LP and Hound Partners Offshore Fund, L.P. The securities may be deemed to be beneficially owned by Hound Performance, LLC, Hound Partners LLC and Jonathan

Auerbach. The aforementioned beneficial ownership is based upon a Schedule 13G jointly filed by Hound Partners, LLC, Hound Performance, LLC, Hound Partners, L.P. and Hound Partners Offshore Fund, LP, with the Securities and Exchange Commission on April 26, 2007, a Form 3 jointly filed by Hound Partners, LLC, Hound Performance, LLC and Jonathan Auerbach with the Securities and Exchange Commission on April 26, 2007 and a Form 4 jointly filed by Hound Partners, LLC, Hound Performance LLC and Jonathan Auerbach with the Securities and Exchange Commission on August 8, 2008. Jonathan Auerbach, by virtue of being the managing member of Hound Performance, LLC and Hound Partners, LLC, has the power to vote and dispose of the securities held by Hound Partners, LP and Hound Partners Offshore Fund, L.P.

(9) Includes (i) 1,057,215 shares of common stock and 484,899 shares of common stock subject to currently exercisable warrants owned by Hound Partners, L.P. and (ii) 1,109,452 shares of common stock and 598,434 shares of common stock subject to currently exercisable warrants owned by Hound Partners Offshore Fund, L.P.

(10) Includes (i) 1,139,368 shares of common stock and (ii) 598,434 shares of common stock subject to currently exercisable warrants held by Hound Partners Offshore Fund, L.P.

(11) Includes (i) 1,109,452 shares of common stock and (ii) 598,434 shares of common stock subject to currently exercisable warrants.

(12) Includes (i) 1,057,215 shares of common stock and (ii) 484,899 shares of common stock subject to currently exercisable warrants owned by Hound Partners, LP.

(13) Includes (i) 333,333 shares of common stock and (ii) 166,667 shares of common stock subject to currently exercisable warrants owned by Graham Partners, L.P. Harold W. Berry III, as the general partner of Graham Partners, L.P., has the power to vote and dispose of the securities owned by Graham Partners, L.P.

(14) Includes 166,667 shares of common stock subject to currently exercisable warrants owned by Graham Partners, L.P.

(15) Includes (i) 444,633 shares of common stock and (ii) 166,667 shares of common stock subject to currently exercisable warrants owned by Aurelian Partners, L.P. Brian Horey, as general partner of Aurelian Partners, L.P., has sole power to vote and dispose of the securities owned by Aurelian Partners, L.P.

(16) Includes 166,667 shares of common stock subject to currently exercisable warrants owned by Aurelian Partners, L.P.

(17) Includes (i) 66,667 shares of common stock and (ii) 33,333 shares of common stock subject to currently exercisable warrants owned by Brian T. Horey SEP-IRA, Charles Schwab & Co. Custodian.

(18) Includes 33,333 shares of common stock subject to currently exercisable warrants.

(19) Includes 33,333 shares of common stock subject to currently exercisable warrants owned by Zaykowski Limited Partners, L.P. Paul Zaykowski, as the general partner of Zaykowski Limited Partners, L.P., has the sole power to vote and dispose of the securities owned by Zaykowski Limited Partners, L.P.

(20) Includes 33,333 shares of common stock subject to currently exercisable warrants owned by Zaykowski Qualified Partners, L.P. Paul Zaykowski, as the general partner of Zaykowski Qualified Partners, L.P., has the sole power to vote and dispose of the securities owned by Zaykowski Qualified Partners, L.P.

(21) Includes 70,833 shares of common stock subject to currently exercisable warrants owned by Lewis Opportunity Fund, L.P. W. Austin Lewis IV as general partner/portfolio manager has the sole power to vote and dispose of the securities owned by Lewis Opportunity Fund, L.P.

(22) Includes 12,500 shares of common stock subject to currently exercisable warrants owned by LAM Opportunity Fund, L.P. W. Austin Lewis IV, as General Partner/Portfolio Manager, has the sole power to vote and dispose of the securities owned by LAM Opportunity Fund.

(23) Includes (i) 29,578 shares of common stock and (ii) 54,000 shares of common stock subject to currently exercisable warrants.

(24) Includes 54,000 shares of common stock subject to currently exercisable warrants.

(25) Includes 37,500 shares of common stock subject to currently exercisable warrants.

(26) Includes 16,500 shares of common stock subject to currently exercisable warrants.

(27) Includes (i) 10,000 shares of common stock and (ii) 7,560 shares of common stock, subject to currently exercisable warrants.

(28) Includes 7,560 shares of common stock subject to currently exercisable warrants.

(29) Includes (i) 1,125,000 shares of common stock and (ii) 187,500 shares of common stock subject to currently exercisable warrants. Howard Millstein, by virtue of being an officer of New York Private Bank and Trust Corporation and trustee of the Paul Milstein Revocable 1998 Trust, both indirect owners of Emigrant Capital Corporation, may be deemed to have sole power to vote and dispose of the securities owned by Emigrant Capital Corporation. The address of Emigrant Capital Corporation is 6 East 43rd Street, New York, New York 10017.

(30) Includes 187,500 shares of common stock subject to currently exercisable warrants.

(31) Includes (i) 452,100 shares of common stock and 268,125 shares of common stock subject to currently exercisable warrants owned by Singer Opportunity Fund, L.P., (ii) 142,900 shares of common stock and 106,875 shares of common stock subject to currently exercisable warrants owned by Singer Fund, L.P., (iii) 38,000 shares of common stock and 168,840 shares of common stock subject to currently exercisable warrants owned by Mr. Singer and (iv) 8,000 shares of common stock owned by Singer Congressional Fund, L.P. Singer Fund Management, LLC makes all investment and

voting decisions on behalf of Singer Opportunity Fund, L.P., Singer Fund, L.P. and Singer Congressional Fund, L.P. The aforementioned is based in part on a Schedule 13G filed jointly by Singer Fund Management, LLC, Singer Opportunity Fund, L.P., Singer Fund, L.P. and Singer Congressional Fund, L.P. with the Securities and Exchange Commission on March 23, 2005.

(32) Includes (i) 268,125 shares of common stock subject to currently exercisable warrants owned by Singer Opportunity Fund, L.P., (ii) 106,875 shares of common stock subject to currently exercisable warrants owned by Singer Fund, L.P., and (iii) 168,840 shares of common stock subject to currently exercisable warrants owned by Mr. Singer.

(33) Includes (i) 452,100 shares of common stock and (ii) 268,125 shares of common stock subject to currently exercisable warrants owned by Singer Opportunity Fund, L.P. Eric Singer, by virtue of being managing member of Singer Opportunity Fund, L.P. and Singer Fund Management, LLC, has sole power to vote and dispose of the shares owned by Singer Opportunity Fund, L.P. The address of Singer Opportunity Fund, L.P. is 650 Fifth Avenue, New York, New York 10019.

(34) Includes 268,125 shares of common stock subject to currently exercisable warrants owned by Singer Opportunity Fund, L.P.

(35) Includes (i) 142,900 shares of common stock and (ii) 106,875 shares of common stock subject to currently exercisable warrants owned by Singer Fund, L.P. Eric Singer, by virtue of being managing member of Singer Fund, L.P. and Singer Fund Management, LLC, has sole power to vote and dispose of the securities owned by Singer Fund, L.P. The address of Singer Fund, L.P. is 650 Fifth Avenue, New York, New York 10019.

(36) Includes 106,875 shares of common stock subject to currently exercisable warrants owned by Singer Fund, L.P.

(37) Includes (i) 409,000 shares of common stock and (ii) 65,000 shares of common stock subject to currently exercisable warrants.

(38) Includes 65,000 shares of common stock subject to currently exercisable warrants.

(39) Includes (i) 154,777 shares of common stock and (ii) 75,000 shares of common stock subject to currently exercisable warrants and (iii) 152,500 shares subject to currently exercisable stock options.

(40) Includes 75,000 shares of common stock subject to currently exercisable warrants.

(41) Includes (i) 150,000 shares of common stock and (ii) 25,000 shares of common stock subject to currently exercisable warrants.

(42) Includes 25,000 shares of common stock subject to currently exercisable warrants.

(43) Includes 50,000 shares of common stock and (ii) 25,000 shares of common stock subject to currently exercisable warrants.

(44) Includes 25,000 shares of common stock subject to currently exercisable warrants.

(45) Includes (i) 75,000 shares of common stock and (ii) 56,250 shares of common stock subject to currently exercisable warrants. Clarke Adams, by virtue of being managing partner of Granite Bridge Fund, L.P., may be deemed to have sole power to vote and dispose of the securities owned by Granite Bridge Fund, L.P.

(46) Include 56,250 shares of common stock subject to currently exercisable warrants.

(47) Includes (i) 75,000 shares of common stock and (ii) 12,500 shares of common stock subject to currently exercisable warrants. Cass Gunther Adelman, by virtue of being the sole member of CGA Resources, LLC, may be deemed to have sole power to vote and dispose of the securities.

(48) Includes 12,500 shares of common stock subject to currently exercisable warrants.

(49) Includes (i) 75,000 shares of common stock and (ii) 12,500 shares of common stock subject to currently exercisable warrants.

(50) Includes 12,500 shares of common stock subject to currently exercisable warrants.

(51) Includes (i) 75,000 shares of common stock and (ii) 12,500 shares of common stock subject to currently exercisable warrants. Allysa Ackerman, by virtue of being the sole member of Dasa Sada, LLC, may be deemed to have sole power to vote and dispose of the securities.

(52) Includes 12,500 shares of common stock subject to currently exercisable warrants.

(53) Includes (i) 75,000 shares of common stock and (ii) 12,500 shares of common stock subject to currently exercisable warrants.

(54) Includes 12,500 shares of common stock subject to currently exercisable warrants.

(55) Includes (i) 37,500 shares of common stock and (ii) 6,250 shares of common stock subject to currently exercisable warrants.

(56) Includes 6,250 shares of common stock subject to currently exercisable warrants.

(57) Includes 7,500 shares of common stock subject to currently exercisable warrants.

(58) Includes (i) 15,000 shares of common stock and (ii) 2,500 shares of common stock subject to currently exercisable warrants.

(59) Includes 2,500 shares of common stock subject to currently exercisable warrants.

(60) Includes (i) 141,700 shares of common stock and (ii) 23,750 shares of common stock subject to currently exercisable warrants. James Bresser, by virtue of being a partner of the investment advisor of Jeb Investment Ltd., may be deemed to have sole power to vote and dispose of the securities.

(61) Includes 23,750 shares of common stock subject to currently exercisable warrants.

(62) Includes (i) 131,300 shares of common stock and (ii) 23,750 shares of common stock subject to currently exercisable warrants. James Bresser, by virtue of being an officer of the general partner of Jeb Partners, L.P., may be deemed to have sole power to vote and dispose of the securities.

(63) Includes 23,750 shares of common stock to currently exercisable warrants.

(64) Includes (i) 100,200 shares of common stock and (ii) 15,000 shares of common stock subject to currently exercisable warrants. James Bresser, by virtue of being an officer of Manchester Explorer Limited Partnership, may be deemed to have sole power to vote and dispose of the securities.

(65) Includes 15,000 shares of common stock subject to currently exercisable warrants.

(66) Includes (i) 1,607,585 shares of common stock and (ii) 91,667 shares of common stock subject to currently exercisable warrants.

(67) Includes 91,667 shares of common stock subject to currently exercisable warrants.

(68) Includes (i) 100,000 shares of common stock and (ii) 12,500 shares of common stock subject to currently exercisable warrants.

(69) Includes 12,500 shares of common stock subject to currently exercisable warrants.

(70) Includes (i) 7,500 shares of common stock and (ii) 43,425 shares of common stock subject to currently exercisable warrants.

(71) Includes 43,425 shares of common stock subject to currently exercisable warrants.

(72) Includes (i) 5,000 shares of common stock and (ii) 3,750 shares of common stock subject to currently exercisable warrants.

(73) Includes 3,750 shares of common stock subject to currently exercisable warrants.

(74) Includes (i) 7,500 shares of common stock and (ii) 43,425 shares of common stock subject to currently exercisable warrants.

(75) Includes 43,425 shares of common stock subject to currently exercisable warrants.

(76) Includes (i) 12,500 shares of common stock and (ii) 2,500 shares of common stock subject to currently exercisable warrants.

(77) Includes 2,500 shares of common stock subject to currently exercisable warrants.

(78) Includes 45,000 shares of common stock subject to currently exercisable warrants.

(79) Includes 5,000 shares of common stock subject to currently exercisable warrants.

(80) Includes 5,000 shares of common stock subject to currently exercisable warrants.

(81) Includes (i) 25,000 shares of common stock and (ii) 18,750 shares of common stock subject to currently exercisable warrants.

(82) Includes 18,750 shares of common stock subject to currently exercisable warrants.

(83) Includes 195,833 shares of common stock subject to currently exercisable warrants and options.

(84) Includes 50,000 shares of common stock subject to currently exercisable warrants.

PLAN OF DISTRIBUTION

This offering is self-underwritten; neither we nor the selling stockholders have employed an underwriter for the sale of common stock by the selling stockholders. We will bear all expenses in connection with the preparation of this prospectus. The selling stockholders will bear all expenses associated with the sale of their common stock including commissions and brokerage fees.

The selling stockholders may offer their shares of common stock directly or through pledgees, donees, transferees or other successors in interest in one or more of the following transactions:

- ordinary brokerage transactions in which the broker-dealer solicits purchasers;
- block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;
- purchases by a broker-dealer as principal and resale by the broker-dealer for its account;
- an exchange distribution in accordance with the rules of the applicable exchange;
- privately negotiated transactions;
- broker-dealers may agree with the selling stockholders to sell a specified number of such shares at a stipulated price per share;
- a combination of any such methods of sale; and
- any other method permitted pursuant to applicable law.

The selling stockholders may offer their shares of common stock at any of the following prices:

- fixed prices that may be changed;
- market prices prevailing at the time of sale;
- prices related to such prevailing market prices; and
- at negotiated prices.

The selling stockholders may effect transactions by selling shares to or through broker-dealers, and all such broker-dealers may receive compensation in the form of discounts, concessions, or commissions from the selling stockholders and/or the purchasers of shares of common stock for whom such broker-dealers may act as agents or to whom they sell as principals, or both (which compensation as to a particular broker-dealer might be in excess of customary commissions).

Any broker-dealer acquiring common stock from the selling stockholders may sell the shares either directly, in its normal market-making activities, through or to other brokers on a principal or agency basis or to its customers. Any such sales may be at prices then prevailing on the OTC Bulletin Board or at prices related to such prevailing market prices or at negotiated prices to its customers or a combination of such methods. The selling stockholders and any broker-dealers that act in connection with the sale of the common stock hereunder may be deemed to be "underwriters" within the meaning of Section 2(11) of the Securities Act; any commission received by them and any profit on the resale of shares as principal might be deemed to be underwriting discounts and commissions under the Securities Act. Any such commissions, as well as other expenses incurred by the selling stockholders and applicable transfer taxes, are payable by the selling stockholders.

The selling stockholders reserve the right to accept, and together with any agent of the selling stockholder, to reject in whole or in part any proposed purchase of the shares of common stock. The selling stockholders will pay any sales commissions or other seller's compensation applicable to such transactions.

We have not registered or qualified offers and sales of shares of the common stock under the laws of any country other than the United States. To comply with certain states' securities laws, if applicable, the selling stockholders will offer and sell their shares of common stock in such jurisdictions only through registered or licensed brokers or dealers. In addition, in certain states the selling stockholders may not offer or sell shares of common stock unless we have registered or qualified such shares for sale in such states or we have complied with an available exemption from registration or qualification.

Any shares of common stock offered under this prospectus that qualify for sale pursuant to Rule 144 of the Securities Act may also be sold under Rule 144 rather than pursuant to this prospectus.

The selling stockholders with respect to any purchase or sale of shares of common stock are required to comply with Regulation M promulgated under the Securities Exchange Act of 1934, as amended. In general, Rule 102 under Regulation M prohibits any person connected with a distribution of securities (the "Distribution") from directly or indirectly bidding for, or purchasing for any account in which he or she has a beneficial interest, any of such securities or any right to purchase such securities, for a period of one business day before and after completion of his or her participation in the Distribution (we refer to that time period as the "Distribution Period").

During the Distribution Period, Rule 104 under Regulation M prohibits the selling stockholders and any other persons engaged in the Distribution from engaging in any stabilizing bid or purchasing of our common stock except for the purpose of preventing or retarding a decline in the open market price of our common stock. No such person may effect any stabilizing transaction to facilitate any offering at the market. Inasmuch as the selling shareholders will be reoffering and reselling our common stock at the market, Rule 104 prohibits

them from effecting any stabilizing transaction in contravention of Rule 104 with respect of our common stock.

There can be no assurance that the selling stockholders will sell any or all of the shares offered by them hereunder or otherwise.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Our principal business is the acquisition, development, licensing and protection of our intellectual property. We presently own six patents covering various telecommunications and data networking technologies (the "Patent Portfolio") including, among others, patents covering the delivery of power over Ethernet for the purpose of remotely powering network devices, and the transmission of audio, video and data over computer and telephony networks. Our strategy is to pursue licensing and strategic business alliances with companies in the industries that manufacture and sell products that make use of the technologies underlying our patents as well as with other users of the technology who benefit directly from the technology including corporate, educational and governmental entities.

To date, our efforts with respect to our Patent Portfolio have focused on licensing our patent (U.S. Patent No. 6,218,930) covering the control of power delivery over Ethernet cables (the "Remote Power Patent"). In August, 2007, as part of a settlement agreement relating to our litigation with D-Link, we entered into a license agreement with D-Link pertaining to our Remote Power Patent (See "Business - Licensing - D-Link License"). In February 2008, we commenced patent infringement litigation against several major data networking equipment manufacturers including Cisco Systems, Inc. and seven (7) other defendants (See "Legal Proceedings"). During the next 12 months we do not presently anticipate licensing efforts for our other patents besides our Remote Power Patent. In August 2008, as part of our new agreement with Microsemi Corp - Analog Mixed Signal Group Ltd. ("Microsemi") entered into in June 2008, Microsemi entered into a license agreement with us with respect to our Remote Power Patent (See "Business - Licensing - Microsemi License").

To date we have incurred significant losses and at June 30, 2008 had an accumulated deficit of $(49,998,000). For the year ended December 31, 2007 and for the three and six months ended June 30, 2008, we incurred net losses of $(2,998,000), $(402,000) and $(721,000), respectively. We anticipate that we will continue to incur losses until we enter into additional license agreements with respect to our patented technologies. We achieved revenue of $232,000 from our technology licensing business for the year ended December 31, 2007 and $134,000 for the six months ended June 30, 2008 with respect to royalties pertaining to our Remote Power Patent. Our inability to consummate additional material license agreements and achieve revenue from our patented technologies would have a material adverse effect on our operations and our ability to continue business.

Our success and ability to generate revenue is largely dependent on our ability to consummate licensing arrangements with third parties. In November 2004, we entered into an agreement with ThinkFire Services USA, Ltd. ("ThinkFire") pursuant to which ThinkFire has been granted the exclusive worldwide rights to negotiate license agreements for our Remote Power Patent with certain agreed-upon potential licensees. We have agreed to pay ThinkFire a fee of up to 20% of the royalty payments received from license agreements consummated by ThinkFire on our behalf after we recover our expenses.

In August 2007 we finalized the settlement of our patent litigation against D-Link in the United States District Court for the Eastern District of Texas, Tyler Division, for infringement of our Remote Power Patent (U.S. Patent No. 6,218,930). Under the terms of the settlement, D-Link has agreed to license our the Remote Power Patent, the terms of which include monthly royalty payments of 3.25% of the net sales of D-Link branded Power over Ethernet products, including those products which comply with the IEEE 802.3af and 802.3at Standards, for the full life of our Remote Power Patent, which expires in March 2020. The royalty rate is subject to adjustment to a rate consistent with other similarly situated licensees of our Remote Power Patent based on units of shipments of licensed products. In addition, D-Link paid us $100,000 upon signing the settlement agreement. Notwithstanding the settlement and our license agreement with D-Link, there is no assurance that we will achieve significant royalty revenue from D-Link, that we will be able to achieve additional license agreements with third parties relating to our Remote Power Patent or our other patents, or that such license arrangements will result in material revenue to us.

In February 2008, we commenced litigation against several major data networking equipment manufacturers in the United States District Court for the Eastern District of Texas, Tyler Division, for infringement of our Remote Power Patent. The defendants in the lawsuit include Cisco Systems, Inc., Cisco Linksys, LLC, Enterasys Networks, Inc., 3COM Corporation, Inc., Extreme Networks, Inc., Foundry Networks, Inc., Netgear, Inc. and Adtran, Inc. We seek injunctive relief and monetary damages for infringement based upon reasonable royalties as well as treble damages for the defendants' continued willful infringement of our Remote Power Patent. To date, all of the defendants have answered the complaint and asserted that they do not infringe any valid claim of our Remote Power Patent, and further asserted that, based on several different theories, the patent claims are invalid or unenforceable. In addition to these defenses, the defendants also asserted counterclaims for, among other things, non-infringement, invalidity, and unenforceability of our Remote Power Patent. In the event that the Court determines that our Remote Power Patent is not valid or enforceable, and/or that the defendants do not infringe, any such determination would have a material adverse effect on us.

RESULTS OF OPERATIONS

Year Ended December 31, 2007 Compared To Year Ended December 31, 2006

We had revenues of $232,000 for the year ended December 31, 2007 (“2007”) which were related to receipt of royalties from our license agreement with D-Link. The Company had no revenues for the year ended December 31, 2006 (“2006”).

We had a cost of royalties of $12,000 for 2007 which was related to the payment of bonus compensation on the royalties pursuant to an agreement with our Chief Executive Officer. The gross profit for 2007 was $220,000 as compared to no gross profit for 2006.

General and administrative expenses include overhead expenses, and finance, accounting, legal and other professional services incurred by us. General and administrative expenses increased by $444,000, from $1,548,000 for 2006 to $1,992,000 for 2007, primarily attributable to increased legal fees and expenses attributable to the D-Link litigation.

We incurred an operating loss of ($3,175,000) for 2007 compared with an operating loss of ($2,027,000) for 2006. Included in the operating loss for 2007 was $1,403,000 in charges relating to non-cash compensation expenses as compared to $479,000 for 2006. These losses were offset by interest earned of $177,000 and $69,000 for 2007 and 2006, respectively.

No provision for or benefit from federal, state or foreign income taxes was recorded for 2007 and 2006 because we incurred net operating losses and fully reserved our deferred tax assets as their future realization could not be determined.

As a result of the foregoing, we incurred a net loss of $(2,998,000) for 2007 compared with a net loss of $(1,958,000) for 2006.

Six Months Ended June 30, 2008 Compared To Six Months Ended June 30, 2007

We had revenues of $134,000 for the six months ended June 30, 2008 which were related to the receipt of royalties from D-Link pursuant to our license agreement with D-Link. We had no revenues for the six months ended June 30, 2007.

We had a cost of royalties of $7,000 for the six months ended June 30, 2008 which was related to the payment of bonus compensation on the royalties pursuant to an employment agreement with our Chief Executive Officer. The gross profit for the six months ended June 30, 2008 was $127,000 as compared to no gross profit for the six months ended June 30, 2007.

General and administrative expenses include overhead expenses, and finance, accounting, legal and other professional services incurred by us. General and administrative expenses decreased by $463,000, from $1,233,000 for the six months ended June 30, 2007 to $770,000 for the six months ended June 30, 2008, due primarily to decreased fees and expenses as a result of the settlement of the D-Link litigation.

We incurred an operating loss of ($789,000) for the six months ended June 30, 2008 compared with an operating loss of ($2,460,000) for the six months ended June 30, 2007. Included

in the operating loss for the six months ended June 30, 2008 was $146,000 in charges relating to non-cash compensation expenses as compared to $1,227,000 for such non-cash compensation expenses for the six months ended June 30, 2007. These losses were offset by interest earned of $68,000 and $63,000 for the six months ended June 30, 2008 and 2007, respectively.

No provision for or benefit from federal, state or foreign income taxes was recorded for the six months ended June 30, 2008 and June 30, 2007 because we incurred net operating losses and fully reserved our deferred tax assets as their future realization could not be determined.

As a result of the foregoing, we incurred a net loss of $(721,000) for the six months ended June 30, 2008 compared with a net loss of $(2,397,000) for the six months ended June 30, 2007.

LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations primarily from the sale of equity securities. In April 2007, we completed a private offering of equity securities resulting in gross proceeds of $5,000,000. In addition, during the fourth quarter of 2007 we received $1,184,375 of cash proceeds from the exercise of warrants issued in December 2004 and January 2005. We anticipate, based on currently proposed plans and assumptions relating to our operations, that our cash and cash equivalents of approximately $5,140,000 as of June 30, 2008 will more likely than not be sufficient to satisfy our operations and capital requirements until at least December 31, 2009. There can be no assurance, however, that such funds will not be expended prior thereto. In the event our plans change, or our assumptions change, or prove to be inaccurate (due to unanticipated expenses, difficulties, delays or otherwise), we may have insufficient funds to support our operations prior to December 31, 2009. Our inability to consummate material licensing arrangements with respect to our Remote Power Patent and generate revenues therefrom on a timely basis or obtain additional financing when needed would have a material adverse effect on our company, requiring us to curtail or cease operations. In addition, any equity financing may involve substantial dilution to our current stockholders.

Critical Accounting Policies:

Patents:

We own a patent portfolio that relates to various telecommunications and data networking technologies. We capitalize the costs associated with the acquisition, registration and maintenance of the patents and amortize these assets over their remaining useful lives on a straight-line basis. Any further payments made to maintain or develop the patents would be capitalized and amortized over the balance of the useful life for the patents.

Impairment of long-lived assets:

In accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”, we record impairment losses on long-lived assets used in operations or expected to be disposed of when indicators of impairment exist and the cash flows expected to be derived from those assets are less than the carrying amounts of those assets.

Use of estimates:

The preparation of 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

On February 2, 2006, we dismissed Eisner LLP, our then principal independent accountant to audit our financial statements. Eisner LLP's report on our financial statements for the year ended December 31, 2004 did not contain an adverse opinion or disclaimer opinion, and was not modified as to uncertainty, audit scope or accounting principles. Eisner LLP did not audit our financial statements for the year ended December 31, 2005 or issue a report thereon. During the year ended December 31, 2005 and the subsequent interim period there were no disagreements with Eisner LLP, whether or not resolved, on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which, if not resolved to the satisfaction of Eisner LLP, would have caused Eisner LLP to make reference to the subject matter of the disagreement(s) in connection with its report on our financial statements.

On February 2, 2006, we engaged Radin, Glass & Co., LLP as our new principal independent accountant to audit our financial statements. We (or someone on our behalf) did not consult Radin, Glass & Co., LLP with respect to the application of accounting principles to a specific completed or contemplated transaction, or the type of audit opinion that might be rendered on our financial statements.

MANAGEMENT

Our current officers and directors as of the date of this prospectus are as follows:

NAME	AGE	POSITION
Corey M. Horowitz	53	Chairman, Chief Executive Officer and Secretary, Chairman of the Board of Directors
David C. Kahn	56	Chief Financial Officer
Robert M. Pons	51	Director
Laurent Ohana	45	Director

Corey M. Horowitz became our Chairman and Chief Executive Officer in December 2003. Mr. Horowitz has also served as Chairman of our Board of Directors since January 1996 and has been a member of our Board of Directors since April 1994. In January 2003, Mr. Horowitz also became our Secretary. Mr. Horowitz is also President and sole shareholder of CMH Capital Management Corp. ("CMH"), a New York investment advisory and merchant banking firm, which he founded in September 1991. During the period June 2001 through December 2003, CMH rendered financial advisory services to us. From January 1986 to February 1991, Mr. Horowitz was a general partner in charge of mergers and acquisitions at Plaza Securities Co., a New York investment partnership.

David C. Kahn, CPA, became our Chief Financial Officer in January 2004. Since December 1989, Mr. Kahn has provided accounting and tax services on a consulting basis to private and public companies. He also serves as a faculty member of Yeshiva University in New York, a position he has held since August 2000.

Robert M. Pons became a director of our company in December 2003. Mr. Pons is currently Senior Vice President of TMNG Global (NasdaqGM: TMNG), a leading provider of professional services to the converging communications media and entertainment industries and the capital formation firms that support it. From January 2004 until April 2007, Mr. Pons served as President and Chief Executive Officer of Uphonia, Inc. (PK:UPHN) (previously SmartServ Online, Inc.), a wireless applications service provider. From August 2003 until January 2004, Mr. Pons served as Interim Chief Executive Officer of SmartServ Online, Inc. on a consulting basis. From March 1999 to August 2003, he was President of FreedomPay, Inc., a wireless device payment processing company. During the period January 1994 to March 1999, Mr. Pons was President of Lifesafety Solutions, Inc., an enterprise software company. Mr. Pons has over 20 years of management experience with telecommunications companies including MCI, Inc., Sprint, Inc. and Geotek, Inc.

Laurent Ohana became a director of our company in September 2005. Mr. Ohana is currently the Managing Partner of Parkview Ventures LLC ("Parkview"), a company engaged in merchant banking activities, including making investments in, and providing strategic advisory services to, information technology firms in the US and internationally. From 1999 to 2002, Mr. Ohana was the CEO of Inlumen, Inc., a company engaged in providing private label web-based financial portals to financial institutions. From 1994 to 2004, Mr. Ohana was the managing partner of New Media Capital LLC, a technology venture capital and advisory firm. From 1987 to 1993, Mr. Ohana was a corporate attorney at Fried Frank Harris Shriver & Jacobson.

Key Consultant

Jonathan Greene has served as a consultant to our company since December 2004 providing technical and marketing analysis for our Patent Portfolio. Mr. Greene also serves as a member of the Company's Technical Advisory Board. Since April 2006, Mr. Greene has also served as a marketing consultant for Avatier Corporation, a developer of identity management software. From August 2003 until December 2004, he served as a consultant to Neartek, Inc., a storage management software company (August 2003 until October 2003) and Kavado Inc., a security software company (November 2003 until December 2004). From January 2003 until July 2003, Mr. Greene served as Director of Product Management for FalconStor Software, Inc., a storage management software company. From December 2001 through December 2002, Mr. Greene served as our Senior Vice President of Marketing and Business Development, at a time when we were engaged in the development, marketing and licensing of security software. From December 1999 until September 2001, he served as Senior Vice President of Marketing for Panacya Inc., a vendor of service management software. Mr. Greene has also held positions at System Management ARTS (SMARTS), Computer Associates, Cheyenne Software and Data General.

Limitation on Liability and Indemnification Matters

Our Certificate of Incorporation limits the liability of directors to the maximum extent permitted by Delaware law. Delaware law provides that directors of a corporation will not be personally liable for monetary damages for breach of their fiduciary duties as directors, except for liability (i) for any breach of their duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law, (iii) for unlawful payments of dividends or unlawful stock repurchases or redemptions as provided in Section 174 of the Delaware General Corporation Law or (iv) for any transaction from which the director derived an improper personal benefit. Our Bylaws provide that we shall indemnify our directors, officers, employees and agents to the fullest extent permitted by law. Our Bylaws also permit us to secure insurance on behalf of any officer, director, employee or other agent for any liability arising out of his or her actions in such capacity. We currently maintain directors and officers liability insurance. At present, there is no pending litigation or proceeding involving any of our directors, officers, employees or agents where indemnification will be required or permitted. We are not aware of any threatened litigation or proceeding that might result in a material claim for such indemnification.

Technical Advisory Board

In November 2004 we established a Technical Advisory Board to assist us with our strategic business plan of maximizing the value of our Patent Portfolio. Each member of the Technical Advisory Board received a five (5) year option to purchase 17,500 shares (vesting in equal quarterly amounts) of our common stock at an exercise price equal to the closing price of the shares on the date of appointment to the Technical Advisory Board.

The members of the Technical Advisory Board include:

George Conant, former CEO and Chairman of the Board of Directors of Merlot Communications, Inc., a broadband communications solutions provider, during the period 2000 – 2006. Prior to joining Merlot Communications, Inc., Mr. Conant co-founded Xyplex, Inc., a manufacturer of data communications equipment and network management software, where he held the positions of Vice President of Engineering, Vice President of Technology and Chief

Technology Officer. Prior to Xyplex, Mr. Conant was employed by Digital Equipment Corporation, where he worked as a network architect. Mr. Conant received a BS and a Masters in theoretical mathematics from the University of Michigan.

Ron Keenan, CEO of IP Infotainment, Limited, a network services company. From 1997 until 2006, Mr. Keenan served as Chief Technology Officer of Merlot Communications, Inc. Mr. Keenan is an expert on the convergence of telecommunications and data who, prior to co-founding Merlot, founded QFR USA Corporation, a high-tech firm engaged in developing custom ASICs for advanced and cost-effective communications systems. He had previously founded two other development firms. He also served as advanced engineering project director at TIE/Communications, Inc., where he developed the TIE 612 Electronic Key System, the first "skinny wire" telephone system and one of the largest selling key systems in history. Mr. Keenan received his BS in Electrical Engineering from the Milwaukee School of Engineering and has more than 20 years experience in advanced analog and digital design techniques.

Andrew Maslow, Director of Industrial Affairs, Memorial Sloan-Kettering Cancer Center. Mr. Maslow heads the intellectual property activities of Sloan-Kettering which includes licensing activities of the Center's technology and management of its patent portfolio. Annual licensing revenue exceeds $60 million. Prior to joining Sloan-Kettering, Mr. Maslow was Associate Director of the Office of Science and Technology of Columbia University where he was responsible for the development, patenting and licensing of inventions originating at the university. Mr. Maslow is a Registered Patent Attorney.

Boris Katzenberg, Senior Electrical Engineer, Ortronics, Inc., a structured cabling solutions provider. Mr. Katzenberg has held numerous positions during his 28-year career in the Telecom and Datacom industries. He has been a force in the fields of power delivery and signal integrity systems, and has lent his expertise in the development of many innovative and cutting-edge technologies. From 1997 to 2002, he was a senior electrical engineer at Merlot Communications, Inc., where he invented the technology underlying our Remote Power Patent. He has also been active in the IEEE 802.3at Task Force, developing the next generation Power over Ethernet standard and continues to be responsible for the evaluation of new technologies and their development into viable products for Ortronics, Inc.

Jonathan Greene also serves as a member of the Technical Advisory Board (see page 41 hereof for a description of Mr. Greene's background).

EXECUTIVE COMPENSATION

The following table summarizes compensation, for the year ended December 31, 2007, awarded to, earned by or paid to the Company's Chief Executive Officer ("CEO") and to each of our executive officers who received total compensation in excess of $80,000 for the year ended December 31, 2007 for services rendered in all capacities to the Company (collectively, the "Named Executive Officers").

Summary Compensation Table

		Annual Compensation			Long Term Compensation Awards	
Name and Principal Position	Year	Salary ($)	Bonus ($)	Option Awards($)	All Other Compensation($)(1)	Total($)
Corey M. Horowitz Chairman and Chief Executive Officer	2007	$286,458	$162,000 (2)	$655,000 (3)	—	$1,103,458
David C. Kahn Chief Financial Officer	2007	$89,380(4)	—	—	—	$ 89,380

(1) We have concluded that the aggregate amount of perquisites and other personal benefits paid to either Mr. Horowitz or Mr. Kahn did not exceed $10,000.

(2) Mr. Horowitz received the following bonus payments for 2007: (i) a discretionary annual bonus of $150,000 for 2007 which was paid in January 2008 and (ii) royalty bonus compensation of $12,000 pursuant to his employment agreement.

(3) In determining the grant date fair value under SFAS No. 123R of (i) a five (5) year option issued in February 2007 to Mr. Horowitz to purchase 375,000 shares of common stock and (ii) a five (5) year option issued in April 2007 to Mr. Horowitz to purchase 732,709 shares of common stock, we made the following assumptions: expected term of the options – 5 years, risk free interest rate for the expected term of the options – 4.52% and 4.67%; expected volatility of the underlying stock – 45.82%; no expected dividends.

(4) Consists of consulting fees paid to Mr. Kahn for his services as Chief Financial Officer.

Narrative Disclosure To Summary Compensation Table

Employment Agreements, Termination of Employment and Change-In-Control Arrangements

On February 28, 2007, we entered into a new Employment Agreement with Corey M. Horowitz pursuant to which Mr. Horowitz continued to serve as our Chairman and Chief Executive Officer for a two year term at an annual base salary of $288,750 for the first year, increasing by 5% for the second year. In connection with his employment agreement, Mr. Horowitz was issued a five (5) year option to purchase 375,000 shares of our common stock at an exercise price of $1.46 per share, which vested on a quarterly basis over a one year period subject to acceleration upon a change of control. We also issued to Mr. Horowitz on the one year anniversary date (February 28, 2008) an additional five (5)

year option to purchase 375,000 shares of our common stock, at an exercise price of $1.32 (the closing price of our common stock on the date of grant), which option vests on a quarterly basis over a one year period. In addition to the aforementioned option grants, the Company agreed to extend for an additional three (3) years the expiration dates of all options and warrants (an aggregate of 2,620,000 shares) expiring in calendar year 2007 and 2008 owned by Mr. Horowitz and CMH Capital Management Corp. (“CMH”), an affiliate. Under the terms of his

Employment Agreement, Mr. Horowitz receives bonus compensation in an amount equal to 5% of our royalties or other payments (before deduction of payments to third parties including, but not limited to, legal fees and expenses and third party license fees) received from licensing its patents (including patents currently owned and acquired or licensed on an exclusive basis during the period in which Mr. Horowitz continues to serve as an executive officer of our company) (the "Royalty Bonus Compensation"). During 2007, Mr. Horowitz received $12,000 of Royalty Bonus Compensation. Mr. Horowitz shall also receive bonus compensation equal to 5% of the gross proceeds from (i) the sale of any of our patents or (ii) our merger with or into another corporation or entity. The Royalty Bonus Compensation shall continue to be paid to Mr. Horowitz for the life of each of the Company's patents with respect to licenses entered into by us with third parties during Mr. Horowitz's term of employment or at anytime thereafter, whether Mr. Horowitz is employed by us or not, provided, that, Mr. Horowitz's employment has not been terminated by us "For Cause" (as defined) or terminated by Mr. Horowitz without "Good Reason" (as defined). In the event that Mr. Horowitz's employment is terminated by us "Other Than For Cause" (as defined) or by Mr. Horowitz for "Good Reason" (as defined), Mr. Horowitz shall be entitled to a severance of 12 months base salary.

In connection with his Employment Agreement, Mr. Horowitz has agreed not to compete with us as follows: (i) during the term of the agreement and for a period of 12 months thereafter if his employment is terminated other than for cause (as defined) provided he is paid his 12 month base salary severance amount and (ii) for a period of two years from the termination date, if terminated "For Cause" by us or "Without Good Reason" by Mr. Horowitz. In accordance with his employment agreement, Mr. Horowitz also had certain anti-dilution rights which provided that if at any time during the period ended December 31, 2008, in the event that we completed an offering of our common stock or any securities convertible or exercisable into common stock (exclusive of securities issued upon exercise of outstanding options, warrants or other convertible securities), Mr. Horowitz shall receive from us, at the same price as the securities issued in the financing, such number of additional options to purchase common stock so that he maintains the same derivative ownership percentage (21.47%) of our company based upon options and warrants owned by Mr. Horowitz and CMH (exclusive of ownership of shares of common stock by Mr. Horowitz and CMH) as he owned as of the time of execution of his employment agreement; provided, that, the aforementioned anti-dilution protection was afforded to Mr. Horowitz up to a maximum financing(s) of $2.5 million. In April 2007, with respect to our completion of a $5.0 million private offering, Mr. Horowitz was issued a five (5) year option to purchase 732,709 shares of our common stock, at an exercise price of $1.67 per share, in accordance with the aforementioned anti-dilution provisions of his employment agreement.

On December 20, 2006, we entered into an agreement with David C. Kahn pursuant to which he continues to serve as our Chief Financial Officer through December 31, 2008. In consideration for his services, Mr. Kahn was compensated at the rate of $6,615 per month for the year ended December 31, 2007 and is compensated at the rate of $6,945 per month for the year ended December 31, 2008. In connection with the agreement, Mr. Kahn was also issued a five (5) year option (the "Option") to purchase 75,000 shares of our common stock at an exercise price of $1.50 per share. The option vested 30,000 shares on the date of grant and the balance of the shares (45,000) vest on a quarterly basis in equal amounts of 5,625 shares beginning March 31, 2007 through December 31, 2008. Upon a "Change in Control" (as defined) all of the unvested shares underlying the Option shall become 100% vested and immediately exercisable. The agreement further provides that we may terminate the agreement at any time for any reason. In the event Mr. Kahn's services are terminated without "Good Cause" (as defined), he will be entitled to accelerated vesting of all unvested shares underlying the Option and the lesser of (i) six months

base monthly compensation or (ii) the remaining balance of the monthly compensation payable through December 31, 2008.

Director Compensation

We compensated each director, who is not an employee of our company, by granting to each such outside director (upon joining the Board) stock options to purchase 50,000 shares of our common stock, at an exercise price equal to the closing price of our common stock on the date of grant, with the options vesting over a one year period in equal quarterly amounts. In addition, subject to the discretion of the Compensation Committee and the Board of Directors, each non-employee director is eligible to receive option grants for each year of service as a director. In December 2007, each member of the Board of Directors (with the exception of Harry Schessel who resigned in December 2007) were granted the following options: (i) a five (5) year option to purchase 25,000 shares at an exercise price of $1.45 per share (closing price of our common stock on the date of grant), which vested on the date of grant, for services as a director for 2007 and (ii) a five (5) year option to purchase 25,000 shares at an exercise price of $1.45 per share (closing price of our common stock on the date of grant), which option vests on a monthly basis over a one (1) year period, for services as a director for 2008.

The following table sets forth the compensation paid to all persons who served as members of our board of directors (other than our Named Executive Officers) during the year ended December 31, 2007. No director who is also a Named Executive Officer received any compensation for services as a director in 2007.

Name	Option Awards ($)	All other Compensation	Total ($)
Robert Graifman(1)	$14,000 (2)	$ —	$14,000
Robert Pons(1)	$14,000 (2)	—	$14,000
Laurent Ohana(1)	$14,000 (2)	—	$14,000
Harry Schessel	—	—	$ —

(1) In December 2007, Robert Graifman, Robert Pons and Laurent Ohana were each granted a five (5) year option to purchase 25,000 shares of our common stock (which vested on grant), at an exercise price of $1.45 per share, for services as a Board member during 2007. Mr. Graifman resigned from the Board of Directors on June 23, 2008.

(2) In determining the grant date fair value of the option grants in December 2007 under SFAS No. 123R, we made the following assumptions: expected term of the options – five years; risk free interest rate for the expected term of the options – 3.28%; expected volatility of the underlying stock - 37.32%; no expected dividends.

Option Grants in 2007

The following stock options were granted to the Named Executive Officers during the year ended December 31, 2007:

Name	Number of Securities Underlying Options Granted	Percent of Total Options Granted to Employees in 2007	Exercise Price	Expiration Date
Corey M. Horowitz	375,000	33.9%	$1.46	2/28/2012
Chairman and	732,709	66.1%	$1.67	4/16/2012
Chief Executive Officer				

Outstanding Equity Awards at December 31, 2007

The following table sets forth information relating to unexercised and outstanding options for each Named Executive Officer as of December 31, 2007:

	Number of Securities Underlying Unexercised Option			
Name	Exercisable	Unexercisable	Option Exercise Price ($)	Option Expiration Date
Corey M. Horowitz				
Chairman and CEO	375,000(1)	—	$ 1.46	02/28/12
	732,709(2)	—	$ 1.67	04/16/12
	1,195,361(3)	—	$ 1.18	03/06/12
	400,000(4)	—	$ .68	11/26/09
	1,100,000(5)	—	$ .25	11/26/14
	515,218(6)	—	$ .13	12/22/11
	1,084,782(7)	—	$ .23	12/22/11
	750,000(8)(20)	—	$ 1.20	04/18/10
	250,000(9)(20)	—	$ 1.48	10/08/10
	300,000(10)(20)	—	$ .70	07/11/11
	—	10,625(18)	$ 3.0625	01/19/11
	20,000(11)		$ 6.00	10/20/11
	10,000(12)		$ 3.75	6/22/09
	7,500(13)		$ 4.25	10/25/09
	5,000(14)		$ 5.50	9/19/10
David Kahn				
Chief Financial Officer	52,500(15)	22,500(19)	$ 1.50	12/20/11
	75,000(16)	—	$ .80	08/04/10
	35,000(17)	—	$ .35	01/21/14

The vesting dates of the foregoing options are as follows: (1) 93,750 shares on a quarterly basis beginning March 31, 2007 through December 31, 2007; (2) April 16, 2007; (3) March 16, 2005; (4) 200,000 shares on November 26, 2004 and 200,000 shares on November 26, 2005; (5) November 26, 2004; (6) December 22, 2003; (7) 434,782 shares on December 22, 2003, 250,000 shares on December 22, 2004, 200,000 shares on December 22, 2005, and 200,000 shares on December 22, 2006; (8) 250,000 shares on April 18, 2005, 250,000 shares on April 18, 2004 and 250,000

shares on April 18, 2005; (9) June 11, 2001; (10) July 11, 2001; (11) on a quarterly basis in equal amounts beginning January 20, 1999 through October 20, 1999; (12) on a quarterly basis in equal amounts beginning September 12, 1999 through June 22, 2000; (13) on a quarterly basis in equal amounts beginning January 25, 2000 through October 25, 2000; (14) on a quarterly basis in equal amounts beginning December 19, 2000 through September 19, 2000; (15) 30,000 shares on December 20, 2006 and 5,625 on a quarterly basis beginning March 31, 2007 through December 31, 2008; (16) 30,000 shares on August 4, 2005 and 7,500 shares on a quarterly basis beginning September 30, 2005 through December 31, 2006; (17) 20,000 shares on January 21, 2004, 2,500 shares on the last day of each month beginning January 31, 2004 through December 31, 2004; (18) 5,313 shares if the stock price reaches $10 per share and 5,312 shares if the stock price reaches $15 per share; and (19) 5,625 shares on a quarterly basis beginning March 31, 2007 through December 31, 2008.

(20) Includes options or warrants held by CMH Capital Management Corp., an entity in which Mr. Horowitz is the sole owner, officer and director.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information regarding the beneficial ownership of our common stock as of the date of this prospectus (i) each person known by us to be the beneficial owner of more than 5% of our outstanding shares of common stock, (ii) each of our directors, (iii) each of our executive officers, and (iv) all of our executive officers and directors as a group.

NAME OF BENEFICIAL OWNER	NUMBER OF SHARES BENEFICIALLY OWNED	PERCENTAGE OF SHARES BENEFICIALLY OWNED(2)
Corey M. Horowitz(3)	10,073,185	32.3%
CMH Capital Management Corp(4)	3,767,800	14.8%
Jonathan Auerbach(5)	3,279,916	12.9%
Hound Partners, LLC(5)	3,279,916	12.9%
Hound Performance, LLC(5)	3,279,916	12.9%
Barry Rubenstein (6)	2,078,896	8.6%
Steven D. Heineman (7)	1,699,252	7.0%
Hound Partners Offshore Fund, L.P.(8)	1,627,275	6.6%
Hound Partners, L.P. (9)	1,622,726	6.6%
Woodland Services Corp. (10)	1,376,209	5.7%
Emigrant Capital Corporation (11) Paul Milstein Revocable 1998 Trust New York Private Bank & Trust Corporation Emigrant Bancorp. Inc. Emigrant Savings Bank	1,312,500	5.4%
Eric Singer(12)	1,184,840	4.8%
Laurent Ohana(13)	195,833	*
David C. Kahn(14)	144,375	*
Robert Pons(15)	145,833	*
All officers and directors as a group (4 Persons)	10,559,226	33.4%

* Less than 1%.

(1) Unless otherwise indicated, we believe that all persons named in the above table have sole voting and investment power with respect to all shares of common stock beneficially owned by them.

(2) A person is deemed to be the beneficial owner of securities that can be acquired by such person within 60 days from the date hereof upon the exercise of options, warrants or convertible securities. Each beneficial owner's percentage ownership is determined by assuming that options, warrants and convertible securities held by such person (but not those held by any other person) and which are exercisable or convertible within 60 days have been exercised and converted. Assumes a base of 24,135,557 shares of our common stock outstanding.

(3) Includes (i) 343,803 shares of common stock held by Mr. Horowitz, (ii) 5,726,820 shares of common stock subject to currently exercisable stock options held by Mr. Horowitz, (iii) 2,467,800 shares of common stock held by CMH Capital Management Corp. ("CMH"), an entity solely owned by Mr. Horowitz, (iv) 550,000 shares of common stock subject to currently exercisable warrants held by CMH, (v) 750,000 shares of common stock subject to currently exercisable options held by CMH, (vi) 67,471 shares of common stock owned by Donna Slavitt, the wife of Mr. Horowitz, (vii) 165,000 shares of common stock held by two trusts and a custodian account for the benefit of Mr. Horowitz's three children and (viii) 2,291 shares of common stock held by Horowitz Partners, a general partnership of which Mr. Horowitz is a partner. Does not include options to purchase 104,375 shares of common stock which are not currently exercisable.

(4) Includes (i) 2,467,800 shares of common stock, (ii) 550,000 shares of common stock subject to currently exercisable warrants and (iii) 750,000 shares of common stock subject to currently exercisable stock options. Corey M. Horowitz, by virtue of being the sole officer, director and shareholder of CMH, has the sole power to vote and dispose of the shares of common stock owned by CMH.

(5) Includes (i) 1,057,215 shares of common stock and 484,899 shares of common stock subject to currently exercisable warrants held by Hound Partners, LP and (ii) 1,139,368 shares of common stock and 598,434 shares of common stock subject to currently exercisable warrants held by Hound Partners Offshore Fund, LP. Jonathan Auerbach is the managing member of Hound Performance, LLC and Hound Partners, LLC. Hound Performance, LLC is the general partner of Hound Partners, LP and Hound Partners Offshore Fund, L.P. Hound Partners, LLC is the investment manager of Hound Partners, LP and Hound Partners Offshore Fund, L.P. The securities may be deemed to be beneficially owned by Hound Performance, LLC, Hound Partners LLC and Jonathan Auerbach. The aforementioned beneficial ownership is based upon a Schedule 13G jointly filed by Hound Partners, LLC, Hound Performance, LLC, Hound Partners, L.P. and Hound Partners Offshore Fund, LP, with the Securities and Exchange Commission on April 26, 2007 and a Form 4 jointly filed by Hound Partners, LLC and Hound Performance, LLC and Jonathan Auerbach with the Securities and Exchange Commission on August 8, 2008 and a Form 3 jointly filed by Hound Partners, LLC, Hound Performance, LLC and Jonathan Auerbach with the Securities and Exchange Commission on April 26, 2007. Jonathan Auerbach, by virtue of being the managing member of Hound Performance, LLC and Hound Partners, LLC, has the power to vote and dispose of the securities held by Hound Partners, LP and Hound Partners Offshore Fund, L.P.

(6) Includes (i) 150,012 shares of common stock held by Mr. Rubenstein, (ii) 47,500 shares of common stock subject to currently exercisable stock options held by Mr. Rubenstein, and (iii) 792,726, 583,483, 309,316, 194,810 and 1,049 shares of common stock held by Woodland Venture Fund, Seneca Ventures, Woodland Partners, Brookwood Partners, L.P. and Marilyn Rubenstein, respectively. Does not include options to purchase 11,875 shares of common stock held by Mr. Rubenstein which are not currently exercisable. The

aforementioned beneficial ownership by Mr. Rubenstein is based upon Amendment No. 7 to Schedule 13D jointly filed by Mr. Rubenstein and related parties with the Securities and Exchange Commission on November 14, 2007 and a Form 4 filed by Mr. Rubenstein with the Securities and Exchange Commission on October 26, 2007. Barry Rubenstein and Woodland Services Corp. are the general partners of Woodland Venture Fund and Seneca Ventures. Barry Rubenstein is the President and sole director of Woodland Services Corp. Marilyn Rubenstein is the wife of Barry Rubenstein.

(7) Includes (i) 1,607,585 shares of common stock and (ii) 91,667 shares of common stock subject to currently exercisable warrants owned by Mr. Heinemann. The aforementioned beneficial ownership is based upon a Schedule 13G filed by Mr. Heinemann with the Securities and Exchange Commission on April 10, 2008.

(8) Includes (i) 1,084,850 shares of common stock and (ii) 542,425 shares of common stock subject to currently exercisable warrants held by Hound Partners Offshore Fund, L.P. Jonathan Auerbach, by virtue of being the managing member of Howard Performance, LLC and Howard Partners, LLC, has the power to vote and dispose of securities held by Howard Partners Offshore Fund, L.P.

(9) Includes (i) 1,081,817 shares of common stock and (ii) 540,909 shares of common stock subject to currently exercisable warrants owned by Hound Partners, LP. Jonathan Auerbach, by virtue of being the managing member of Howard Performance, LLC and Howard Partners, LLC, has the power to vote and dispose of the securities held by Howard Partners, L.P.

(10) Includes (i) 792,726 shares of common stock owned by Woodland Venture Fund and (ii) 583,483 shares of common stock owned by Seneca Ventures. Woodland Services Corp. is a general partner of Woodland Venture Fund and Seneca Ventures. The aforementioned beneficial ownership of Woodland Services Corp. is based upon Amendment No. 7 to Schedule 13D jointly filed by Woodland Services Corp. and related parties with the Securities and Exchange Commission on November 14, 2007. Barry Rubenstein, by virtue of being President and the sole director of Woodland Services Corp., has the sole power to vote and dispose of the shares owned by Woodland Services Corp.

(11) Includes (i) 1,125,000 shares of common stock and (ii) 187,500 shares of common stock subject to currently exercisable warrants held by Emigrant Capital Corporation (“Emigrant Capital”). Emigrant Capital is a wholly owned subsidiary of Emigrant Savings Bank (“ESB”), which is a wholly-owned subsidiary of Emigrant Bancorp, Inc. (“EBI”). EBI is a wholly-owned subsidiary of New York Private Bank & Trust Corporation (“NYPBTC”). The Paul Milstein Revocable 1998 Trust (the “Trust”) owns 100% of the voting stock of NYPBTC. ESB, EBI, NYPBTC and the Trust each may be deemed to be the beneficial owner of the shares of common stock and warrants held by Emigrant Capital. The aforementioned is based upon a Schedule 13G/A filed jointly by Emigrant Capital, ESB, EBI, NYPBTC, the Trust and others with the Securities and Exchange Commission on January 12, 2005. Howard Milstein, by virtue of being an officer of New York Private Bank and Trust Corporation and trustee of the Paul Milstein Revocable 1998 Trust, both indirect owners of Emigrant Capital Corporation, may be deemed to have sole power to vote and dispose of the securities owned by Emigrant Capital Corporation.

(12) Includes (i) 452,100 shares of common stock and 268,125 shares of common stock subject to currently exercisable warrants owned by Singer Opportunity Fund, L.P., (ii) 142,900 shares of common stock and 106,875 shares of common stock subject to currently exercisable warrants owned by Singer Fund, L.P., (iii) 38,000 shares of common stock and 168,840 shares of common stock subject to currently exercisable warrants owned by Mr. Singer and (iv) 8,000 shares of common stock owned by Singer Congressional Fund, L.P. Singer Fund Management, LLC makes all investment and voting decisions on behalf of Singer Opportunity Fund, L.P., Singer Fund, L.P. and Singer Congressional Fund, L.P. The aforementioned is based in part on a Schedule 13G filed jointly by Singer Fund Management, LLC, Singer Opportunity Fund, L.P., Singer Fund, L.P. and Singer Congressional Fund, L.P. with the Securities and Exchange Commission on March 23, 2005. Eric Singer, by virtue of being managing member of Singer Fund, L.P., Singer Fund Management, LLC, and Singer Congressional Fund, L.P., has sole power to vote and dispose of the securities owned by Singer Fund, L.P.

(13) Includes 195,833 shares subject to currently exercisable options and warrants issued to Mr. Ohana. Does not include options to purchase 4,167 shares of common stock held by Mr. Ohana.

(14) Includes 144,375 shares of common stock subject to currently exercisable stock options issued to Mr. Kahn. Does not include options to purchase 5,625 shares of common stock which are not currently exercisable.

(15) Includes 145,833 shares subject to currently exercisable stock options issued to Mr. Pons. Does not include options to purchase 4,167 shares of common stock held by Mr. Pons.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

On December 20, 2006, we entered into an agreement with David C. Kahn pursuant to which he agreed to continue to serve as our Chief Financial Officer through December 31, 2008. In consideration for his services, Mr. Kahn was compensated at the rate of $6,615 per month for the period through December 31, 2007 and is currently compensated at the rate of $6,945 per month for the year ended December 31, 2008. (See “Executive Compensation-Employment Agreements, Termination of Employment and Change-In-Control Arrangements” for the detailed terms of our arrangement with Mr. Kahn).

On February 28, 2007, we entered into an Employment Agreement with Corey M. Horowitz pursuant to which Mr. Horowitz continues to serve as our Chairman and Chief Executive Officer for a two year term at an annual base salary of $288,750 for the first year with a 5% increase on the one year anniversary thereof. In accordance with his employment agreement, on February 28, 2007, we issued Mr. Horowitz a five (5) year option to purchase 375,000 shares of our common stock, at an exercise price of $1.46 per share, which option vested in equal quarterly amounts of 93,950 shares beginning March 31, 2007 through December 31, 2007. (See. “Executive Compensation-

Employment Agreements, Termination of Employment and Change-In-Control Arrangements" for the detailed terms of our employment agreement with Mr. Horowitz).

On April 16, 2007, we issued to Corey M. Horowitz, our Chairman and Chief Executive Officer, a five (5) year option to purchase 732,709 shares of our common stock, at an exercise price of $1.67 per share, which option fully vested on the date of issue. The aforementioned option was issued to Mr. Horowitz pursuant to the anti-dilution provisions of his employment agreement as a result of our completion of a $5,000,000 private placement in April 2007.

On February 28, 2008, in accordance with his employment agreement, we issued to Mr. Horowitz an additional five (5) year option to purchase 375,000 shares of our common stock, at an exercise price of $1.32 per share, which option vests in equal quarterly amounts of 93,750 shares beginning March 31, 2008 through December 31, 2008. (See "Executive Compensation - Employment Agreements, Termination of Employment and Change-In-Control Arrangements).

In December 2007, our Board of Directors extended the expiration dates and adjusted exercise prices of warrants to purchase an aggregate of 2,013,750 shares of our common stock (the "Warrants") issued to investors in our private offering completed in December 2004 and January 2005. The Warrants were exercisable for (i) an aggregate of 1,342,500 shares at an exercise price of $1.25 per share (the "$1.25 Warrants") and (ii) an aggregate of 671,250 shares at an exercise price of $1.75 per share (the "$1.75 Warrants"). Investors in the aforementioned private offering included two of our principal stockholders, Emigrant Capital Corporation (invested $750,000 and received 375,000 $1.25 Warrants and 187,500 $1.75 Warrants), Eric Singer (through two affiliated entities invested an aggregate of $500,000 and received 250,000 $1.25 Warrants and 125,000 $1.75 Warrants), and one of our then directors, Robert Graifman (invested $100,000 and received 50,000 $1.25 Warrants and 25,000 $1.75 Warrants). The Warrants were scheduled to expire on December 21, 2007 or January 13, 2008 (three (3) years from the date of issuance). The extended expiration dates and adjusted exercise prices were as follows:

• The expiration date of the Warrants (both the $1.25 Warrants and the $1.75 Warrants) was extended until March 14, 2008;

• In addition, to the extent the holders exercised in full their $1.25 Warrants no later than December 21, 2007, such holders were afforded an extension of the expiration date of their $1.75 Warrants until May 21, 2010 such that the exercise price of the $1.75 Warrants will remain at $1.75 per share through March 31, 2009 and will increase to $2.00 per share if exercised thereafter until May 21, 2010, at which time they will expire; and

• To the extent holders exercised in full their $1.25 Warrants prior to the new expiration date of March 14, 2008, the expiration date of their $1.75 Warrants would be extended until December 15, 2008 and such warrants would be exercisable at $2.00 per share beginning March 14, 2008.

Prior to December 21, 2007, 902,500 shares of our $1.25 Warrants were exercised by holders resulting in proceeds to us of $1,128,125.

On December 21, 2007, our Board also extended the expiration date of warrants issued in December 2004 to Laurent Ohana, one of our directors, to purchase 50,000 shares of our common stock, from December 21, 2007 until May 21, 2010.

As a result of further action by our Board of Directors, the expiration dates and exercise prices of our remaining outstanding $1.25 Warrants (exercisable to purchase 395,000 shares) and the $1.75 Warrants (exercisable to purchase 197,500 shares) held by holders of such $1.25 Warrants, have been amended as follows: (i) the expiration date of our outstanding $1.25 Warrants was extended until March 31, 2009 and the exercise price of such warrants was adjusted to $1.45 per share and (ii) the expiration date of our $1.75 Warrants was extended until December 15, 2008 and the exercise price of such warrants was adjusted to $2.00 per share.

Director Independence

Two of our three directors – Robert Pons and Laurent Ohana are considered independent directors based upon the standard of independence adopted by the Board of Directors as promulgated under Rule 121A of the Company Guide of the American Stock Exchange ("AMEX"). While we are not listed on AMEX, our Board has adopted its independence rules in making its determination of director independence.

Compensation Committee Interlocks and Insider Participation

Robert Pons was the sole member of the Compensation Committee during the year ended December 31, 2007. No member of the Compensation Committee was at any time during or prior to the year ended December 31, 2007, an officer or employee of our company. No interlocking relationship existed between Mr. Pons and any member of our company's board of directors or Compensation Committee during that period.

DESCRIPTION OF SECURITIES

Our authorized capital stock consists of 50,000,000 shares of common stock, par value $.01 per shares, and 10,000,000 shares of preferred stock, par value $.01 per share. As of the date of this Prospectus, we have outstanding 24,135,557 shares of common stock and no outstanding shares of preferred stock.

Common Stock

Holders of our common stock are entitled to one vote per share on all matters submitted to a vote of stockholders. There are no cumulative voting rights for the election of directors, which means that the holders of more than 50% of such outstanding shares voting for the election of directors can elect all of the directors standing for election. Subject to the rights of any outstanding class or series of preferred stock created by the authority of our Board of Directors, holders of common stock are entitled to receive dividends as and when declared by our Board of Directors out of funds legally available therefor. Subject to the rights of any outstanding class or series of preferred stock created by the authority of our Board of Directors, in the event of the liquidation, dissolution or winding up of our company, the holder of each share of common stock is entitled to share equally in the balance of any of the assets of our company available for distribution to stockholders. Outstanding shares of common stock do not have subscription or conversion rights and there are no redemption or sinking fund provisions applicable thereto. Holders of common stock have no preemptive rights to purchase pro-rata portions of newly issued common stock or preferred stock.

Preferred Stock

Our Board is authorized, subject to any limitations prescribed by Delaware law, to provide for the issuance of additional shares of preferred stock in one or more series, to establish from time to time the number of shares to be included in each such series, to fix the rights, preferences and privileges of the shares of each wholly unissued series and any qualifications, limitations or restrictions thereon, and to increase or decrease the number of shares of any such series (but not below the number of shares of such series then outstanding), without any further vote or action by the stockholders. Our Board may authorize the issuance of preferred stock with voting or conversion rights that could adversely affect the voting power or other rights of the holders of our common stock. Thus, the issuance of preferred stock may have the effect of delaying, deferring or preventing a change in control of our company. Our company has no current plan to issue any shares of preferred stock.

Warrants and Options

As of the date of this prospectus, there are outstanding options and warrants to purchase an aggregate of 12,058,357 shares of our common stock at exercise prices ranging from $.12 to $10.00. To the extent that outstanding options and warrants are exercised, stockholder percentage ownership will be diluted and any sales in the public market of the common stock underlying such options and warrants may adversely affect prevailing market prices for our common stock.

With respect to our $5,000,000 private offering completed on April 16, 2007, we issued to ten (10) investors five (5) year warrants to purchase an aggregate of 1,666,667 shares of common stock, at an exercise price of $2.00 per share, which underlying shares are being registered for resale in this Prospectus pursuant to a registration rights agreement with such investors. In connection with the private offering, we also issued to our two placements agents five (5) year warrants to purchase an aggregate of 360,000 shares of our common stock, of which 240,000 shares are exercisable at $1.50 per share and 120,000 shares are exercisable at $2.00 per share, which underlying shares are being registered for resale in this Prospectus pursuant to a registration rights agreement with such investors.

With respect to our $2,685,000 private placement completed in December 2004 and January 2005, we issued warrants to purchase an aggregate of 2,013,750 shares of common stock. As of the date of this prospectus, such private placement warrants to purchase an aggregate of 1,066,250 shares remain outstanding and such underlying shares are being registered for resale in this prospectus. Such warrants include (i) warrants to purchase 395,000 shares of common stock at an exercise price of $1.45 per share, which expiration date has been extended until March 31, 2009, (ii) warrants to purchase an aggregate of 473,750 shares at an exercise price of $1.75 per share through March 31, 2009, which exercise price increases to $2.00 per share thereafter until the expiration date of May 21, 2010 and (iii) warrants to purchase 197,500 shares at an exercise price of $2.00 per share which expire on December 15, 2008.

Transfer Agent

The Transfer Agent for our common stock is American Stock Transfer and Trust Company, 59 Maiden Lane, New York, New York 10038.

LEGAL MATTERS

The validity of the securities offered hereby will be passed upon for us by the law firm of Eiseman Levine Lehrhaupt & Kakoyiannis, P.C., 805 Third Avenue, New York, New York. Sam Schwartz, a member of such firm, owns 23,584 shares of our common stock and owns options to purchase 12,500 shares of our common stock as of the date of this prospectus.

EXPERTS

Our financial statements as of December 31, 2007 and 2006 and for each of the years then ended appearing in this Prospectus and Registration Statement have been audited by Radin, Glass Co., LLP, independent registered public accounting firm, as set forth in their report thereon appearing elsewhere herein, and are included in reliance upon such report given upon authority of said firm as experts in accounting and auditing.

DISCLOSURE OF COMMISSION POSITION ON INDEMNIFICATION FOR SECURITIES ACT LIABILITIES

Our Certificate of Incorporation and Bylaws provide our directors with protection for breaches of their fiduciary duties to us and our shareholders. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors, officers or persons controlling us, we have been advised that it is the SEC's opinion that such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

In the event that a claim for indemnification against such liabilities (other than the payment by us of expenses incurred or paid by a director, officer or controlling person in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, we will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports and other information with the SEC. You may read and copy any document we file at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Our SEC filings are also available to you on the SEC's Internet site at http://www.sec.gov.

This prospectus is part of a Post-Effective Amendment on Form S-1 to Form SB-2 and Form S-2 Registration Statement filed by us with the SEC under the Securities Act and therefore omits certain information in the Registration Statement. We have also filed exhibits with the Registration Statement that are not included in this Prospectus, and you should refer to the applicable exhibit for a complete description of any statement referring to any document. You can inspect a copy of the Registration Statement and its exhibits, without charge, at the SEC's Public Reference Room, and can copy such material upon paying the SEC's prescribed rates.

You may also request a copy of our filings at no cost by writing or telephoning us at:

Network-1 Security Solutions, Inc.
445 Park Avenue, Suite 1028
New York, New York 10022
Attention: Corey M. Horowitz, Chairman and
Chief Executive Officer
(212) 829-5770

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NETWORK-1 SECURITY SOLUTIONS, INC.
INDEX TO FINANCIAL STATEMENTS

NETWORK-1 SECURITY SOLUTIONS, INC.

CONDENSED BALANCE SHEETS

UNAUDITED

Assets:	June 30, 2008 (UNAUDITED)	DECEMBER 31, 2007
Current assets:		
Cash and cash equivalents	$ 5,140,000	$ 5,928,000
Royalty and Interest Receivable	28,000	23,000
Other current assets	41,000	71,000
Total current assets	5,209,000	6,022,000
Security Deposits	6,000	6,000
Patents	69,000	72,000
	$ 5,284,000	$ 6,100,000
Liabilities:		
Current liabilities:		
Accounts payable	$ 42,000	$ 103,000
Accrued expenses and other current liabilities	84,000	264,000
Total current liabilities	126,000	367,000
Commitments and contingencies		
Stockholders' Equity		
Common stock - $0.01 par value ; authorized 50,000,000 shares; 24,135,557 shares issued and outstanding at June 30, 2008 and December 31, 2007	241,000	241,000
Additional paid-in capital	54,915,000	54,769,000
Accumulated deficit	(49,998,000)	(49,277,000)
	5,158,000	5,733,000
	$ 5,284,000	$ 6,100,000

See notes to condensed financial statements

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NETWORK-1 SECURITY SOLUTIONS, INC.

CONDENSED STATEMENTS OF OPERATIONS

UNAUDITED

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Royalty Revenue	$ 65,000	$ —	$ 134,000	$ —
Cost of Revenue	4,000	—	7,000	—
Gross Profit	61,000	—	127,000	—
Operating expenses:				
General and administrative	$ 418,000	$ 619,000	$ 770,000	$ 1,233,000
Non Cash Compensation	73,000	766,000	146,000	1,227,000
Total Operating Expense	$ 491,000	1,385,000	916,000	2,460,000
Loss before interest income	(430,000)	(1,385,000)	(789,000)	(2,460,000)
Interest income – net	28,000	48,000	68,000	63,000
Net Loss	$ (402,000)	$ (1,337,000)	$ (721,000)	$ (2,397,000)
Loss per common share: basic and diluted	$ (0.02)	$ (0.06)	$ (0.03)	$ (0.11)
Weighted average shares: basic and diluted	24,135,557	22,589,449	24,135,557	21,194,834

See notes to condensed financial statements

NETWORK-1 SECURITY SOLUTIONS, INC.

CONDENSED STATEMENTS OF CASH FLOWS

UNAUDITED

	SIX MONTHS ENDED JUNE 30,	
	2008	2007
Cash flows from operating activities:		
Net loss	$ (721,000)	$ (2,397,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,000	5,000
Non Cash Compensation	146,000	1,227,000
Changes in:		
Prepaid expenses and other current assets	26,000	45,000
Accounts payable, accrued expenses and other current liabilities	(242,000)	(299,000)
Net cash used in operating activities	(788,000)	(1,419,000)
Cash Flows from Investing Activities	—	—
Cash Flows from Financing Activities		
Issuance of Common Stock, net of expenses of $275,000	—	4,767,000
NET INCREASES (DECREASE) IN CASH AND CASH EQUIVALENTS	(788,000)	3,348,000
Cash and cash equivalents, beginning of period	5,928,000	1,797,000
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 5,140,000	$ 5,145,000
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the periods for:		
Interest	$ 2,000	$ 2,000
Taxes	$ —	$ —

See notes to condensed financial statements

NETWORK-1 SECURITY SOLUTIONS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE A – NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

[1] BASIS OF PRESENTATION:

The accompanying condensed financial statements as of June 30, 2008 and for the three and six month periods ended June 30, 2008 and June 30, 2007 are unaudited, but in the opinion of the management of Network-1 Security Solutions, Inc. (the "Company"), contain all adjustments consisting only of normal recurring items which the Company considers necessary for the fair presentation of the Company's financial position as of June 30, 2008, and the results of its operations and its cash flows for the three and six month periods ended June 30, 2008 and June 30, 2007. The condensed financial statements included herein have been prepared in accordance with the accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-QSB. Accordingly, certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such rules and regulations, although management believes that the disclosures are adequate to make the information presented not misleading. These financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2007 included in the Company's Annual Report on Form 10-KSB filed with the Securities and Exchange Commission. The results of operations for the six months ended June 30, 2008 are not necessarily indicative of the results of operations to be expected for the full year.

[2] BUSINESS:

(a) The principal business of the Company is the acquisition, development, licensing and protection of its intellectual property. The Company presently owns six patents covering various telecommunications and data networking technologies including, among others, patents covering the delivery of power over Ethernet cable for the purpose of remotely powering network devices, and the transmission of audio, video and data over computer and telephony networks. The Company's strategy is to pursue licensing and strategic business alliances with companies in the industries that manufacture and sell products that make use of the technologies underlying its patents as well as with other users of the technology who benefit directly from the technology including corporate, educational and governmental entities. The Company may seek to acquire additional patents in the future.

To date, the Company's efforts with respect to its Patent Portfolio have focused on licensing its patent (U.S. Patent No. 6,218,930) covering the control of power delivery over Ethernet cables (the "Remote Power Patent"). In August, 2007, as part of a settlement agreement relating to the Company's litigation with D-Link, the Company entered into a license agreement with D-Link

[2] BUSINESS: (CONTINUED)

pertaining to its Remote Power Patent (See Note D[2]). In February 2008, the Company commenced patent infringement litigation against several major data networking equipment manufacturers including Cisco Systems, Inc. and 7 other defendants (See Note D[1]). As part of the Company's agreement with Microsemi Corp - Analog Mixed Signal Group Ltd ("Microsemi Corporation), the parent company of Microsemi Analog, Microsemi entered into a license agreement, dated August 13, 2008, with the Company with respect to the Remote Power Patent as part of the Company's Special Licensing Program. At least for the next twelve months, the Company does not currently anticipate licensing efforts for its other patents besides its Remote Power Patent.

(b) As reflected in the accompanying financial statements, the Company has incurred substantial losses and has experienced net cash outflows from operations for the year ended December 31, 2007 and the three and six month period ended June 30, 2008. For the year ended December 31, 2007 and the three and six month period ended June 30, 2008, the Company had revenue of $232,000, $65,000 and $134,000, respectively. The Company will continue to have operating losses for the foreseeable future until it is successful in licensing its patented technologies. The Company is dependent upon equity financings until it generates sufficient cash flow from operations. The Company had cash and cash equivalents of $5,140,000 as of June 30, 2008. The Company believes its current cash position will more likely than not be sufficient to satisfy the Company's operations and capital requirements until at least December 31, 2009, although there can be no assurance that such funds will not be expended prior thereto.

[3] STOCK-BASED COMPENSATION:

Effective January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), Share Based Payment, or SFAS 123(R), which is a revision of Statement No. 123 ("SFAS 123") Accounting for Stock Based Compensation. SFAS 123(R) supersedes Accounting Principles Board ("APB") No. 25, Accounting for Stock Issued to Employees ("APB"), and amends Financial Accounting Standards Board ("FASB") Statement No. 95. Statement of Cash Flows. SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values.

[3] STOCK-BASED COMPENSATION: (CONTINUED)

On February 28, 2007, the Company granted a 5 year option to its Chairman and CEO to purchase 375,000 shares of common stock, at an exercise price of $1.46 per share, in accordance with a new employment agreement (See Note C – Employment Arrangements and Other Agreements). Such options vested in equal quarterly amounts of 93,750 shares beginning March 31, 2007 through December 31, 2007. The Company recorded non-cash compensation expenses of $63,000 for this option during the quarter ended March 31, 2007 based on the Black-Scholes option-pricing model. In addition, during the quarter ended March 31, 2007, the Company recorded non-cash compensation expense of $17,000 for the vested portion of options granted to directors and consultants prior to January 1, 2007.

On January 2, 2008, the Company granted the following options: (i) 5 year options to purchase an aggregate of 150,000 shares of common stock, at an exercise price of $1.45 per share, to its 3 outside directors, 75,000 shares of which vested on grant and 75,000 shares vest over one year in equal monthly installments, and (ii) a 5 year option to purchase 100,000 shares of common stock, at an exercise price of $1.45 per share, granted to a consultant, which vests over a 5 year period in equal monthly installments. The Company recorded non-cash compensation expense of $24,000 for these options based on the Black-Scholes option-pricing model.

In February 2008, the Company also granted to another consultant a 5 year option to pursue 50,000 shares of common stock, at an exercise price of $1.42 per share, and also granted to a new advisory board member an option to purchase 17,500 shares of common stock, at an exercise price of $1.32 per share, which option vests on a quarterly basis. The Company recorded non-cash compensation expense of $18,000 for these options based on the Black-Scholes option-pricing model.

On February 28, 2008 the Company granted an additional 5 year option to its Chairman and CEO to purchase 375,000 shares of common stock, at an exercise price of $1.32 per share, pursuant to his employment agreement. These options vest in equal quarterly amounts of 93,750 shares beginning March 31, 2008 through December 31, 2008. The Company recognized non-cash compensation expense of $96,000 for these options during the six months ended June, 2008. In addition, during the six month period ended June 30, 2008 the Company recorded non-cash compensation expense of $8,000 for the vested portion of options granted to a consultant prior to January 1, 2008.

The fair value of each option grant on the date of grant is estimated using the Black-Scholes option-pricing utilizing the following weighted average assumptions:

	SIX MONTHS ENDED JUNE 30,	
	2008	2007
Risk-free interest rates	2.73% - 3.28%	4.62%
Expected option life in years	5 yrs.	5 yrs.
Expected stock price volatility	37.32 - 39.35%	45.92%
Expected dividend yield	-0-	-0-

[4] REVENUE RECOGNITION:

The Company recognizes revenue received from the licensing of its intellectual property portfolio in accordance with Staff Accounting Bulletin No. 104, “Revenue Recognition” (“SAB No. 104”) and related authoritative pronouncements. Revenue is recognized when (i) persuasive evidence of an arrangement exists, (ii) all obligations have been performed pursuant to the terms of the license agreement, (iii) amounts are fixed or determinable and (iv) collectibility of amounts is reasonably assured.

[5] LOSS PER SHARE:

Basic net loss per share is calculated by dividing the net loss by the weighted average number of outstanding common shares during the period. Diluted per share data includes the dilutive effects of options, warrants and convertible securities. Potential shares of 12,070,856 and 12,315,857 at June, 2008 and 2007, respectively, are anti-dilutive, and are not included in the calculation of diluted loss per share. Such potential common shares reflect outstanding options and warrants.

[6] CASH EQUIVALENTS:

The Company places cash investments in high quality financial institutions insured by the Federal Deposit Insurance Corporation (“FDIC”). At June 30, 2008, the Company maintained cash balance of approximately $5,040,000 in excess of FDIC limits.

NOTE B – COMMITMENTS AND CONTINGENCIES

Services Agreement:

On November 30, 2004, the Company entered into a master services agreement (the “Agreement”) with ThinkFire Services USA, Ltd. (“ThinkFire”) pursuant to which ThinkFire has been granted the exclusive worldwide rights (except for direct efforts by the Company and related companies) to negotiate license agreements for the Remote Power Patent with respect to certain potential licensees agreed to between the parties. Either the Company or ThinkFire can terminate the Agreement upon 60 days’ notice for any reason or upon 30 days’ notice in the event of a material breach. The Company has agreed to pay ThinkFire a fee not to exceed 20% of the royalty payments received from license agreements consummated by ThinkFire on its behalf.

Amended Patent Purchase Agreement:

On January 18, 2005, the Company and Merlot Communications, Inc. (“Merlot”) amended the Patent Purchase Agreement originally entered into in November 2003 (the “Amendment”) pursuant to which the Company paid additional purchase price of $500,000 to Merlot in consideration for the restructuring of future contingent payments to Merlot from the licensing or sale of the Patents. The Amendment provides for future contingent payments by the Company to Merlot of $1.0 million upon achievement of $25 million of Net Royalties (as defined), an additional $1.0 million upon achievement of $50 million of Net Royalties and an additional $500,000 upon achievement of $62.5 million of Net Royalties from licensing or sale of the patents acquired from Merlot. At the time of the original agreement in November 2003 and the Amendment, certain then principal stockholders of the Company and related parties were also principal stockholders and directors of Merlot.

NOTE B – COMMITMENTS AND CONTINGENCIES: (continued)

Legal Fees:

Dovel & Luner, LLP provide legal services to the Company with respect to the litigation commenced in February 2008 against several major data networking equipment manufacturers (See Note D[1]). The terms of the Company's agreement with Dovel & Luner, LLP provide for legal fees of a maximum aggregate cash payment of $1.5 million plus a contingency fee of up to 24% depending upon when an outcome is achieved.

With respect to the Company's litigation against D-Link, which was settled in May 2007 (See Note D[2]), the Company utilized the services of Blank Rome, LLP on a full contingency basis. In accordance with the Company's contingency fee agreement with Blank Rome LLP, the Company will pay legal fees to Blank Rome LLP equal to 25% of the royalty revenue received by the Company from its license agreement with D-Link after the Company recovers its expenses related to the litigation.

NOTE C – EMPLOYMENT ARRANGEMENTS AND OTHER AGREEMENTS

On February 28, 2007, the Company entered into a new Employment Agreement with Corey M. Horowitz pursuant to which Mr. Horowitz continued to serve as Chairman and Chief Executive Officer for a two year term at an annual base salary of $288,750 for the first year, increasing by 5% for the second year. In connection with his employment agreement, Mr. Horowitz was issued a five (5) year option to purchase 375,000 shares of common stock, at an exercise price of $1.46 per share, which vests on a quarterly basis over a one year period subject to acceleration upon a change of control. The Company also agreed to issue to Mr. Horowitz on the one year anniversary date an additional five (5) year option to purchase a minimum of 375,000 shares of our common stock at an exercise price equal to the closing price of the Company's common stock on the date of grant, which option will vest on a quarterly basis over a one year period. On February 28, 2008, the Company issued such option to Mr. Horowitz to purchase 375,000 shares at an exercise price of $1.32 per share. In addition to the aforementioned option grants, the Company agreed to extend for an addition three (3) years the expiration dates of all options and warrants (an aggregate of 2,620,000 shares) expiring in calendar year 2007 and 2008 owned by Mr. Horowitz and CMH Capital Management Corp. ("CMH"), an affiliate. In connection with the extension of the expiration dates of such options and warrants, the Company recorded compensation expense of $371,000 during the three months ended March 31, 2007 based on the Black-Scholes option pricing model. Under the terms of his Employment Agreement, Mr. Horowitz receives bonus compensation in a amount equal to 5% of Company royalties or other payments (before deduction of payments to third parties including, but not limited to, legal fees and expenses and third party license fees) received from licensing its patents (including patents currently owned and acquired or licensed on an exclusive basis during the period in which Mr. Horowitz continues to serve as an executive officer of the Company) (the "Royalty Bonus Compensation"). For the six months ended June 30, 2008, Mr. Horowitz received $7,000 of Royalty Bonus Compensation. Mr. Horowitz shall also receive bonus compensation equal to 5% of the gross proceeds from (i) the sale of any of the Company's patents or (ii) the Company's merger with or into another corporation or entity.

NOTE C – EMPLOYMENT ARRANGEMENTS AND OTHER AGREEMENTS: (continued)

The Royalty Bonus Compensation shall continue to be paid to Mr. Horowitz for the life of each of the Company's patents with respect to licenses entered into by the Company with third parties during Mr. Horowitz's term of employment or at anytime thereafter, whether Mr. Horowitz is employed by the Company or not, provided, that, Mr. Horowitz's employment has not been terminated by the Company "For Cause" (as defined) or terminated by Mr. Horowitz without "Good Reason" (as defined). In the event that Mr. Horowitz's employment is terminated by the Company "Other Than For Cause" (as defined) or by Mr. Horowitz for "Good Reason" (as defined), Mr. Horowitz shall be entitled to a severance of 12 months base salary.

In accordance with his employment agreement, Mr. Horowitz also had certain anti-dilution rights which provided that if at any time during the period ended December 31, 2008, in the event that the Company completed an offering of its common stock or any securities convertible or exercisable into common stock (exclusive of securities issued upon exercise of outstanding options, warrants or other convertible securities), Mr. Horowitz shall receive from the Company, at the same price as the securities issued in the financing, such number of additional options to purchase common stock so that he maintains the same derivative ownership percentage (21.47%) of the Company based upon options and warrants owned by Mr. Horowitz and CMH, an affiliated entity, (exclusive of his ownership of shares of common stock) as he and CMH owned as of the time of execution of his employment agreement; provided, that, the aforementioned anti-dilution protection was afforded to Mr. Horowitz up to maximum financings of $2.5 million. In April 2007, with respect to the Company's completion of a $5.0 million private placement, Mr. Horowitz was issued a five (5) year option to purchase 732,709 shares of common stock, at an exercise price of $1.67 per share, in accordance with the aforementioned anti-dilution provision of his employment agreement.

NOTE D – LITIGATION

[1] In February 2008, the Company commenced litigation against several major data networking equipment manufacturers in the United States District Court for the Eastern District of Texas, Tyler Division, for infringement of the Company's Remote Power Patent. The defendants in the lawsuit include Cisco Systems, Inc., Cisco Linksys, LLC, Enterasys Networks, Inc., 3COM Corporation, Inc., Extreme Networks, Inc., Foundry Networks, Inc., Netgear, Inc. and Adtran, Inc. The Company seeks injunctive relief and monetary damages for infringement based upon reasonable royalties as well as treble damages for the defendants continued willful infringement of the Remote Power Patent. To date all of the defendants have answered the complaint and asserted that they do not infringe any valid claim of the Remote Power Patent, and further asserted that, based on several different theories, the patent claims are invalid or unenforceable. In addition to these defenses, the defendants also asserted counterclaims for, among other things, non-infringement, invalidity, and unenforceability of the Remote Power Patent. In the event that the Court determines that the Remote Power Patent is not valid or enforceable, and/or that the defendants do not infringe, any such determination would have a material adverse effect on the Company.

[2] In August 2005, the Company commenced patent litigation against D-Link Corporation and D-Link Systems, Incorporated (collectively "D-Link") in the United States District Court for the Eastern District of Texas, Tyler division (Civil Action No. 6:05W291), for infringement of the Company's Remote Power Patent. The complaint sought, among other things, a judgment that the

NOTE D – LITIGATION: (continued)

Company's Remote Power Patent is enforceable and has been infringed by the defendants. The Company also sought a permanent injunction restraining the defendants from continued infringement, or active inducement of infringement by others, of the Remote Power Patent.

In August 2007, the Company finalized the settlement of its patent infringement litigation against D-Link. Under the terms of the settlement, D-Link entered into a license agreement for the Company's Remote Power Patent the terms of which include monthly royalty payments of 3.25% of the net sales of D-Link Power over Ethernet products, including those products which comply with the IEEE 802.3af and 802.3at Standards, for the full term of our Remote Power Patent, which expires in March 2020. The royalty rate is subject to adjustment to a rate consistent with other similarly situated licensees of the Remote Power Patent based on units of shipments of licensed products. In addition, D-Link paid the Company $100,000 upon signing of the Settlement Agreement.

[3] On November 17, 2005 the Company entered into a Settlement Agreement with PowerDsine, Inc and PowerDsine Ltd. which dismisses, with prejudice, a civil action brought by PowerDsine in the United States District Court for the Southern District of New York that sought a declaratory judgment that U.S. Patent No. 6,218,930 (the "Remote Power Patent") owned by the Company was invalid and not infringed by PowerDsine and/or its customers. Under the terms of the Settlement Agreement, the Company has agreed that it will not initiate litigation against PowerDsine for its sale of Power over Ethernet (PoE) integrated circuits. In addition, the Company agreed that it will not seek damages for infringement from customers that incorporate PowerDsine integrated circuit products in PoE capable Ethernet switches manufactured on or before April 30, 2006. PowerDsine has agreed that it will not initiate, assist or cooperate in any legal action relating to the Remote Power Patent. The Company also agreed that it will not initiate litigation against PowerDsine or its customers for infringement of the Remote Power Patent arising from the manufacture and sale of PowerDsine Midspan products for three years following the dismissal date. Following such three year period, the Company may seek damages for infringement of the Remote Power Patent from PowerDsine or its customers with respect to the purchase and sale of Midspan products beginning 90 days following the dismissal date. No licenses to use the technologies covered by the Company's Remote Power Patent were granted to PowerDsine or its customers under the terms of the settlement. The Settlement Agreement further provides that PowerDsine is obligated to provide each of its customers with written notice of the settlement which notice shall disclose that no license for the Company's Remote Power Patent has been provided to PowerDsine's customers and that in order to combine, modify or integrate any PowerDsine product with or into any other device or software, PowerDsine's customers may need to receive patent license(s) for such third party patents which is the customer's responsibility.

NOTE D – LITIGATION: (continued)

In June 2008 the Company entered into a new agreement with Microsemi Corp-Analog Mixed Signal Group Ltd (previously PowerDsine Ltd), a subsidiary of Microsemi Corporation (Nasdaq: MSCC) a leading manufacturer of high performance analog mixed-signal integrated circuits and high reliability semiconductors, which, among other things, amended the prior settlement agreement entered into between the parties in November 2005. Under the new agreement, on June 25, 2008 the Company announced the commencement of an industry-wide Special Licensing Program for its "Remote Power Patent to vendors of PoE equipment. The Special Licensing Program is of limited duration (through December 31, 2008) and is being implemented on an industry-wide basis to offer discounted running royalty rates and exceptions to the Company's standard licensing terms and conditions for the '930 Patent to PoE vendors who are "early adopters" and enter into license agreements without delay to avoid litigation and higher royalties. The new agreement enables Microsemi to assist in its customer's evaluation of the Remote Power Patent and the terms being made available to vendors of PoE equipment pursuant to the Company's new Special Licensing Program, an activity that was previously prohibited by the 2005 Settlement Agreement with PowerDsine. As part of the Company's agreement with Microsemi Corp-Analog Mixed Signal Group Ltd. ("Microsemi-Analog") entered into in June 2008, Microsemi Corporation ("Microsemi"), the parent company of Microsemi-Analog, entered into a license agreement, dated August 13, 2008, with the Company with respect to the Remote Power Patent as part of the Special Licensing Program. The license agreement provides that Microsemi is obligated to pay the Company quarterly royalty payments of 2% of the sales price for certain of Microsemi's Midspan PoE products for the full term of the Remote Power Patent (March 2020).

NETWORK-1 SECURITY SOLUTIONS, INC.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Network-1 Security Solutions, Inc.

We have audited the accompanying balance sheets of Network-1 Security Solutions, Inc. as of December 31, 2007 and 2006 and the related statements of operations, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Network-1 Security Solutions, Inc. as of December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Radin, Glass & Co., LLP

New York, New York
March 25, 2008

NETWORK-1 SECURITY SOLUTIONS, INC.

Balance Sheets

	December 31, 2007	2006
CURRENT ASSETS		
Cash and cash equivalents	$ 5,928,000	$ 1,797,000
Royalty and interest receivable	23,000	4,000
Prepaid insurance	71,000	74,000
Total current assets	6,022,000	1,875,000
OTHER ASSETS:		
Patent, net of accumulated amortization of $28,000 and $21,000, respectively	72,000	79,000
Security deposits	6,000	17,000
Total Other Assets	78,000	96,000
TOTAL ASSETS	$ 6,100,000	$ 1,971,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 103,000	$ 350,000
Accrued expenses	264,000	219,000
TOTAL LIABILITIES	367,000	569,000
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Common stock, $0.01 par value; authorized 50,000,000 shares; 24,135,557 and 19,764,724 issued and outstanding in 2007 and 2006,respectively	241,000	197,000
Additional paid-in capital	54,769,000	47,484,000
Accumulated deficit	(49,277,000)	(46,279,000)
TOTAL STOCKHOLDERS' EQUITY	5,733,000	1,402,000
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 6,100,000	$ 1,971,000

See notes to financial statements

NETWORK-1 SECURITY SOLUTIONS, INC.

Statements of Operations

	Year Ended December 31, 2007	2006
ROYALTY REVENUE	$ 232,000	—
COST OF REVENUE	12,000	—
GROSS PROFIT	220,000	—
OPERATING EXPENSES:		
General and administrative	$ 1,992,000	$ 1,548,000
Non-cash compensation	1,403,000	479,000
TOTAL OPERATING EXPENSES	3,395,000	2,027,000
OPERATING LOSS	(3,175,000)	(2,027,000)
OTHER INCOME (EXPENSES):		
Interest income, net	177,000	69,000
LOSS BEFORE INCOME TAXES	(2,998,000)	(1,958,000)
INCOME TAXES	—	—
NET LOSS	$ (2,998,000)	$ (1,958,000)
Net Loss Per Share - Basic and Diluted	$ (0.13)	$ (0.10)
Weighted average number of common shares outstanding -Basic and Diluted	22,250,144	18,952,137

See notes to financial statements

NETWORK-1 SECURITY SOLUTIONS, INC.

Statements of Changes in Stockholders' Equity
For the Years Ended December 31, 2007 and 2006

	Common Stock		Additional Paid-in	Accumulated	
	Shares	Amount	Capital	Deficit	Total
Balance – December 31, 2005	17,697,572	$ 177,000	$ 44,896,000	$ (44,321,000)	$ 752,000
Exercise of Warrants	1,987,152	20,000	2,109,000	—	2,129,000
Issuance of common stock for services	80,000	—	120,000	—	120,000
Granting of options	—	—	359,000	—	359,000
Net loss	—	—		(1,958,000)	(1,958,000)
Balance - December 31, 2006	19,764,724	197,000	47,484,000	(46,279,000)	1,402,000
Reclassification		1,000	(1,000)	—	—
Exercise of options and warrants	1,037,500	10,000	1,191,000	—	1,201,000
Sales of common stock, net of finder's fee of $275,000	3,333,333	33,000	4,692,000	—	4,725,000
Granting of options and extensions of options	—	—	1,403,000	—	1,403,000
Net loss	—	—	—	(2,998,000)	(2,998,000)
	24,135,557	$ 241,000	$ 54,769,000	$ (49,277,000)	$ 5,733,000

Balance - December
31, 2007

See notes to financial statements
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NETWORK-1 SECURITY SOLUTIONS, INC.

Statements of Cash Flows

	Year Ended December 31, 2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (2,998,000)	$ (1,958,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	18,000	8,000
Stock-based compensation	1,403,000	359,000
Issuance of common stock for services	—	120,000
Changes in operating assets and liabilities:		
Royalty and interest receivable	(19,000)	(1,000)
Prepaid insurance	3,000	8,000
Accounts payable and accrued expenses	(202,000)	206,000
NET CASH USED IN OPERATING ACTIVITIES	(1,795,000)	(1,258,000)
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchase of property and equipment	—	(12,000)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock, net of finders fee of $275,000	4,725,000	—
Proceeds from exercise of options and warrants	1,201,000	2,129,000
NET CASH PROVIDED BY FINANCING ACTIVITIES	5,926,000	2,129,000
NET INCREASE IN CASH AND CASH EQUIVALENTS	4,131,000	859,000
CASH AND CASH EQUIVALENTS, Beginning	1,797,000	938,000
CASH AND CASH EQUIVALENTS, Ending	$ 5,928,000	$ 1,797,000
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the years for:		
Interest	$ 4,000	$ 1,000
Taxes	—	—

See notes to financial statements

NETWORK-1 SECURITY SOLUTIONS, INC.

Note A – The Company

Network-1 Security Solutions, Inc. (the "Company") is engaged in the acquisition, licensing and protection of its intellectual property and proprietary technologies. The Company owns six patents covering various telecommunications and data networking technologies (the "Patent Portfolio") and includes, among other things, patents covering the control of power delivery over Ethernet networks for the purpose of remotely powering network devices and systems and methods for the transmission of audio, video and data over local area networks (LANS) in order to achieve higher quality of service (QoS). The Company's strategy is to pursue licensing and strategic business alliances with companies that manufacture and sell products that make use of the technologies underlying the Patent Portfolio as well as with other users of the technologies who benefit directly from the technologies including corporate, educational and governmental entities. To date, the Company's efforts with respect to its Patent Portfolio have focused on licensing its patent (U.S. Patent No. 6,218,930) covering the control of power delivery over Ethernet cables (the "Remote Power Patent"). At least for the next twelve months, the Company does not currently anticipate licensing efforts for its other patents besides its Remote Power Patent. The Company may seek to acquire additional patents in the future.

Note B – Summary of Significant Accounting Policies

[1] Cash equivalents:

The Company considers all highly liquid short-term investments purchased with an original maturity of three months or less to be cash equivalents.

[2] Revenue recognition:

The Company recognizes revenue received from the licensing of its intellectual property portfolio in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition" ("SAB No. 104") and related authoritative pronouncements. Under this guidance, revenue is recognized when (i) persuasive evidence of an arrangement exists, (ii) all obligations have been performed pursuant to the terms of the license agreement, (iii) amounts are fixed or determinable and (iv) collectability of amounts is reasonably assured.

[3] Patents:

The Company owns a Patent Portfolio that relates to various telecommunications and data networking technologies. The Company capitalizes the costs associated with acquisition, registration and maintenance of the patents and amortizes these assets over their remaining useful lives on a straight-line basis. Any further payments made to maintain or develop the patents would be capitalized and amortized over the balance of the useful life of the patents.

[4] Impairment of long-lived assets:

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," intangible assets with finite lives are tested for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. Accordingly, the Company records impairment losses on long-lived assets used in operations or expected to be disposed of when indicators of impairment exist and the undiscounted cash flows expected to be derived from those assets are less than carrying amounts of those assets. During the years ended December 31, 2007 and 2006, there was no impairment to its patents.

[5] Income taxes:

The Company utilizes the liability method of accounting for income taxes. Under such method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect at the balance sheet date. The resulting asset or liability is adjusted to reflect enacted changes in tax law. Deferred tax assets are reduced, if necessary, by a valuation allowance when the likelihood of realization is not assured.

Note B – Summary of Significant Accounting Policies (continued)

[6] Net Loss per share:

Basic net loss per share is calculated by dividing the net loss by the weighted average number of outstanding common shares during the year. Diluted per share data includes the dilutive effects of options, warrants and convertible securities. Potential common shares of 11,553,356 and 9,281,481 at December 31, 2007 and 2006, respectively, are not included in the calculation of diluted loss per share because its effect will be anti-dilutive. Such potential common shares are options and warrants.

[7] Use of estimates:

The preparation of 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

[8] Financial instruments:

The carrying amounts of cash and cash equivalents, accounts payable and accrued expenses approximate their fair value due to the short period to maturity of these instruments.

[9] Stock-based compensation:

Effective January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), Share Based Payment, or SFAS 123(R), which is a revision of Statement No. 123 (“SFAS 123”) Accounting for Stock Based Compensation. SFAS 123(R) supersedes Accounting Principles Board (“APB”) No. 25, Accounting for Stock Issued to Employees (“APB 25”), and amends Financial Accounting Standards Board (“FASB”) Statement No. 95 Statement of Cash Flows. SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values.

Note B – Summary of Significant Accounting Policies (continued)

The fair value of options on the date of grant is estimated using the Black-Scholes option-pricing model utilizing the following weighted average assumptions:

	Year Ended December 31,	
	2007	2006
Risk-free interest rates	3.28 – 4.67%	4.51 – 4.57%
Expected option life in years	5 years	5 to 10 years
Expected stock price volatility	37.32 - 45.92%	48.45 – 69.82%
Expected dividend yield	0.00%	0.00%

The weighted average fair value on the option grant date during the years ended December 31, 2007 and 2006 were $0.82 and $0.77 per option, respectively.

[10] Recently issued accounting standards:

In September 2006, the FASB issued SFAS No. 157 “Fair Value Measures” (“SFAS 157”). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements, however it does not apply to SFAS 123R. This Statement shall be effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not believe that SFAS 157 will have a material impact on its financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (“SFAS 159”). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities and to provide additional information that will help investors and other financial statement users to more easily understand the effect of the Company’s choice to use fair value on its earnings. Finally, SFAS 159 requires entities to display the fair value of those assets and liabilities for which the Company has chosen to use fair value on the face of the balance sheet. SFAS 159 is effective as of the beginning of an entity’s first fiscal year beginning after November 15, 2007. Early adoption is permitted. The Company does not believe that SFAS No. 159 will have a material impact on its financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interest In Consolidated Financial Statements” (SFAS 160). SFAS 160 requires all entities to report noncontrolling (minority) interests in subsidiaries in the same way as equity in the consolidated financial statement. Moreover, SFAS 160 eliminates the diversity that currently exists in accounting for transactions between an entity and noncontrolling interests by requiring they be treated as equity transactions. This statement is effective for fiscal years beginning after December 15, 2008. The Company does not believe that SFAS No. 160 will have a material impact on its financial position, results of operations, or cash flows.

Note C- Patents

In November 2003, the Company acquired a portfolio of telecommunications and data networking patents (six patents) from Merlot Communications, Inc. (the "Seller") in which certain principal stockholders of the Company owned a majority of the Seller's voting stock at the time of the transaction. The purchase price for the Patent Portfolio was $100,000, paid in cash. The cash price paid has been capitalized and is being amortized over the remaining useful life of each patent. In addition, the Company has granted the Seller a nonexclusive, royalty free, perpetual license for the term of each patent to use the patents for the development, manufacture or sale of its own branded products to end users. The Company had agreed to pay the Seller 20% of the net income, as defined, after the first $4,000,000 of net income realized by the Company on a per patent basis from the sale or licensing of the patents. On January 18, 2005, the Company and Seller amended the Patent Purchase Agreement (the "Amendment") pursuant to which the Company paid additional purchase price of $500,000 to Seller in consideration for the restructuring of future contingent payments to Seller from the licensing or sale of the Patents. Such $500,000 has been recorded as an expense in the accompanying statement of operations. The Amendment provides for future contingent payments by the Company to Seller of $1.0 million upon achievement of $25 million of Net Royalties (as defined), an additional $1.0 million upon achievement of $50 million of Net Royalties and an additional $500,000 upon achievement of $62.5 million of Net Royalties from licensing or sale of the patents acquired from Merlot. Amortization expense amounted to $7,000 each for the years ended December 31, 2007 and December 31, 2006.

Note D - Stockholders' Equity

[1] Private Placement:

On April 16, 2007, the Company sold in a private placement 3,333,333 shares of common stock at a price of $1.50 per share or an aggregate purchase price of $5,000,000 and five (5) year warrants to purchase 1,666,667 shares of common stock, at an exercise price of $2.00 per share. In connection with the private placement the Company paid placement agent fees of $275,000 and issued warrants to purchase an aggregate of 360,000 shares of common stock (240,000 shares exercisable at $1.50 per share and 120,000 shares exercisable at $2.00 per share).

[2] Stock options:

During 1996, the Board of Directors and stockholders approved the adoption of the 1996 Stock Option Plan (the "1996 Plan"). The 1996 Plan, as amended, provided for the granting of both incentive and non-qualified options to purchase common stock of the Company. A total of 4,000,000 were eligible to be issued under the 1996 Plan. As of March 2006, in accordance with the terms of the plan, no further options were eligible to be issued under the Plan.

The term of options granted under the 1996 Plan may not exceed ten years (five years in the case of an incentive stock option granted to an employee/director owning more than 10% of the voting stock of the Company) ("10% stockholder"). The option price for incentive stock options cannot be less than 100% of the fair market value of the shares of common stock at the time the option is granted (110% for a 10% stockholder). Option terms and vesting periods were set by the Compensation Committee in its discretion.

Note D - Stockholders' Equity (continued)

The following table summarizes stock option activity for the years ended December 31:

	2007		2006	
	Options Outstanding	Weighted Average Exercise Price	Options Outstanding	Weighted Average Exercise Price
Options outstanding at beginning of year	6,667,731(a)(b)	$ 0.89	6,337,731(c)	$ 0.87
Granted	1,282,709(d)(e)(f)(g)	1.58	330,000(a)(b)	1.40
Cancelled/expired/Exercised	90,000	0.18	—	
Options outstanding at end of year	7,860,440	1.01	6,667,731	0.89
Options exercisable at end of year	7,703,565	$ 0.99	6,562,106	0.87

(a) Includes an aggregate of 30,000 and 150,000 ten-year and five-year stock options issued to directors on February 2, 2006 and December 20, 2006, respectively, at exercise prices of $1.31 and $1.50 per share. The Company recorded non-cash compensation of $8,000 and $132,000 relating to the issuance of these options for the years ended December 31, 2007 and 2006, respectively.

(b) Includes 75,000 five-year stock options issued to each of the Chief Financial Officer and a consultant to the Company on December 20, 2006 and February 2, 2006, respectively, at exercise prices of $1.50 and $1.20 per share. The Company recorded non-cash compensation of $31,000 and $68,000 relating to the issuance of these options for the years ended December 31, 2007 and 2006, respectively.

(c) In 2003, the Company granted 1,084,782 stock options to the Chairman and Chief Executive Officer in connection with his employment agreement, of which 200,000 stock options were vested in 2006. Accordingly, the Company recorded non-cash compensation of $42,000 relating to these options in accordance with SFAS 123 (R).

(d) Includes an aggregate of 75,000 five-year stock options granted to directors on December 21, 2007, at exercise prices of $1.45 per share. The Company recorded non-cash compensation of $42,000 relating to the issuance of these options for the year ended December 31, 2007 since none of these options were vested in 2007.

(e) Includes 100,000 five-year stock options granted to a consultant to the Company on December 21, 2007, at exercise prices of $1.45 per share. The Company recorded non-cash compensation of $-0- relating to the issuance of these options for the year ended December 31, 2007 since none of the options were vested in 2007.

(f) In 2007, the Company granted 375,000 stock options to the Chairman and Chief Executive Officer in connection with his employment agreement, which were fully vested in 2007. Accordingly, the Company recorded non-cash compensation of $252,000 relating to these options in accordance with SFAS 123 (R).

(g) In 2007 the Company granted 732,709 stock options to the Chairman and Chief Executive Officer in connection with the anti-dilution provision of his employment agreement. Accordingly, the Company recorded non-cash compensation of $403,000 relative to these options in 2007.

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Note D - Stockholders' Equity (continued)

The following table presents information relating to all stock options outstanding and exercisable at December 31, 2007:

Range of Exercise Price	Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Life in Years	Options Exercisable	Weighted Average Exercise Price
$0.12 - $2.91	7,537,215	$ 0.85	4.19	7,414,715	$ 0.84
$3.00 - $3.75	146,625	3.44	2.31	112,250	3.56
$4.13 - $5.69	77,100	5.08	2.08	77,100	5.08
$6.00 - $6.88	89,500	6.21	2.13	89,500	6.21
$10.00	10,000	10.00	2.21	10,000	10.00
	7,860,440	1.01	4.11	7,703,565	0.99

[3] Warrants:

As of December 31, 2007, the following are the outstanding warrants to purchase shares of the Company's common stock:

Number of Warrants	Exercise Price	Expiration Date
300,000	0.70	July 11, 2011 (a)
50,000	1.00	May 21, 2010 (b) (e)
342,500	1.25	March 14, 2008 (b) (f)
52,500	1.25	March 14, 2008 (c) (g)
250,000	1.48	October 8, 2011 (a)
240,000	1.50	April 16, 2012 (d)
171,250	1.75	December 15, 2008 (b) (h)
350,000	1.75	May 21, 2010 (b) (i)
26,250	1.75	December 15, 2008 (c) (j)
123,750	1.75	May 21, 2010 (c) (k)
1,786,667	2.00	April 16, 2012 (d)
3,692,917		

(a) Issued to CMH Capital Management Corp. in 2001, a company owned by the Chairman and Chief Executive Officer.

(b) Issued in connection with December 2004 private offering of common stock.

(c) Issued in connection with the January 2005 private offering of common stock.

(d) Issued in connection with the April 2007 private offering of common stock.

(e) These warrants were to expire on December 21, 2007 and were extended to May 21, 2010.

(f) These warrants were to expire on December 21, 2007 and were extended to March 14, 2008.

Note D - Stockholders' Equity (continued)

(g) These warrants were to expire on January 12, 2008 and were extended to March 14, 2008.

(h) These warrants were to expire on December 21, 2007 and were extended to December 15, 2008.

(i) These warrants were to expire on December 21, 2007 and were extended to May 20, 2010.

(j) These warrants were to expire on January 12, 2008 and were extended to December 15, 2008.

(k) These warrants were to expire on January 12, 2008 and were extended to May 20, 2010.

In 2007 and 2006 warrants to purchase 947,500 and 1,987,152 shares of common stock were exercised for $1,184,000 and $2,129,000, respectively.

Note E - Commitments and Contingencies

[1] Services agreement:

On November 30, 2004, the Company entered into a master services agreement (the "Agreement") with ThinkFire Services USA, Ltd. ("ThinkFire") pursuant to which ThinkFire has been granted the exclusive worldwide rights (except for direct efforts by the Company and related companies) to negotiate license agreements for the Remote Power Patent with respect to certain potential licensees agreed to between the parties. Either the Company or ThinkFire can terminate the Agreement upon 60 days' notice for any reason or upon 30 days' notice in the event of a material breach. The Company has agreed to pay ThinkFire a fee not to exceed 20% of the royalty payments received from license agreements consummated by ThinkFire on its behalf after the Company recovers its expenses.

[2] Legal fees:

With respect to the Company's litigation against D-Link, which was settled in May 2007 (See Note J[1]), the Company utilized the services of Blank Rome, LLP, on a full contingency basis and also the services of Potter Mitton, P.C. (Tyler, Texas) on an hourly basis to serve as local counsel. In accordance with the Company's contingency fee agreement with Blank Rome LLP, the Company will pay legal fees to Blank Rome LLP equal to 25% of the royalty revenue received by the Company from its license agreement with D-Link after it recovers its expenses related to the litigation.

[3] Operating leases:

The Company leases its principal office space in New York City at a monthly rent of approximately $3,000 for a one year period ended June 2008.

Rental expense for the years ended December 31, 2007 and 2006 aggregated $39,000 and $38,000, respectively.

[4] Savings and investment plan:

The Company has a Savings and Investment Plan which allows participants to make contributions by salary reduction pursuant to Section 401(k) of the Internal Revenue Code of 1986. The Company also may make discretionary annual matching contributions in amounts determined by the Board of Directors, subject to statutory limits. The Company did not make any contributions to the 401(k) Plan during the years ended December 31, 2007 and 2006.

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Note F - Income Taxes

At December 31, 2006, the Company has available net operating loss carryforwards to reduce future federal taxable income of approximately $45,364,000 for tax reporting purposes, which expire from 2009 through 2027.

Pursuant to the provisions of the Internal Revenue Code, future utilization of these past losses is subject to certain limitations based on changes in the ownership of the Company's stock that have occurred.

The principal components of the net deferred tax assets are as follows:

	Year Ended December 31,	
	2007	2006
Deferred tax assets:		
Net operating loss carry forwards	$ 16,800,000	$ 16,136,000
Options and warrants not yet deducted, for tax purposes	705,000	177,000
Other	-0-	-0-
	17,505,000	16,313,000
Valuation allowance	(17,505,000)	(16,313,000)
Net deferred tax assets	$ 0	$ 0

The Company has recorded a valuation allowance for the full amount of its deferred tax assets as the likelihood of the future realization cannot be presently determined. The valuation allowance increased by $1,192,000 in 2007 and $1,618,000 in 2006.

The reconciliation between the taxes as shown and the amount that would be computed by applying the statutory federal income tax rate to the loss before income taxes is as follows:

	Year Ended December 31,	
	2007	2006
Income tax benefit - statutory rate	(34.0)%	(34.0)%
State and local, net	(3.5)%	(3.5)%
Valuation allowance on deferred tax assets	37.5 %	37.5 %

Note G - Concentrations

The Company places its cash investments in high quality financial institutions insured by the Federal Deposit Insurance Corporation ("FDIC"). At December 31, 2007, the Company maintained cash balances of $5,828,000 in excess of FDIC limits.

Note H - Related Party Transactions

[1] In December 2007, the Company extended the expiration date of warrants to purchase an aggregate of 2,013,750 shares of our common stock (the "Warrants") issued to investors in the Company's private offering completed in December 2004 and January 2005. The Warrants were exercisable for (i) an aggregate of 1,342,500 shares at an exercise price of $1.25 per share (the "$1.25 Warrants") and (ii) an aggregate of 671,250 shares at an exercise price of $1.75 per share (the "$1.75 Warrants"). Investors in the aforementioned private offering included two principal stockholders of the Company, who invested an aggregate of $1,250,000 and as part of the offering received an aggregate of 625,000 $1.25 Warrants and 312,500 $1.75 Warrants, and a director of the Company, who invested $100,000 and received 50,000 $1.25 Warrants and 25,000 $1.75 Warrants as part of the offering. The Warrants were scheduled to expire on December 21, 2007 or January 13, 2008 (three (3) years from the date of issuance). The expiration date of the Warrants (both the $1.25 Warrants and the $1.75 Warrants) was extended until March 14, 2008. In addition, to the extent the holders exercised in full their $1.25 Warrants no later than December 21, 2007, such holders were afforded an extension of the expiration date of their $1.75 Warrants until May 21, 2010 such that the exercise price of the $1.75 Warrants will remain at $1.75 per share through March 31, 2009 and increased to $2.00 per share if exercised thereafter until May 21, 2010, at which time they will expire. In December 2007 (prior to December 21) holders of $1.25 Warrants to purchase 902,500 shares were exercised which resulted in proceeds to the Company of $1,128,125. To the extent the remaining holders exercised in full their $1.25 Warrants prior to the new expiration date of March 14, 2008, the expiration date of their $1.75 Warrants was extended until December 15, 2008 and such warrants will be exercisable at $2.00 per share beginning March 14, 2008.

[2] On December 21, 2007, the Company extended the expiration date of warrants issued in December 2004 to a director of the Company, to purchase 50,000 shares of our common stock, from December 21, 2007 until May 21, 2010.

Note I - Employment Arrangements and Other Agreements

[1] On February 28, 2007, the Company entered into a new Employment Agreement with Corey M. Horowitz pursuant to which Mr. Horowitz continued to serve as Chairman and Chief Executive Officer for a two year term at an annual base salary of $288,750 for the first year, increasing by 5% for the second year. In connection with his employment agreement, Mr. Horowitz was issued a five (5) year option to purchase 375,000 shares of common stock at an exercise price of $1.46 per share which vests, on a quarterly basis over a one year period subject to acceleration upon a change of control. The Company also issued to Mr. Horowitz on the one year anniversary date (February 28, 2007) an additional five (5) year option to purchase a minimum of 375,000 shares of common stock at an exercise price equal to the closing price of our common stock on the date of grant, which option will vest on a quarterly basis over a one year period. In addition to the aforementioned option grants, the Company agreed to extend for an additional three (3) years the expiration dates of all options and warrants (an aggregate of 2,620,000 shares) expiring in calendar year 2007 and 2008 owned by Mr. Horowitz and CMH Capital Management Corp. ("CMH"), an affiliate. Under the terms of his Employment Agreement, Mr. Horowitz shall receive bonus compensation in an amount equal to 5% of Company royalties or other payments (before deduction of payments to third parties including, but not limited to, legal fees and expenses and third party license fees) received from licensing its patents (including patents currently owned and acquired or licensed on an exclusive basis during the period in which Mr. Horowitz continues to serve as an executive officer of the Company) (the "Royalty Bonus Compensation"). During 2007, Mr. Horowitz received $12,000 of Royalty Bonus Compensation. Mr. Horowitz shall also receive bonus compensation equal to 5% of the gross proceeds from (i) the sale of any of the Company's patents or (ii) the Company's merger with or into another corporation or entity. The Royalty Bonus Compensation shall continue to be paid to Mr. Horowitz for the life of each of the Company's patents with respect to licenses entered

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Note I - Employment Arrangements and Other Agreements (continued)

into by us with third parties during Mr. Horowitz's term of employment or at anytime thereafter, whether Mr. Horowitz is employed by the Company or not, provided, that, Mr. Horowitz's employment has not been terminated by the Company "For Cause" (as defined) or terminated by Mr. Horowitz without "Good Reason" (as defined). In the event that Mr. Horowitz's employment is terminated by the Company "Other Than For Cause" (as defined) or by Mr. Horowitz for "Good Reason" (as defined), Mr. Horowitz shall be entitled to a severance of 12 months base salary.

In accordance with his employment agreement, Mr. Horowitz also has certain anti-dilution rights which provide that if at any time during the period ended December 31, 2008, in the event that the Company completes an offering of its common stock or any securities convertible or exercisable into common stock (exclusive of securities issued upon exercise of outstanding options, warrants or other convertible securities), Mr. Horowitz shall receive from the Company, at the same price as the securities issued in the financing, such number of additional options to purchase common stock so that he maintains the same derivative ownership percentage (21.47%) of the Company based upon options and warrants owned by Mr. Horowitz and CMH (exclusive of ownership of shares of common stock by Mr. Horowitz and CMH) owned as of the time of execution of his employment agreement; provided, that, the aforementioned anti-dilution protection shall be afforded to Mr. Horowitz up to maximum financings of $2.5 million. In April 2007, with respect to the Company's completion of a $5.0 million private placement (See Note D[1]), Mr. Horowitz was issued a five (5) year option to purchase 732,709 shares of common stock, at an exercise price of $1.67 per share in accordance with the aforementioned anti-dilution provision of his employment agreement.

[2] On December 20, 2006, the Company entered into a new agreement with David Kahn pursuant to which he agreed to continue to serve as Chief Financial Officer through December 31, 2008. In consideration for his services, Mr. Kahn is compensated at the rate of $6,615 per month for the period through December 31, 2007 and $6,945 per month for the year ended December 31, 2008. Mr. Kahn was also issued a five (5) year option to purchase 75,000 shares of common stock at an exercise price of $1.50 per share. The option vested 30,000 shares on the date of grant and the balance of the shares (45,000) vest on a quarterly basis in equal amounts of 5,625 shares beginning March 31, 2007 through December 31, 2008. The agreement further provides that the Company may terminate the agreement at any time for any reason. In the event Mr. Kahn's services are terminated without "Good Cause" (as defined), he will be entitled to accelerated vesting of all unvested shares underlying the option and the lesser of (i) six months base monthly compensation or (ii) the remaining balance of the monthly compensation payable through December 31, 2008.

Note J – Litigation

[1] In August 2005, the Company commenced patent litigation against D-Link Corporation and D-Link Systems, Incorporated (collectively "D-Link") in the United States District Court for the Eastern District of Texas, Tyler division (Civil Action No. 6:05W291), for infringement of the Company's Remote Power Patent. The complaint sought, among other things, a judgment that the Company's Remote Power Patent is enforceable and has been infringed by the defendants. The Company also sought a permanent injunction restraining the defendants from continued infringement, or active inducement of infringement by others, of the Remote Power Patent.

In August 2007, the Company finalized the settlement of its patent infringement litigation against D-Link. Under the terms of the settlement, D-Link entered into a license agreement for the Company's Remote Power Patent the terms of which include monthly royalty payments of 3.25% of the net sales of D-Link Power over Ethernet products, including those products which comply with the IEEE 802.3af and 802.3at Standards, for the full term of our Remote Power Patent, which

Note J – Litigation (continued)

expires in March 2020. The royalty rate is subject to adjustment beginning after the first quarter of 2008 to a rate consistent with other similarly situated licensees of the Remote Power Patent based on units of shipments of licensed products. In addition, D-Link paid the Company $100,000 upon signing of the Settlement Agreement.

[2] On November 17, 2005 the Company entered into a Settlement Agreement with PowerDsine, Inc and PowerDsine Ltd. which dismisses, with prejudice, a civil action brought by PowerDsine in the United States District Court for the Southern District of New York that sought a declaratory judgment that U.S. Patent No. 6,218,930 (the "Remote Power Patent") owned by the Company was invalid and not infringed by PowerDsine and/or its customers. Under the terms of the Settlement Agreement, the Company has agreed that it will not initiate litigation against PowerDsine for its sale of Power over Ethernet (PoE) integrated circuits. In addition, the Company has agreed that it will not seek damages for infringement from customers that incorporate PowerDsine integrated circuit products in PoE capable Ethernet switches manufactured on or before April 30, 2006. PowerDsine has agreed that it will not initiate, assist or cooperate in any legal action relating to the Remote Power Patent. The Company also agreed that it will not initiate litigation against PowerDsine or its customers for infringement of the Remote Power Patent arising from the manufacture and sale of PowerDsine Midspan products for three years following the dismissal date. Following such three year period, the Company may seek damages for infringement of the Remote Power Patent from PowerDsine or its customers with respect to the purchase and sale of Midspan products beginning 90 days following the dismissal date.

Note K – Subsequent Events

[1] In February 2008, the Company commenced litigation against several major data networking equipment manufacturers in the United States District Court for the Eastern District of Texas, Tyler Division, for infringement of the Company's Remote Power Patent. The defendants in the lawsuit include Cisco Systems, Inc., Cisco Linksys, LLC, Enterasys Networks, Inc., 3COM Corporation, Inc., Extreme Networks, Inc., Foundry Networks, Inc., Netgear, Inc. and Adtran, Inc. The Company seeks injunctive relief and monetary damages for infringement based upon reasonable royalties as well as treble damages for the defendants continued willful infringement of the Remote Power Patent. To date all of the defendants, other than Netgear, Inc., have answered the complaint and asserted that they do not infringe any valid claim of the Remote Power Patent, and further asserted that, based on several different theories, the patent claims are invalid or unenforceable. In addition to these defenses, the defendants also asserted counterclaims for, among other things, non-infringement, invalidity, and unenforceability of the Remote Power Patent. In the event that the courts determine that the Remote Power Patent is not valid or enforceable, and/or that the defendants do not infringe, any such determination would have a material adverse effect on the Company.

[2] Dovel & Luner, LLP provides legal services to the Company with respect to the above referenced litigation (See Note K[1]). The terms of the Company's agreement with Dovel & Luner, LLP provides for legal fees of a maximum aggregate cash payment of $1.5 million plus a contingency fee of up to 24% depending upon when an outcome is achieved.

[3] On March 7, 2008, the Company further extended the expiration dates of its outstanding $1.25 Warrants and $1.75 Warrants (See Note H[1]) as follows: (i) the expiration date of the $1.25 Warrants was extended from March 14, 2008 until June 16, 2008 and the exercise price of such warrants was adjusted to $1.30 per share and (ii) the expiration date of our $1.75 Warrants was extended until December 15, 2008 and the exercise price of such warrants was adjusted to $2.00 per share.

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