

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2001

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

For the Transition Period from _____ to _____

Commission File Number: 811-1825

Rand Capital Corporation

(Exact Name of Registrant as specified in its Charter)

New York

(State or Other Jurisdiction of Incorporation
or organization)

16-0961359

(IRS Employer
Identification No.)

2200 Rand Building, Buffalo, NY

(Address of Principal executive offices)

14203

(Zip Code)

(716) 853-0802

(Registrant's Telephone No. Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: None

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

Common Stock, \$.10 par value

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

Yes: No

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant as of March 14, 2002 was approximately \$1.20 based upon the last sale price as quoted by NASDAQ SmallCap Market on such date. As of March 14, 2002 there were 5,763,034 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The Corporation's definitive proxy statement for the Annual Meeting of Stockholders to be held on April 24, 2002 is incorporated by reference into certain sections of Part III herein.

RAND CAPITAL CORPORATION

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PART I

Item 1. Business

Rand Capital Corporation ("Rand" or "Corporation") was incorporated under the law of New York on February 24, 1969. Commencing in 1971, Rand operated as a publicly traded, closed-end, diversified management company that was registered under Section 8(b) of the Investment Company Act of 1940 (the "1940 Act"). On August 16, 2001, Rand filed an election to be treated as a business development company ("BDC") under the 1940 Act, which became effective on the date of filing.

Throughout its history, Rand's principal business has been to make venture capital investments in small, early-stage and developing enterprises that are principally engaged in the development or exploitation of inventions, technological improvements, and new products and services not previously generally available. Rand's principal objective is long-term capital appreciation. Rand typically invests in debt securities of small, developing companies and concurrently acquires an equity interest in the form of stock, warrants or options to acquire stock or the right to convert the debt securities into stock. Consistent with its status as a BDC and the purposes of the regulatory framework for BDCs under the 1940 Act, Rand provides managerial assistance to the developing companies in which it invests.

Rand operates as an internally managed investment company whereby its officers and employees conduct its operations under the general supervision of its Board of Directors. Rand has not elected to qualify to be taxed as a regulated investment company as defined under Subchapter M of the Internal Revenue Code.

Regulation as a BDC

Although the 1940 Act exempts a BDC from registration under that Act, it contains significant limitations on the operations of BDCs. Among other things, the 1940 Act contains prohibitions and restrictions relating to transactions between a BDC and its affiliates, principal underwriters and affiliates of its affiliates or underwriters, and it requires that a majority of the BDC's directors be persons other than "interested persons," as defined under the 1940 Act. The 1940 Act also prohibits a BDC from changing the nature of its business so as to cease to be, or to withdraw its election as, a BDC unless so authorized by the vote of the holders of a majority of its outstanding voting securities. BDCs are not required to maintain fundamental investment policies relating to diversification and concentration of investments within a single industry.

Generally, a BDC must be primarily engaged in the business of furnishing capital and managerial expertise to companies that do not have ready access to capital through conventional financial channels. Such portfolio companies are termed "eligible portfolio companies." More specifically, in order to qualify as a BDC, a company must (1) be a domestic company; (2) have registered a class of its equity securities or have filed a registration statement with the Commission pursuant to Section 12 of the Securities Exchange Act of 1934; (3) operate for the purpose of investing in

the securities of certain types of portfolio companies, namely immature or emerging companies and businesses suffering or just recovering from financial distress; (4) extend significant managerial assistance to such portfolio companies; and (5) have a majority of "disinterested" directors (as defined in the 1940 Act).

An eligible portfolio company is, generally, a U.S. company that is not an investment company and that (1) does not have a class of securities registered on an exchange or included in the Federal Reserve Board's over-the-counter margin list; or (2) is actively controlled by a BDC and has an affiliate of a BDC on its board of directors; or (3) meets such other criteria as may be established by the Securities and Exchange Commission. Control under the 1940 Act is generally presumed to exist where a BDC owns 25% of the outstanding voting securities of the company.

The 1940 Act prohibits or restricts companies subject to the 1940 Act from investing in certain types of companies, such as brokerage firms, insurance companies, investment banking firms and investment companies. Moreover, the 1940 Act limits the type of assets that BDCs may acquire to "qualifying assets" and certain assets necessary for its operations (such as office furniture, equipment and facilities) if, at the time of acquisition, less than 70% of the value of the BDC's assets consist of qualifying assets. Qualifying assets include: (1) securities of companies that were eligible portfolio companies at the time the BDC acquired their securities; (2) securities of bankrupt or insolvent companies that were eligible at the time of the BDC's initial acquisition of their securities but are no longer eligible, provided that the BDC has maintained a substantial portion of its initial investment in those companies; (3) securities received in exchange for or distributed in or with respect to any of the foregoing; and (4) cash items, government securities and high-quality short-term debt. The 1940 Act also places restrictions on the nature of the transactions in which, and the persons from whom, securities can be purchased in order for the securities to be considered qualifying assets. These restrictions include limiting purchases to transactions not involving a public offering and acquiring securities from either the portfolio company or its officers, directors, or affiliates.

A BDC is permitted to invest in the securities of public companies and other investments that are not qualifying assets, but those kinds of investments may not exceed 30% of the BDC's total asset value at the time of the investment.

A BDC must make significant managerial assistance available to the issuers of eligible portfolio securities in which it invests. Making available significant managerial assistance means, among other things, any arrangement whereby the BDC, through its directors, officers or employees, offers to provide, and, if accepted does provide, significant guidance and counsel concerning the management, operations or business objectives and policies of a portfolio company; or in the case of an SBIC, making loans to a portfolio company.

SBIC Subsidiary

On January 16, 2002, Rand organized a wholly owned subsidiary, Rand Capital SBIC, L.P., as a Delaware limited partnership ("Rand SBIC"). At the same time, Rand organized another wholly owned subsidiary, Rand Capital Management, LLC, as a Delaware limited liability company ("Rand Management"), to act as the general partner of Rand SBIC.

Rand formed Rand SBIC as a subsidiary for the purpose of causing it to be licensed as a small business investment company (an "SBIC") under the Small Business Investment act of 1958 (the "SBA Act") by the Small Business Administration (the "SBA"), in order to have access to various forms of leverage provided by the SBA to SBICs. Rand received the preliminary approval of the SBA and was given permission to submit an application for approval to operate as an SBIC and, on February 1, 2002, Rand SBIC submitted an application to operate as an SBIC. Rand intends to file an exemption application with the SEC for certain exemptions under the 1940 Act from restrictions on the operation of subsidiaries that the SEC has commonly granted to BDCs that have wholly owned SBIC subsidiaries.

Rand intends to operate Rand SBIC through Rand Management for the same investment purposes, and with investments in the same kinds of securities, as Rand. Rand SBIC's operations will be consolidated with those of Rand for both financial reporting and tax purposes.

Regulation of SBIC Subsidiary

Lending Restrictions. The SBA licenses SBICs as part of a program designed to stimulate the flow of private debt and/or equity capital to "Eligible Concerns" and "Smaller Concerns." SBICs use funds borrowed from the SBA, together with their own capital, to provide loans to, and make equity investments in, concerns that (a) do not have a net worth in excess of \$18 million and do not have average net income after U.S. federal income taxes for the two years preceding any date of determination of more than \$6 million, or (b) meet size standards set by the SBA that are measured by either annual receipts or number of employees, depending on the industry in which the concerns are primarily engaged. The types and dollar amounts of the loans and other investments an SBIC may make are limited by

the 1940 Act, the SBA Act and SBA regulations. The SBA is authorized to examine the operations of SBICs, and an SBIC's ability to obtain funds from the SBA is also governed by SBA regulations.

SBA regulations also set certain limitations on the terms of loans by SBICs. The maximum maturity of these loans may not exceed 20 years. A borrower from an SBIC cannot be required during the first five years to repay, on a cumulative basis, more principal than an amount calculated on a straight line, five year amortization schedule. SBIC regulations also limit the rate of interest that an SBIC can charge on the loans it makes, the amount of the limit depending upon whether or not equity components are included with the loan.

SBICs may invest directly in the equity of their portfolio companies, but they may not become a general partner of a non-incorporated entity or otherwise become jointly or severally liable for the general obligations of a non-incorporated entity. An SBIC may acquire options or warrants in its portfolio companies, and the options or warrants may have redemption provisions, subject to certain restrictions. In general, an SBIC may not "control" a portfolio company. For SBA Act purposes, control is defined as the ownership (or control) of a 50% or greater interest in the outstanding voting securities of a portfolio company if it is held by fewer than 50 shareholders, or if there are 50 or more shareholders, a 20% to 25% interest (depending on the holdings of the other shareholders in the portfolio company).

SBA Leverage. The SBA raises capital to enable it to provide funds to SBICs by guaranteeing certificates or bonds that are pooled and sold to purchasers of the government guaranteed securities. The amount of funds that the SBA may lend is determined by annual Congressional appropriations of amounts necessary to cover anticipated losses in the program. Congress authorizes appropriations to the extent it determines to fund SBIC borrowings from the SBA.

In order to obtain SBA leverage, an SBIC must demonstrate its need to the SBA. To demonstrate need, an SBIC must invest 50% of its Leverageable Capital (defined as Regulatory Capital less unfunded commitments and federal funds) and any outstanding SBA Leverage. Other requirements include compliance with SBA regulations, adequacy of capital, and meeting liquidity standards. An SBIC's license entitles an SBIC to apply for SBA leverage, but does not assure that it will be available, or if available, that it will be available at the level of the relevant matching ratio. Availability depends on the SBIC's continued regulatory compliance and sufficient SBA funds being available when the SBIC applies to draw down SBA leverage.

SBA debentures are issued with 10-year maturities. Interest only is payable semi-annually until maturity. Ten-year SBA debentures may be prepaid with a penalty during the first 5 years, and then are pre-payable without penalty. Rand initially capitalized Rand SBIC with \$5 million in Regulatory Capital. Rand expects that Rand SBIC will be approved to obtain SBA leverage at a 2:1 matching ratio, resulting in a total capital pool eligible for investment of \$15 million. The SBA's review of Rand SBIC's application and the completion of the licensing process will take at least 6 to 9 months. Rand expects to use Rand SBIC as Rand's primary investment vehicle.

Employees

As of December 31, 2001, Rand had three full time employees.

Risk Factors and Other Considerations

Investing in Rand's Stock is Highly Speculative and an Investor Could Lose Some or All of the Amount Invested

The value of Rand's common stock may decline and may be affected by numerous market conditions, which could result in the loss of some or the entire amount invested in Rand's shares. The securities markets frequently experience extreme price and volume fluctuations which affect market prices for securities of companies generally, and technology and very small capitalization companies in particular. General economic conditions, and general conditions in the Internet and information technology, life sciences, material sciences and other high technology industries, will also affect Rand's stock price. The recent decimalization of the stock exchanges, particularly NASDAQ, is a new risk factor that may decrease liquidity of smaller capitalization issues such as the Corporation's own common stock and that of its publicly traded holdings.

Investing in Rand's Shares May be Inappropriate for the Investor's Risk Tolerance

Rand's investments, in accordance with its investment objective and principal strategies, result in a far above average amount of risk and volatility and may well result in loss of principal. Rand's investments in portfolio companies are highly speculative and aggressive and, therefore, an investment in its shares may not be suitable for investors for whom such risk is inappropriate.

Competition

Rand faces competition in its investing activities from private venture capital funds, investment affiliates of large industrial, technology, service and financial companies, small business investment companies, wealthy individuals and foreign investors. As a regulated Business Development Company ("BDC"), the Company is required to disclose quarterly the name and business description of portfolio companies and value of any portfolio securities. Most of Rand's competitors are not subject to this disclosure requirement. Rand's obligation to disclose this information could hinder its ability to invest in certain portfolio companies. Additionally, other regulations, current and future, may make Rand less attractive as a potential investor to a given portfolio company than a private venture capital fund.

Rand is Subject to Risks Created by its Regulated Environment

Rand and Rand SBIC are subject to regulation as BDCs, and Rand SBIC is subject to regulation as an SBIC. The loans and other investments that Rand makes, and Rand SBIC is expected to make, in small business concerns are extremely speculative. Substantially all of these concerns are and will be privately held. Even if a public market for their securities later develops, the debt obligations and other securities purchased by Rand and Rand SBIC are likely to be restricted from sale or other transfer for significant periods of time. These securities will be very illiquid.

Rand's and Rand SBIC's capital may include large amounts of debt securities issued to the SBA, and all of the debentures issued to the SBA will have fixed interest rates. Until and unless Rand SBIC is able to invest substantially all of the proceeds from debentures that it sells to the SBA at annualized interest or other rates of return that substantially exceed annualized interest rates that Rand SBIC must pay the SBA under debentures sold to it, Rand's operating results will be adversely affected which may, in turn, depress the market price of Rand's common stock.

Rand is Dependent Upon Key Management Personnel for Future Success

Rand is dependent for the selection, structuring, closing and monitoring of its investments on the diligence and skill of its two senior officers, Allen F. Grum and Daniel P. Penberthy. The future success of Rand depends to a significant extent on the continued service and coordination of its senior management team. The departure of either of its executive officers could materially adversely affect Rand's ability to implement its business strategy. Rand does not maintain key man life insurance on any of its officers or employees.

Investment in Small, Private Companies

There are significant risks inherent in Rand's venture capital business. Rand typically invests a substantial portion of its assets in early stage or start-up companies. These private businesses tend to be thinly capitalized, unproven small companies with risky technologies that lack management depth and have not attained profitability or have no history of operations. Because of the speculative nature and the lack of a public market for these investments, there is significantly greater risk of loss than is the case with traditional investment securities. Rand expects that some of its venture capital investments will be a complete loss or will be unprofitable and that some will appear to be likely to become successful but never realize their potential. Rand has been risk seeking rather than risk averse in its approach to venture capital and other investments. Neither Rand's investments nor an investment in Rand is intended to constitute a balanced investment program. Rand has in the past relied, and continues to rely to a large extent, upon proceeds from sales of investments rather than investment income to defray a significant portion of its operating expenses. Such sales are unpredictable and may not occur. The terrorist acts in the United States of September 11, 2001 are the type of events that could severely impact a small company that does not have as many resources to ride out market downturns and would need immediate investment capital that might be temporarily unavailable.

Illiquidity of Portfolio Investments

Most of the investments of Rand are or will be either equity securities acquired directly from small companies or below investment grade subordinated debt securities. The Corporation's portfolio of equity securities is and will usually be subject to restrictions on resale or otherwise have no established trading market. The illiquidity of most of the Corporation's portfolio may adversely affect the ability of the Company to dispose of such securities at times when it may be advantageous for the Company to liquidate such investments.

Even if Rand's portfolio companies are able to develop commercially viable products, the market for new products and services is highly competitive and rapidly changing. Commercial success is difficult to predict and the marketing efforts of Rand's portfolio companies may not be successful.

Valuation of Portfolio Investments

There is typically no public market of equity securities of the small privately held companies in which Rand invests. As a result, the valuation of the equity securities in Rand's portfolio are stated at fair value as determined by the good faith estimate of Rand's Board of Directors. In the absence of a readily ascertainable market value, the estimated value of Rand's portfolio of securities may differ significantly, favorably or unfavorably, from the values that would be placed on the portfolio if a ready market for the equity securities existed. Any changes in estimated net asset value are recorded in Rand's statement of operations as "Change in unrealized appreciation on investments."

Fluctuations of Quarterly Results

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

Subsequent Events

Rand has formed a wholly owned subsidiary, Rand Capital SBIC, L.P., for the purpose of operating it as a small business investment company. On January 25, 2002, Rand transferred \$5 million in cash to this subsidiary to serve as "regulatory capital." On February 1, 2002, Rand received notification that its small business investment company (SBIC) application for the subsidiary had been received by the Small Business Administration. The licensing process is expected to take from six to nine months.

Item 2. Properties

Rand maintains its offices at 2200 Rand Building, Buffalo, New York 14203, where it leases approximately 1,290 square feet of office space pursuant to a lease agreement that expired September 30, 2001. Since that time Rand has been paying rent on a month-to-month basis at the amount stated on the expired lease. Rand believes that its leased facilities are adequate to support its current staff and expected future needs, and that adequate alternative facilities are readily available if it does not renew its lease.

Item 3. Legal Proceedings

None

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

Not applicable

Part II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Rand's common stock, par value \$0.10 per share ("Common Stock"), is traded on the NASDAQ Small Cap Market ("NASDAQ") under the symbol "RAND." The following table sets forth, for the period indicated, the range of high and low closing prices per share as reported by NASDAQ:

2001 Quarter ending:	<u>High</u>	<u>Low</u>
March 31st	\$ 3.500	\$ 1.313
June 30th	\$ 2.500	\$ 1.688
September 30th	\$ 2.200	\$ 1.010
December 31st	\$ 1.740	\$ 1.010
2000 Quarter ending:	<u>High</u>	<u>Low</u>
March 31st	\$ 9.188	\$ 1.344
June 30th	\$ 4.000	\$ 1.500
September 30th	\$ 3.938	\$ 2.031
December 31st	\$ 3.250	\$ 1.500

Rand did not sell any securities during the period covered by this report that were not registered under the Securities Act.

On March 14, 2002, the Corporation had an estimated total of 999 shareholders, which included approximately 145 record holders of its common stock, and an estimated 854 shareholders with shares held under beneficial ownership in nominee name or under clearinghouse positions of brokerage firms or banks.

On October 18, 2001 the Board of Directors authorized the repurchase of up to 5% of the Corporation's outstanding stock through purchases on the open market during the one-year period ending October 18, 2002. Such repurchases, if any, must be made in accordance with restrictions under the Investment Company Act. As of December 31, 2001 no stock repurchases had occurred.

Item 6. Selected Financial Data

The following table provides selected financial data of the Corporation for the periods indicated. You should read the selected financial data set forth below in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and with our financial statements and related notes appearing elsewhere in this report.

Balance Sheet Data as of December 31:	2001	2000	1999	1998	1997
Total assets	\$10,282,493	\$8,441,884	\$7,648,947	\$8,306,038	\$8,455,500
Total liabilities	224,209	56,187	44,204	69,006	114,280
Net assets	10,058,284	8,385,697	7,604,743	8,237,032	8,341,220
Net asset value per outstanding share	\$ 1.75	\$ 1.46	\$ 1.33	\$ 1.44	\$ 1.46
Common stock shares outstanding	5,763,034	5,748,034	5,708,034	5,708,034	5,708,034

Operating Data for the year ended December 31:	2001	2000	1999	1998	1997
Investment income	\$159,479	\$239,769	\$363,094	\$593,086	\$457,514
Total expenses	825,765	633,403	738,803	758,630	772,511
Net investment (loss)	(1,551,001)	(109,864)	(387,097)	(56,339)	(301,749)
Net realized gain (loss) on investments	3,286,078	(296,298)	(42,625)	(316,559)	797,329
Net (decrease) increase in unrealized appreciation	(94,365)	1,129,416	(202,567)	268,710	(840,162)
Net Increase (decrease) in net assets from operations	1,640,712	723,254	(632,289)	(104,188)	(344,582)

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

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our financial statements and related notes included elsewhere in this report.

FORWARD LOOKING STATEMENTS

Statements included in this Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this document that do not relate to present or historical conditions are "forward-looking statements" within the meaning of that term in Section 27A of the Securities Act of 1933, and in Section 21F of the Securities Exchange Act of 1934. Additional oral or written forward-looking statements may be made by the Company from time to time, and those statements may be included in documents that are filed with the Securities and Exchange Commission. Such forward-looking statements involve risks and uncertainties that could cause results or outcomes to differ materially from those expressed in the forward-looking statements. Forward-looking statements may include, without limitation, statements relating to the Corporation's plans, strategies, objectives, expectations and intentions and are intended to be made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Words such as "believes," "forecasts," "intends," "possible," "expects," "estimates," "anticipates," or "plans" and similar expressions are intended to identify forward-looking statements. Among the important factors on which such statements are based are assumptions concerning the state of the national economy and the local markets in which the Corporation's portfolio companies operate, the state of the securities markets in which the securities of the Corporation's portfolio company trade or could be traded, liquidity within the national financial markets, and inflation. Forward-looking statements are also subject to the risks and uncertainties described under the caption "Risk Factors and Other considerations" contained in Part I, Item 1, which is incorporated herein by reference.

Financial Condition

Rand's total assets increased by \$1,840,609 or 22% to \$10,282,493 and its net assets increased by \$1,672,587 or 20% to \$10,058,284 at December 31, 2001, versus \$8,441,884 and \$8,385,697 at December 31, 2000, respectively.

This increase was primarily due to the realization of proceeds from the investment in Pathlight Technology, Inc. (Pathlight). Rand had a 5% ownership in Pathlight when it was acquired in February 2001 by Advanced Digital Information Corporation (ADIC). The Pathlight securities, with a cost basis of \$1.2 million, were converted into 558,047 shares of ADIC common stock in 2001, and became tradable in August 2001. The subsequent sale of ADIC stock for a \$5.3 million realized gain attributed to the increase in assets and net assets.

Rand's financial condition is dependent on the success of its holdings. Rand has invested a substantial portion of its assets in early stage or start-up companies. These private businesses generally tend to be unproven, thinly capitalized small companies that may lack experienced management and may have no history of operations. The following summarizes Rand's investment portfolio at the year-ends indicated.

	<u>December 31, 2001</u>	<u>December 31, 2000</u>
- Investments at cost	\$3,157,017	\$6,159,330
Unrealized appreciation, net	<u>853,874</u>	<u>974,597</u>
Investments at fair value	<u>\$4,010,891</u>	<u>\$7,133,927</u>

The decrease in investment cost is due to the sale of the Pathlight/ADIC stock (cost basis of \$1.2 million) as well as the realized losses of several investments in 2001. Among the significant realized losses were ARIA Wireless Systems, Inc. (ARIA) for \$543,840, BNKR, Inc. (BNKR) for \$400,000, Reflection Technology for \$500,000 and TSS Transnet for \$316,401.

Rand's total investments at fair value approximated 40% of net assets at December 31, 2001 and 85% of net assets at December 31, 2000. This decrease can be attributed to the liquidation of 483,313 shares of the ADIC stock from August 2001 to December 2001 resulting in a realized gain of approximately \$5.3 million and the realized losses previously discussed. Rand's cash and cash equivalents approximated 59% of net assets at December 31, 2001 compared to 4% at December 31, 2000. The cash increase at December 31, 2001 is due primarily from the proceeds from the sale of the ADIC stock in 2001.

Other investing activity during the twelve months ended December 31, 2001 included the sale of Rand's investments of preferred stock in Motorola and Texaco, in 2001, valued at \$208,000 at December 31, 2000. New investments included \$200,000 in bridge loans to Ultra-Scan Corporation, the exercise of \$94,000 in ADIC warrants and a \$55,000 follow-on investment in Platform Technologies Holdings.

The effect of the portfolio valuation changes, net operating losses for the period, and the realized gain from the sale of ADIC securities, resulted in a net change in net deferred tax assets from \$660,790 at December 31, 2000 to a net deferred tax liability of (\$150,000) at December 31, 2001.

Results of Operations

On May 11, 2001, one of Rand's privately held portfolio investments, Pathlight, was acquired by ADIC. In exchange for Rand's estimated 5% ownership of Pathlight (cost basis of approximately \$1.2 million), Rand has received 558,047 shares of ADIC common stock with 13,683 of these shares held in escrow. The shares being held by ADIC in escrow under the terms of the acquisition agreement are not valued in the December 31, 2001 portfolio. The ADIC shares received by Rand were subject to sale restrictions under Rule 145 and became tradable August 20, 2001.

Between August 20th and December 31, 2001, Rand sold a total of 483,313 shares at a price range of \$10.10 to \$17.20 with gross proceeds of \$6.4 million and a realized gain of approximately \$5.3 million. Rand's average cost basis per share for the ADIC securities is \$2.27. In January 2002, Rand sold an additional 61,051 of the ADIC stock at a price range of \$17.30 to \$18.45 with gross proceeds of approximately \$1.1 million and a realized gain of approximately \$1.0 million.

Investment Income and Expenses

Investment income for the years ended December 31, 2001, 2000 and 1999 were \$159,479, \$239,769 and \$363,094, respectively. This income is comprised mainly of interest income from portfolio companies and income on cash and cash equivalents.

Rand's primary investment objective is to achieve long-term capital appreciation on its portfolio investments. Therefore, a considerable portion of the investment portfolio is structured to realize capital appreciation over the long-

term and not necessarily generate income in the form of dividends or interest. The company does earn interest income from investing its idle funds in money market instruments.

Rand had portfolio income of \$118,192, \$169,590, \$152,548 for the years ended December 31, 2001, 2000 and 1999, which comprised 74%, 71% and 42% of the total investment income for those years. This income includes investments that have high interest accruals and often do not pay a current yield. In 1999, idle fund balances were high for a significant part of the year and Rand was able to earn substantial interest on these idle funds. Interest from other investments was \$29,194 (18%), \$69,585 (29%) and \$153,988 (42%) for the years ended December 31, 2001, 2000 and 1999, respectively.

Operating expenses were \$825,765 in 2001, \$633,403 in 2000 and \$738,803 in 1999. The operating expenses predominately consist of employee compensation and benefits, shareholder related costs, office expenses, expenses related to identifying and reviewing investment opportunities and professional fees. Included in the 2001 expenses were non-routine costs of \$166,147 related primarily to professional costs (consulting and advisory fees) incurred for restructuring the Corporation to a Business Development Company ("BDC") and preparing an application for the Small Business Administration (SBA) for participation in the SBIC program and transaction fees associated with the sale of the ADIC securities.

Net investment losses from operations were (\$1,551,001) in 2001, (\$109,864) in 2000 and (\$387,097) in 1999. The fluctuations from year to year are partly due to the deferred income tax expense (benefit). The deferred tax expense (benefit) was \$837,148 in 2001, (\$297,288) in 2000 and \$0 in 1999. The increase in 2001 can be attributed to the tax consequence as a result of the realized gain on the sale of the ADIC securities. Deferred income tax expense relates to the net unrealized appreciation (depreciation) of investments. Such appreciation (depreciation) is not included in taxable income until realized. (See "Note 3 of Notes to Financial Statements" contained in Item 8. "Financial Statements and Supplementary Data.")

Net Realized Gains and Losses on Investments:

During the twelve months ended December 31, 2001, Rand realized total net gains of \$3,286,078, including the \$5.3 million gain on the sale of 483,313 shares of its ADIC holdings. Also, during 2001, Rand recognized realized losses on several of its holdings, most notably ARIA for (\$543,840), Reflection Technology for (\$500,000), BNKR for (\$400,000) and TSS Transnet for (\$316,401).

During 2000, Rand realized total net losses of (\$296,298). These net losses included realized losses of (\$142,666) from Hammertime Kitchen & Bath Works, Inc., (\$98,115) from CMO, Inc. and (\$55,517) in various publicly traded securities.

During 1999, Rand had a total net loss from Lightbridge, Inc. for (\$42,625).

Net Increase (Decrease) in Net Assets from Operations:

Rand accounts for its operations under accounting principles generally accepted in the United States of America for investment companies. The principal measure of its financial performance is "net increase (decrease) in net assets from operations" on its statements of operations. For 2001, the net increase in net assets from operations was \$1,640,712 as compared to net increases (decreases) in net assets from operations of \$723,254 for 2000 and (\$632,289) for 1999. The increase in net realized and unrealized gain on investments during 2001 is primarily attributable to the sale of ADIC securities at a gain. The 2000 net increase is due to the change in unrealized appreciation on investments from the Pathlight valuation offset by (\$296,298) in net realized losses. The 1999 net decrease in net assets from operations is due to a net investment loss of (\$387,097), a realized loss on investments of (\$42,625) and a net decrease in unrealized appreciation of investments of (\$202,567).

Liquidity and Capital Resources

Rand's principal objective is to achieve capital appreciation. Therefore, a significant portion of the investment portfolio is structured to maximize the potential for capital appreciation and certain Rand portfolio investments may be structured to provide little or no current yield in the form of dividends or interest payments. Rand does earn interest income on idle cash balances. Rand has historically relied on and continues to rely to a large extent upon proceeds from sales of investments rather than investment income to defray a significant portion of its operating expenses. Because such sales cannot be predicted with certainty, Rand attempts to maintain adequate working capital necessary for short-term needs.

As of December 31, 2001, December 31, 2000 and December 31, 1999 respectively, Rand's total liquidity,

consisting of cash and cash equivalents, was \$5,941,517, \$304,152 and \$1,139,708. Management believes that these cash and cash equivalents will provide Rand with the liquidity necessary to fund operations over the next twelve (12) months.

The increase in liquidity in 2001 was primarily due to the Pathlight/ADIC sale augmented by the sale of certain preferred stocks throughout the year. Rand's largest new investment in 2001 was a bridge loan for \$200,000 to Ultra-Scan Corporation.

From December 31, 1999 to 2000, the liquidity decreased by \$835,556 as a result of the investment in several new holdings in 2000. During the twelve months ending December 31, 2000 Rand invested \$1,629,939 for investments/loans to several companies that included Pathlight Technology (\$749,998), BNKR (\$400,000) and TSS-Transnet (\$316,401).

Subsequent Events

Rand has formed a wholly owned subsidiary, Rand Capital SBIC, L.P., for the purpose of operating it as a small business investment company. On January 25, 2002, Rand transferred \$5 million in cash to this subsidiary to serve as "regulatory capital." On February 1, 2002, Rand received notification that its small business investment company (SBIC) application for the subsidiary had been received by the Small Business Administration. The licensing process is expected to take from six to nine months. Reference is made to the information under the headings "SBIC Subsidiary," and "SBIC Regulation" in Part I, Item 1 of this report, which is incorporated herein by reference.

Item 7a. Quantitative and Qualitative Disclosures about Market Risk

Rand's investment activities contain elements of risk. The portion of Rand's investment portfolio consisting of equity and equity-linked debt securities in private companies is subject to valuation risk. Because there is typically no public market for the equity and equity-linked debt securities in which Rand invests, the valuation of the equity interests in the portfolio is stated at "fair value" as determined in good faith by the Board of Directors in accordance with the Corporation's investment valuation policy. (The discussion of valuation policy contained in the "Notes to Schedule of Portfolio Investments" in the financial statements contained in Item 8 of this report is hereby incorporated herein by reference.) In the absence of a readily ascertainable market value, the estimated value of Rand's portfolio may differ significantly for the values that would be placed on the portfolio if a ready market for the investments existed. Any changes in valuation are recorded in Rand's statement of operations as "Net unrealized gain (loss) on investments."

At times a portion of Rand's portfolio may include marketable securities traded in the over-the-counter market. In addition, there may be a portion of the Corporation's portfolio for which no regular trading market exists. In order to realize the full value of a security, the market must trade in an orderly fashion or a willing purchaser must be available when a sale is to be made. Should an economic or other event occur that would not allow the markets to trade in an orderly fashion, the Company may not be able to realize the fair value of its marketable investments or other investments in a timely manner.

As of December 31, 2001, the Company did not have any off-balance sheet investments or hedging investments.

Item 8. Financial Statements and Supplementary Data

The following financial statements of our Corporation and report of independent auditors thereon are set forth below:

Statements of Financial Position as of December 31, 2001 and 2000

Statements of Operation for the three years in the period ended December 31, 2001

Statements of Cash Flows for the three years in the period ended December 31, 2001

Statements of Changes in Net Assets for the three years in the period ended December 31, 2001

Schedule of Portfolio Investments as of December 31, 2001

Schedules of Selected Per Share Data and Ratios for the five years in the period ended December 31, 2001

Notes to Financial Statements

Supplemental Schedule of Changes in Investments at Cost and Realized Gain (Loss) for the year ended December 31, 2001

Independent Auditors' Report

Statements Of Financial Position December 31, 2001 and 2000

	<u>2001</u>	<u>2000</u>
ASSETS		
Investments at fair value (identified cost: 2001 - \$3,157,017, 2000 - \$6,159,330)	\$4,010,891	\$7,133,927
Cash and cash equivalents	5,941,517	304,152
Interest receivable (net of allowance of \$13,167 in 2001 and \$21,729 in 2000)	167,844	136,780
Deferred tax asset	-	660,790
Promissory notes receivable	150,605	186,000
Other assets	<u>11,636</u>	<u>20,235</u>
TOTAL ASSETS	<u>\$10,282,493</u>	<u>\$8,441,884</u>

LIABILITIES AND STOCKHOLDERS' EQUITY (NET ASSETS)

LIABILITIES:		
Accounts payable and accrued expenses	\$33,679	\$54,657
Income taxes payable	40,530	1,530
Deferred tax liability _	<u>150,000</u>	-
 Total liabilities _	 <u>224,209</u>	 <u>56,187</u>

STOCKHOLDERS' EQUITY (NET ASSETS)

Common stock, \$.10 par - shares authorized 10,000,000, issued and outstanding 5,763,034 in 2001 and 5,748,034 in 2000	576,304	574,804
Capital in excess of par value	6,973,454	6,943,079
Accumulated net investment (loss)	(3,616,673)	(2,065,672)
Undistributed net realized gain on investments	5,686,311	2,400,233
Net unrealized appreciation (depreciation) on investments _	<u>438,888</u>	<u>533,253</u>
 Net assets (per share 2001-\$1.75; 2000-\$1.46) _	 <u>10,058,284</u>	 <u>8,385,697</u>
 TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY _	 <u>\$10,282,493</u>	 <u>\$8,441,884</u>

See notes to financial statements.

Statements Of Operations Years Ended December 31, 2001, 2000 and 1999

	2001	2000	1999
Investment Income:			
Interest from portfolio companies	\$118,192	\$169,590	\$152,548
Interest from other investments	29,194	69,585	153,988
Other investment income	<u>12,093</u>	<u>594</u>	<u>56,558</u>
	<u>159,479</u>	<u>239,769</u>	<u>363,094</u>
 Expenses:			
Salaries	304,520	279,969	334,463
Employee benefits	63,690	46,370	60,189
Directors' fees	30,000	26,250	33,500

Professional fees	59,790	71,596	56,625
Stockholders and office operating	113,906	100,452	131,858
Insurance	26,676	31,355	37,336
Corporate development	36,891	40,707	60,064
Other operating	<u>24,145</u>	<u>36,704</u>	<u>24,768</u>
	659,618	633,403	738,803
Organizational costs	81,523	-	-
Bad debt expense	46,715	-	-
Transaction fees on ADIC sales	<u>37,909</u>	<u>-</u>	<u>-</u>
Total expenses	<u>825,765</u>	<u>633,403</u>	<u>738,803</u>
Investment (loss) before income taxes:	(666,286)	(393,634)	(375,709)
Income tax provision	47,567	13,518	11,388
Deferred income tax expense (benefit)	<u>837,148</u>	<u>(297,288)</u>	<u>-</u>
Net investment (loss)	<u>(1,551,001)</u>	<u>(109,864)</u>	<u>(387,097)</u>
Realized and unrealized gain (loss) on investments:			
Net gain (loss) on sales and dispositions	<u>3,286,078</u>	<u>(296,298)</u>	<u>(42,625)</u>
Unrealized appreciation (depreciation) on investments:			
Beginning of period	974,597	(863,197)	(660,630)
End of period	<u>853,874</u>	<u>974,597</u>	<u>(863,197)</u>
Change in unrealized (depreciation) appreciation before income taxes	(120,723)	1,837,794	(202,567)
Deferred income tax (benefit) expense	<u>(26,358)</u>	<u>708,378</u>	<u>-</u>
Net (decrease) increase in unrealized appreciation	<u>(94,365)</u>	<u>1,129,416</u>	<u>(202,567)</u>
Net realized and unrealized gain (loss) on investments	<u>3,191,713</u>	<u>833,118</u>	<u>(245,192)</u>
Net increase (decrease) in net assets from operations	<u>\$1,640,712</u>	<u>\$723,254</u>	<u>\$(632,289)</u>
Weighted average shares outstanding	5,762,294	5,746,776	5,708,034
Basic and diluted net increase (decrease) in net assets from operations per share	\$0.28	\$0.13	\$(0.11)

See notes to financial statements.

Statements Of Cash Flows Years Ended December 31, 2001, 2000 and 1999

	2001	2000	1999
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net increase (decrease) in net assets from operations	<u>\$1,640,712</u>	<u>\$723,254</u>	<u>\$(632,289)</u>
Adjustments to reconcile net increase (decrease) in net assets to net cash (used in) provided by operating activities:			
Depreciation and amortization	13,041	13,329	14,768
Interest receivable allowance	(8,562)	8,562	-
Decrease (increase) in unrealized appreciation of investments, net of deferred income tax	94,365	(1,129,416)	202,567
Change in deferred taxes	810,790	411,090	-
Net realized (gain) loss on portfolio investments	(3,286,078)	296,298	42,625
Non cash conversion of debentures		(186,000)	
Changes in operating assets and liabilities:			

(Increase) in interest receivable	(22,502)	(44,694)	(22,844)
Decrease in other assets	2,489	872	5,548
Increase (decrease) in accounts payable and other accrued liabilities _	<u>18,022</u>	<u>11,983</u>	<u>(24,800)</u>
Total adjustments _	<u>(2,378,435)</u>	<u>(617,976)</u>	<u>217,864</u>
Net cash (used in) provided by operating activities _	<u>(737,723)</u>	<u>105,278</u>	<u>(414,425)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sale of portfolio investments	6,653,474	631,405	175,646
Proceeds from loan repayments	35,395	-	436,647
New portfolio investments	(338,725)	(1,629,939)	(2,789,715)
Capital expenditures _	<u>(6,931)</u>	<u>-</u>	<u>(25,844)</u>
Net cash provided by (used in) investing activities _	<u>6,343,213</u>	<u>(998,534)</u>	<u>(2,203,266)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of stock _	<u>31,875</u>	<u>57,700</u>	<u>-</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS			
	5,637,365	(835,556)	(2,617,691)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR _			
	<u>304,152</u>	<u>1,139,708</u>	<u>3,757,399</u>
CASH AND CASH EQUIVALENTS, END OF YEAR _			
	<u>\$5,941,517</u>	<u>\$304,152</u>	<u>\$1,139,708</u>

See notes to financial statements.

Statements Of Changes In Net Assets Years Ended December 31, 2001, 2000 and 1999

	2001	2000	1999
Net assets at beginning of period (includes accumulated net investment loss of \$2,065,672, \$1,955,808 and \$1,568,711, respectively)	<u>\$8,385,697</u>	<u>\$7,604,743</u>	<u>\$8,237,032</u>
Net investment (loss)	(1,551,001)	(109,864)	(387,097)
Net realized gain (loss) on investments	3,286,078	(296,298)	(42,625)
Net (decrease) increase in unrealized appreciation on investments	<u>(94,365)</u>	<u>1,129,416</u>	<u>(202,567)</u>
Net increase (decrease) in net assets from operations _	<u>1,640,712</u>	<u>723,254</u>	<u>(632,289)</u>
Net proceeds of private stock offerings _	<u>31,875</u>	<u>57,700</u>	<u>-</u>
Net assets at end of period (including accumulated net investment loss of \$3,616,673, \$2,065,672 and \$1,955,808, respectively) _	<u>\$10,058,284</u>	<u>\$8,385,697</u>	<u>\$7,604,743</u>

See notes to financial statements.

Schedule Of Portfolio Investments December 31, 2001

<u>Company and Business</u>	<u>Date</u>	<u>Acquired</u>	<u>Equity</u>	<u>Cost</u>	<u>Value</u>
ADIC (NASDAQ:ADIC)* ^ (f) Redmond, WA. Manufactures data storage systems and specialized storage management software. www.adic.com. Acquired Pathlight Technology 5/11/01.	74,734 shares Common Stock (61,051 shares sold in January 2002)	5/11/01	<1%	\$169,958	\$976,816
American Tactile Corporation Medina, NY. Develops equipment and systems	Convertible debentures at 8% due June 2000 and April 2001	6/23/95	<1%	150,000	25,000

to produce commercial signage. www.americantactile.com	with detachable warrants				
BioWorks, Inc. Geneva, NY. Develops and manufactures biological alternative to chemical pesticides. www.bioworksbiocontrol.com	Series A convertible preferred stock - 32,000 shares	11/6/95	<1%	56,000	28,000
Clearview Cable TV, Inc. New Providence, NJ. Cable television operator.	Common stock - 400 shares	2/23/96	5%	55,541	28,000
Contract Staffing Buffalo, NY. PEO providing human resource administration for small businesses. www.contract-staffing.com	Series A 8% Cumulative preferred stock - 10,000 shares	11/8/99	10%	100,000	100,000
DataView, LLC Mt. Kisco, NY. Designs, develops and markets browser based software for investment professionals. www.marketgauge.com	5% Membership interest	10/1/98	5%	310,357	155,179
G-TEC Natural Gas Systems Buffalo, NY. Manufactures and distributes systems that allow natural gas to be used as an alternative fuel to gases. www.gas-tec.com	41.67% Class A Membership interest. 8% cumulative dividend	8/31/99	42%	300,000	300,000
INRAD, Inc. (OTC: INRD.OB) * Northvale, NJ. Develops and manufactures products for laser photonics industry. www.inrad.com	Series B Preferred Stock - 100 shares. 10% dividend. Common stock - 2,000 shares	10/31/00	2%	100,000	102,000
MemberWare Technologies, Inc. (e) Pittsford, NY. Internet company engaged in web related consulting services. www.memberware.com	Promissory Note at prime rate + 4.5% due September 2004. Common stock - 40,000 34,000 warrants for shares of stock	9/16/99	2%	100,000	100,000
MINRAD, Inc. Buffalo, NY. Developer of laser devices.	608,193 Common shares. 56,020 Preferred Series A shares. 13,767 Preferred Series B	8/4/97	5%	919,422	1,160,558
Ultra - Scan Corporation Amherst, NY. Ultrasonic Fingerprint Technology www.ultra-scan.com	Common Shares - 49,290. Warrants - 4,000 for Common shares. Two Bridge Loans each for \$100,000 at 12%, due on demand anytime after March 31, 2002.	12/11/92	4%	502,586	595,676
UStec, Inc. (e) Victor, NY. Manufactures and markets digital wiring systems for residential new home construction. www.ustecnet.com	Promissory Note at 12% due January 2003 50,000 Common Shares. 8,200 Warrants for Common Shares	12/17/98	<1%	100,500	150,000
Vanguard Modular Building Systems Philadelphia, PA. Leases and sells high-end modular space solutions. www.vanguardmodular.com	Preferred Units - 2,673 Units with warrants, 14% interest rate.	12/16/99	<1%	270,000	270,000
Other Investments	Other	Various	-	<u>17,653</u>	<u>19,662</u>
	Total portfolio investments			<u>\$3,157,017</u>	<u>\$4,010,891</u>

See notes to financial statements.

Notes to Portfolio of Investments

- (a) Unrestricted securities (indicated by ^) are freely marketable securities having readily available market quotations. All other securities are restricted securities, which are subject to one or more restrictions on resale and are not freely marketable. At December 31, 2001 restricted securities represented approximately 76% of the value of the investment portfolio. Deloitte & Touche LLP has not examined the business descriptions of the portfolio companies.
- (b) The Date Acquired column indicates the year in which the Corporation acquired its first investment in the company or a predecessor company.
- (c) The equity percentages estimate the Corporation's ownership interest in the portfolio investment. The estimated ownership is calculated based on the percent of outstanding voting securities held by the Corporation or the potential percentage of voting securities held by the Corporation or the potential percentage of voting securities held by the Corporation upon exercise of its warrants or conversion of debentures; or other available data. Deloitte & Touche LLP has not audited the equity percentages of the portfolio companies. The symbol "<1%" indicates that the Corporation holds equity interest of less than one percent.

- (d) Under the valuation policy of the Corporation, unrestricted securities are valued at the closing price for publicly held securities for the last three days of the month. Restricted securities, including securities of publicly-owned companies, which are subject to restrictions on resale, are valued at fair value as determined by the Board of Directors. Fair value is considered to be the amount, which the Corporation may reasonably expect to receive for portfolio securities if such securities were sold on the valuation date. Valuations as of any particular date, however, are not necessarily indicative of amounts which may ultimately be realized as a result of future sales or other dispositions of securities and these favorable or unfavorable differences could be material. Among the factors considered by the Board of Directors in determining the fair value of restricted securities are the financial condition and operating results, projected operations, and other analytical data relating to the investment. Also considered are the market prices for unrestricted securities of the same class (if applicable) and other matters which may have an impact on the value of the portfolio company.
- (e) These investments are income producing. All other investments are non-income producing.
- (f) See Note 2 to the financial statements.
- (g) Income Tax Information - As of December 31, 2001, the aggregate cost of investment securities approximated \$3.2 million. Net unrealized appreciation aggregated approximately \$850,000, of which \$1,200,000 related to appreciated investment securities and \$350,000 related to depreciated investment securities.

* Publicly-owned Company

Schedules Of Selected Per Share Data And Ratios Five Years Ended December 31, 2001

Selected data for each share of capital stock outstanding throughout the five most current years is as follows:

	<u>Year Ended December 31,</u>				
	2001	2000	1999	1998	1997
INCOME FROM INVESTMENT OPERATIONS (1):					
Investment income	\$0.02	\$0.04	\$0.06	\$0.10	\$0.08
Expenses _	<u>0.14</u>	<u>0.11</u>	<u>0.13</u>	<u>0.13</u>	<u>0.14</u>
Investment (loss) before income taxes	(0.12)	(0.07)	(0.07)	(0.03)	(0.06)
Income tax expense (benefit)	<u>0.15</u>	<u>(0.05)</u>	-	<u>(0.02)</u>	-
Net investment (loss)	(0.27)	(0.02)	(0.07)	(0.01)	(0.06)
Net realized and unrealized gain (loss) on investments	0.55	0.14	(0.04)	(0.01)	(0.01)
Net proceeds from private stock offering	<u>0.01</u>	<u>0.01</u>	<u>0.00</u>	<u>0.00</u>	<u>0.37</u>
Increase (decrease) in net asset value	0.29	0.13	(0.11)	(0.02)	0.30
Net asset value, beginning of year _	<u>1.46</u>	<u>1.33</u>	<u>1.44</u>	<u>1.46</u>	<u>1.16</u>
Net asset value, end of year _	<u>\$1.75</u>	<u>\$1.46</u>	<u>\$1.33</u>	<u>\$1.44</u>	<u>\$1.46</u>
Per share market value, end of year _	<u>\$1.27</u>	<u>\$2.19</u>	<u>\$1.72</u>	<u>\$0.78</u>	<u>\$0.94</u>
Total return based on market value	(42.0)%	27.3%	120.1%	(16.7)%	34.8%
Total return based on net asset value	19.9%	10.3%	(7.7)%	(1.2)%	29.1%
SUPPLEMENTAL DATA:					
Ratio of expenses before income taxes to average net assets	8.95%	7.92%	9.33%	9.15%	10.44%
Ratio of expenses including income taxes to average net assets	18.55%	4.37%	9.47%	7.83%	10.26%
Ratio of net investment (loss) to average net assets	(16.82)%	(1.37)%	(4.89)%	(0.68)%	(4.08)%

Portfolio turnover	6.3%	26.2%	15.0%	35.8%	27.5%
Net assets at end of year	\$10,058,284	\$8,385,697	\$7,604,743	\$8,237,032	\$8,341,220
Weighted shares outstanding at end of year	5,762,294	5,746,776	5,708,034	5,708,034	5,558,451

(1) Per share data are based on weighted average shares outstanding.

See notes to financial statements.

Notes To Financial Statements Years Ended December 31, 2001, 2000 and 1999

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of the Business - Effective August 16, 2001 the Corporation made an election, following an authorized vote of the shareholders to become a Business Development Company, or "BDC." Generally, a BDC is a specialized type of investment company that is primarily engaged in the business of furnishing capital and managerial expertise to companies that do not have ready access to capital through conventional finance channels. There was no impact on the corporate structure as a result of the change to a BDC. Prior to this election, the Corporation operated as a diversified closed-end management investment company registered under the Investment Company Act of 1940. Rand continues to operate as a publicly held venture capital company, listed on the NASDAQ Small Cap Market under the symbol "RAND." The Corporation was founded in 1969 and is headquartered in Buffalo, New York. The Corporation's investment strategy is to seek capital appreciation through venture capital investments in small, unseasoned, developing companies, primarily in Upstate New York.

Investments - Investments are stated at fair value as determined in good faith by the Board of Directors, as described in the Notes to Schedule of Portfolio Investments on page 25. Certain investment valuations have been determined by the Board of Directors in the absence of readily ascertainable fair values. The estimated valuations are not necessarily indicative of amounts which may ultimately be realized as a result of future sales or other dispositions of securities, and these favorable or unfavorable differences could be material. Amounts reported as realized gains and losses are measured by the difference between the proceeds of sale or exchange and the cost basis of the investment without regard to unrealized gains or losses reported in prior periods. The cost of securities that have, in the Board of Directors' judgment, become worthless, are written off and reported as realized losses.

Cash and Cash Equivalents - Temporary cash investments having a maturity of three months or less when purchased are considered to be cash equivalents.

Interest Income - Interest income generally is recorded on the accrual basis except where the investment is valued at less than cost to reflect risk of loss. In such cases, interest is recorded at the time of receipt. A reserve for possible losses on interest receivable is maintained when appropriate.

Organizational Costs - During 2001, the Corporation incurred \$81,523 in legal and accounting related services in conjunction with its election to become a BDC, the establishment of stock options plans, and the application to the Small Business Administration regarding a pending establishment of a wholly owned Small Business Investment Company subsidiary. These organizational related costs have been expensed in 2001.

Net Assets per Share - Net assets per share are based on the number of shares of common stock outstanding.

Use of Estimates - The preparation of the 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.

Supplemental Cash Flow Information - - In 2001, the Corporation converted \$10,465 of interest receivable

from ADIC into common stock of ADIC.

Reclassifications - Certain prior year amounts have been reclassified to conform with the 2001 financial statement presentation.

2. SALE OF INVESTMENT

The Corporation announced on February 1, 2001 the acquisition of Pathlight Technology, Inc. ("Pathlight") by Advanced Digital Information Corporation (NASDAQ: ADIC). At the time of announcement the Corporation owned approximately 5% of Pathlight, with a cost basis of approximately \$1.2 million. The Pathlight securities were converted into 558,047 shares of ADIC in 2001, and became freely tradable in August 2001.

From August 2001 through December 31, 2001, the Corporation liquidated 483,313 shares of ADIC common stock resulting in a realized gain of approximately \$5.3 million. In January 2002 the Corporation sold an additional 61,051 of its ADIC common stock holdings for approximately \$1.1 million. The Corporation is eligible to receive an additional 13,683 shares of ADIC under the terms of the agreement, however, such shares are being held by ADIC in escrow under terms of the acquisition agreement. As such, these escrow shares have not been valued in the December 31, 2001 portfolio.

3. INCOME TAXES

Deferred tax assets and liabilities are recorded for temporary differences between the financial statement and tax bases of assets and liabilities using the currently enacted tax rate expected to be in effect when the taxes are actually paid or recovered.

The tax effect of the major temporary difference and carryforwards that give rise to the Corporation's net deferred tax (liabilities) assets at December 31, 2001 and 2000 are as follows

	<u>2001</u>	<u>2000</u>
Operations	\$(113,019)	\$(51,697)
Investments	(362,896)	(389,254)
Net operating loss carryforwards	325,915	1,086,443
Capital loss carryforwards _	<u>-</u>	<u>183,948</u>
Subtotal	(150,000)	829,440
Valuation allowance _	<u>-</u>	<u>(168,650)</u>
Deferred tax (liabilities) assets, net	<u>\$(150,000)</u>	<u>\$660,790</u>

The net deferred tax (liabilities) assets are presented in the statements of financial position as follows:

	<u>2001</u>	<u>2000</u>
-		
Deferred tax assets - current	\$369,488	\$1,113,470
Deferred tax liabilities - current	<u>519,488</u>	<u>452,680</u>
Deferred tax (liabilities) assets, net	<u>\$(150,000)</u>	<u>\$660,790</u>

The components of income tax expense reported in the statements of operations are as follows:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Current:			
Federal	\$34,000	\$-	\$-
State	<u>13,567</u>	<u>13,518</u>	<u>11,388</u>
	<u>47,567</u>	<u>13,518</u>	<u>11,388</u>
Deferred:			
Federal	575,215	357,825	-
State	<u>235,575</u>	<u>53,265</u>	<u>-</u>
	<u>810,790</u>	<u>411,090</u>	<u>-</u>

Total	<u>\$858,357</u>	<u>\$424,608</u>	<u>\$11,388</u>
-------	------------------	------------------	-----------------

A reconciliation of the expense for income taxes at the federal statutory rate to the expense reported is as follows:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
-			
Net investment income (loss) and realized gain (loss) before income tax expense (benefit)	<u>\$2,499,069</u>	<u>\$1,147,862</u>	<u>\$(620,901)</u>
Expected tax (benefit) at statutory rate	<u>\$850,706</u>	<u>\$390,273</u>	<u>\$(211,106)</u>
State - net of federal effect	<u>164,434</u>	<u>44,070</u>	<u>(14,343)</u>
Other	<u>(12,083)</u>	<u>(9,735)</u>	<u>68,187</u>
Valuation allowance	<u>(144,700)</u>	<u>-</u>	<u>168,650</u>
Total	<u>\$858,357</u>	<u>\$424,608</u>	<u>\$11,388</u>

Deferred income tax expense of approximately \$363,000 and \$389,000 at December 31, 2001 and 2000, respectively, relate to net unrealized appreciation (depreciation) of investments. Such appreciation (depreciation) is not included in taxable income until realized.

At December 31, 2001 and 2000, the Corporation had a federal and state net operating loss carryforward of approximately \$781,000 and \$2,720,000, respectively, which expire commencing in 2007.

At December 31, 2000, the Corporation had established a valuation allowance against the deferred tax asset in the event that the tax asset may not be realized prior to its expiration. The entire valuation allowance was reversed and taken into the net increase in net assets from operations in 2001.

4. STOCKHOLDERS' EQUITY (NET ASSETS)

At December 31, 2001 and 2000, there were 500,000 shares of \$10.00 par value preferred stock authorized and unissued.

On January 18, 2001, January 21, 2000 and October 2, 2000, the Corporation sold 15,000, 15,000 and 25,000 shares of common stock through a private stock offering at \$2.125, \$1.33 and \$1.51 per share, respectively. There was no common stock issued in 1999.

On October 18, 2001, the Board of Directors authorized the repurchase of up to 5% of the Corporation's outstanding stock through purchases on the open market during the one-year period ending October 18, 2002. As of December 31, 2001 no stock repurchases had occurred.

Summary of change in capital accounts:

	<u>Undistributed Net Investment Loss</u>	<u>Undistributed Realized Gain (Loss) on Investments</u>	<u>Net Unrealized Appreciation (Depreciation) on Investments</u>
-			
Balance, January 1, 1999	<u>\$(1,568,711)</u>	<u>\$2,739,156</u>	<u>\$(393,596)</u>
Net (decrease) increase in net assets from operations	<u>(387,097)</u>	<u>(42,625)</u>	<u>(202,567)</u>
Balance, December 31, 1999	<u>(1,955,808)</u>	<u>2,696,531</u>	<u>(596,163)</u>
Net (decrease) increase in net assets from operations	<u>(109,864)</u>	<u>(296,298)</u>	<u>1,129,416</u>
Balance, December 31, 2000	<u>(2,065,672)</u>	<u>2,400,233</u>	<u>533,253</u>
Net (decrease) increase in net assets from operations	<u>(1,551,001)</u>	<u>3,286,078</u>	<u>(94,365)</u>
Balance, December 31, 2001	<u>\$(3,616,673)</u>	<u>\$5,686,311</u>	<u>\$438,888</u>
-			
	<u>Common Stock</u>		<u>Capital in Excess of Par Value</u>
	<u>Shares</u>	<u>Amount</u>	
Balance, December 31, 1999	<u>5,708,034</u>	<u>\$570,804</u>	<u>\$6,889,379</u>
Common stock issued	<u>40,000</u>	<u>4,000</u>	<u>53,700</u>
Balance, December 31, 2000	<u>5,748,034</u>	<u>574,804</u>	<u>6,943,079</u>

Common stock issued	<u>15,000</u>	<u>1,500</u>	<u>30,375</u>
Balance, December 31, 2001	<u>5,763,034</u>	<u>\$576,304</u>	<u>\$6,973,454</u>

5. STOCK OPTION PLANS

In July 2001, the shareholders of the Corporation authorized the establishment of two stock option plans - the Employee Plan, and the Director Plan. The Plans provide for an aggregate of 200,000 and 100,000 shares, respectively, to be awarded to eligible employees and non-officer directors. As of December 31, 2001, no stock options have been awarded from either plan. The Director Plan will not take effect, if at all, until an SEC exemption is obtained from restrictions under the Investment Company Act of 1940.

6. COMMITMENTS AND CONTINGENCIES

The Corporation has an agreement that includes health benefits for the spouse of a former officer of the Corporation. Remaining payments projected to be paid to the surviving spouse have been fully accrued. Total accrued deferred compensation under this agreement at December 31, 2001 and 2000 was \$25,874 and \$29,296, respectively.

7. PENSION EXPENSE

The Corporation has a defined contribution 401(k) Plan. The Plan provides a base contribution of 1% for eligible employees and also provides up to 5% matching contribution. Pension plan expenses were \$18,041, \$15,822, and \$18,317 in 2001, 2000 and 1999, respectively.

8. PROMISSORY NOTES RECEIVABLE

In January 2001, the Corporation received promissory notes from certain principals of its former portfolio companies. Principal payments commenced in January 2001. Interest, at the rate of 12%, will accrue during the term of the promissory notes and may be waived by the Corporation if the payors meet certain of the promissory notes' provisions. Principal installments due subsequent to December 31, 2001 are as follows: 2002 - \$28,600, 2003 - \$45,745, 2004 - \$31,400, and 2005 - \$44,860.

9. SUBSEQUENT EVENT

On February 1, 2002, Rand received notification that its Small Business Investment Company (SBIC) application had been received by the United States Small Business Administration's (SBA's) Investment Division. A review of the application will take place before the SBIC license is granted. This licensing process may take six to nine months. On January 25, 2002, Rand transferred \$5,000,000 in cash to its newly formed wholly owned subsidiary, Rand Capital SBIC, L.P. Once approved and licensed by the SBA, this new subsidiary will be able to obtain up to two times its initial \$5,000,000 of "regulatory capital" from the SBA for purposes of new investment.

10. QUARTERLY OPERATIONS AND EARNINGS DATA - UNAUDITED

	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
2001				
Investment income	\$55,552	\$27,578	\$31,212	\$45,137
Net increase (decrease) in net assets from operations	968,394	130,319	936,031	(394,032)
Basic and diluted net increase (decrease) in net assets from operations per share	0.17	0.02	0.16	(0.07)
2000				
Investment income	\$53,630	\$62,368	\$55,974	\$67,797
Net increase (decrease) in net assets from operations	(319,009)	(26,253)	(279,522)	1,348,038
Basic and diluted net increase (decrease) in net assets from operations per share	(0.06)	0.00	(0.05)	0.24

Changes In Investments At Cost And Realized Gain (Loss) Year Ended December 31, 2001

	Cost Increase (Decrease)	Realized Gain (Loss)
NEW AND ADDITIONS TO PREVIOUS INVESTMENTS		
ADIC/Pathlight Technology, Inc.	\$94,190	
Platform Technology Holdings	55,000	
Ultra-Scan Corporation	<u>200,000</u>	
	<u>349,190</u>	
INVESTMENTS SOLD/LIQUIDATED		
ADIC/Pathlight Technology, Inc.	(1,099,137)	\$5,327,772
Aria Wireless Systems, Inc.	(543,840)	(543,840)
BNKR, Inc.	(400,000)	(400,000)
Fertility Acoustics, Inc.	(87,440)	(87,440)
HCI Systems, Inc.	(100,500)	(100,500)
MobileMedia	(94,250)	(94,250)
Reflection Technology, Inc.	(500,000)	(500,000)
TSS Transnet	(316,401)	(316,401)
Preferred Stocks (Motorola; Texaco)	<u>(211,650)</u>	<u>693</u>
	<u>(3,353,218)</u>	<u>3,286,034</u>
OTHER CHANGES		
Debenture repayments, distributions and other	<u>1,715</u>	<u>44</u>
NET CHANGE IN INVESTMENTS AT COST AND REALIZED GAIN (LOSS)	<u>\$(3,002,313)</u>	<u>\$3,286,078</u>

Independent Auditors' Report Deloitte & Touche LLP

**To the Board of Directors and Stockholders
Rand Capital Corporation
Buffalo, New York**

We have audited the accompanying statements of financial position of Rand Capital Corporation (the "Corporation") as of December 31, 2001 and 2000, including the schedule of portfolio investments as of December 31, 2001, and the related statements of operations, cash flows and changes in net assets for each of the three years in the period ended December 31, 2001, and the selected per share data and ratios for each of the five years in the period then ended. These financial statements and the selected per share data and ratios are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements and selected per share data and ratios based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and selected per share data and ratios are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included examination or confirmation of securities owned as of December 31, 2001, and 2000. 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 and selected per share data and ratios referred to above present fairly, in all material respects, the financial position of Rand Capital Corporation as of December 31, 2001 and 2000, the results of its operations, its cash flows and the changes in its net assets for each of the three years in the period ended December 31, 2001, and the selected per share data and ratios for each of the five years in the period then ended, in conformity with accounting principles generally accepted in the United States of America.

As explained in Note 1, the financial statements include securities valued at \$3,034,075 (30% of net assets) and \$7,133,927 (85% of net assets), as of December 31, 2001 and 2000, respectively, whose fair values have been

estimated by the Board of Directors in the absence of readily ascertainable fair values. We have reviewed the procedures used by the Board of Directors in arriving at its estimate of fair value of such securities and have inspected underlying documentation. In our opinion, those procedures are reasonable, and the documentation is appropriate to determine the securities' estimated fair values. The estimated valuations, however, are not necessarily indicative of the amounts which may ultimately be realized as a result of future sales or other dispositions of securities, and these favorable or unfavorable differences could be material.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule of changes in investments at cost and realized gain for the year ended December 31, 2001 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This supplemental schedule is the responsibility of the Corporation's management. Such schedule has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

Deloitte & Touche LLP
Buffalo, New York
January 11, 2002
(February 1, 2002 as to Note 9)

Rand Capital Corporation Form 10-K

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Part III

Item 10. Directors and Executive Officers of the Registrant

Information in response to this Item is incorporated herein by reference to the information provided in the Corporation's definitive Proxy Statement for its Annual Meeting of Shareholders to be held April 24, 2002, to be filed under Regulation 14A (the "2002 Proxy Statement") under the heading "ELECTION OF DIRECTORS" and "EXECUTIVE OFFICERS."

Item 11. Executive Compensation

Information in response to this Item is incorporated herein by reference to the information provided in the 2002 Proxy Statement under the heading "COMMITTEES AND MEETING DATA," "COMPENSATION" and "DIRECTOR COMPENSATION."

Item 12. Security Ownership of Certain Beneficial Owners and Management

Information in response to this Item is incorporated herein by reference to the information provided in the 2002 Proxy Statement under the heading "BENEFICIAL OWNERSHIP OF SHARES."

Item 13. Certain Relationships and Related Transactions

There were no relationships or transactions within the meaning of this item during the year ended December 31, 2001.

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) The following documents are filed as part of this report and included in Item 8:

(1) FINANCIAL STATEMENTS

Statements of Financial Position as of December 31, 2001 and 2000

Statements of Operations for the three years in the period ended December 31, 2001

Statements of Cash Flows for the three years in the period ended December 31, 2001

Statements of changes in Net Assets for the three years in the period ended December 31, 2001

Schedule of Portfolio Investments as of December 31, 2001

Schedules of Selected Per Share Data and Ratios for the five years in the period ended December 31, 2001

Notes to Financial Statements

Supplemental Schedule of Changes in Investments at Cost and Realized Gain (Loss) for the year ended December 31, 2001

Independent Auditors' Report

(2) FINANCIAL STATEMENT SCHEDULES

There were no schedules required to be filed as part of this report

(b) Reports on Form 8-K

No Form 8-K reports were filed during the quarter ended December 31, 2001.

(c) The following exhibits are filed with this report or are incorporated herein by reference to a prior filing, in accordance with Rule 12b-32 under the Securities Exchange Act of 1934.

(3)(i) Certificate of Incorporation of the Corporation, incorporated by reference to Exhibit (a)(1) of Form N-2 filed with the Securities Exchange Commission on April 22, 1997.

(3)(ii) By-laws of the Corporation incorporated by reference to Exhibit (b) of Form N-2 filed with the Securities Exchange Commission on April 22, 1997.

(4) Specimen certificate of common stock certificate, incorporated by reference to Exhibit (b) of Form N-2 filed with the Securities Exchange Commission on April 22, 1997.

(10.1) Employee Stock Option Plan - incorporated by reference Appendix B to the Corporation's definitive Proxy Statement filed on June 1, 2002.*

(10.2) Director Stock Option Plan - incorporated by reference Appendix C to the Corporation's definitive Proxy Statement filed on June 1, 2002.*

(10.3) Agreement of Limited Partnership for Rand Capital SBIC, L.P. - filed herewith.

(10.4) Certificate of Limited Partnership of Rand Capital SBIC, L.P. - filed herewith.

(10.5) Limited Liability Company Agreement of Rand Capital Management, LLC - filed herewith.

(10.6) Certificate of Formation of Rand Capital Management, LLC - filed herewith.

(11) Computation of Per Share Earnings is set forth under Item 8 of this report.

(21) Subsidiaries of the Corporation - filed herewith.

* Management contract or compensatory plan.

Signatures

Pursuant to the requirements of Section 13 or 15(d) of Securities Exchange Act of 1934, the registrant has duly caused this Report on Form 10-K to be signed on its behalf by the undersigned thereunto duly authorized.

Date: March 14, 2002

RAND CAPITAL CORPORATION

By: /s/ Allen F. Grum

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report on Form 10-K has been signed below by the following persons on behalf of the Company in the capacities and on the date indicated.

Signature/Title

(i) Principal Executive Officer:

/s/ Allen F. Grum

Allen F. Grum / President

March 28, 2002

(ii) Principal Accounting & Financial Officer:

/s/ Daniel P. Penberthy

Daniel P. Penberthy / Treasurer

March 28, 2002

(iii) Directors:

/s/ Allen F. Grum

Allen F. Grum / Director

March 28, 2002

/s/ Luiz F. Kahl

Luiz F. Kahl / Director

March 28, 2002

/s/ Erland E. Kailbourne

Erland E. Kailbourne / Director

March 28, 2002

/s/ Ross B. Kenzie

Ross B. Kenzie / Director

March 28, 2002

/s/ Willis S. McLeese

Willis S. McLeese / Director

March 28, 2002

Reginald B. Newman II / Director

March __, 2002

/s/ Jayne K. Rand

Jayne K. Rand / Director

March 28, 2002

RAND CAPITAL SBIC, L.P.

Dated as of January 16, 2002

RAND CAPITAL SBIC, L.P.
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AGREEMENT OF LIMITED PARTNERSHIP dated and effective as of January 16, 2002, among Rand Capital Management, LLC, a Delaware limited liability company in its capacity as a general partner of the Partnership) and the private limited partners, as amended from time to time.

The parties, in consideration of their mutual agreements stated in this Agreement, agree to become partners and to form a limited partnership under the Act. The purpose of the Partnership is to operate as a small business investment company under the SBIC Act, licensed by SBA for the period and upon the terms and conditions stated in this Agreement. The parties further agree as follows:

ARTICLE 1
General Provisions

Section 1.01 Definitions.

For the purposes of this Agreement, the following terms have the following meanings:

"Act" means the Delaware Revised Uniform Limited Partnership Act.

"Affiliate" has the meaning stated in the SBIC Act.

"Agreement" means this agreement of limited partnership, as amended from time to time. References to this Agreement will be deemed to include all provisions incorporated in this Agreement by reference.

"Assets" means common and preferred stock (including warrants, rights and other options relating to such stock), notes, bonds, debentures, trust receipts and other obligations, instruments or evidences of indebtedness, and other properties or interests commonly regarded as securities, and in addition, interests in real property, whether improved or unimproved, and interests in personal property of all kinds (tangible or intangible), choses in action, and cash, bank deposits and so-called "money market instruments".

"Assets Under Management" means, as of any specified date, the value of all Assets owned by the Partnership (the value to be determined as provided in this Agreement), including contributions requested and due from Partners and uncalled amounts of Commitments that are included in the Partnership's regulatory capital (as such term is used in the SBIC Act), less the amount of any liabilities of the Partnership, determined in accordance with generally accepted accounting principles, consistently applied.

"Associate" has the meaning stated in the SBIC Act.

"Capital Account" means the account of each Partner that reflects its interest in the Partnership determined in accordance with Section 6.03.

"Capital Contribution" means a contribution of capital to the Partnership by a Partner.

"Certificate of Limited Partnership" means the certificate of limited partnership with respect to the Partnership filed for record in the office of the Secretary of State of the State of Delaware.

"Closing Capital Account" means, with respect to any fiscal period, the Opening Capital Account of each Partner for the fiscal period after allocations have been made to the Capital Account in accordance with Section 6.03.

"Code" means the Internal Revenue Code of 1986, as amended, and the regulations thereunder and interpretations thereof promulgated by the Internal Revenue Service, as in effect from time to time.

"Commitments" means the capital contributions to the Partnership that the Partners have made or are obligated to make to the Partnership. The amounts and terms of the Commitments of the General Partner and the Private Limited Partners will be as stated in this Agreement.

"Control Person" has the meaning stated in the SBIC Act.

"Debentures" has the meaning stated in the SBIC Act.

"Designated Party" means any of the General Partner, any Investment Adviser/ Manager, and any partner, member, manager, stockholder, director, officer, employee or Affiliate of the General Partner and any Investment Adviser/ Manager.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended, and the regulations thereunder and interpretations thereof promulgated by the Department of Labor, as in effect from time to time.

"Exchange Act" means the Securities Exchange Act of 1934, as amended, and the regulations thereunder and interpretations thereof promulgated by the Securities and Exchange Commission, as in effect from time to time.

"General Partner" means the general partner or general partners of the Partnership, as set forth in this Agreement.

"Indemnifiable Costs" means all costs, expenses, damages, claims, liabilities, fines and judgments (including the reasonable cost of the defense, and any sums which may be paid with the consent of the Partnership in settlement), incurred in connection with or arising from a claim, action, suit, proceeding or investigation, by or before any court or administrative or legislative body or authority.

"Investment" means the securities acquired by the Partnership in any other corporation, partnership, limited liability company, or any or business or concern in which the Partnership becomes an investor in accordance with the provisions of this Agreement, including capital stock, partnership interests, bonds, notes, debentures, warrants, trust receipts, futures and other obligations and instruments or evidences of indebtedness, as well as rights and options to purchase, sell or invest in the foregoing. Except where the context requires otherwise, any reference to an "Investment" shall refer to all securities acquired by the Partnership with respect to a portfolio company in a single or a series of related transactions.

"Investment Advisers Act" means the Investment Advisers Act of 1940, as amended, and the regulations thereunder and interpretations thereof promulgated by the Securities and Exchange Commission, as in effect from time to time.

"Investment Company Act" means the Investment Company Act of 1940, as amended, and the regulations thereunder and interpretations thereof promulgated by the Securities and Exchange Commission, as in effect from time to time.

"Investment Adviser/Manager" has the meaning stated in the SBIC Act.

"Leverage" has the meaning stated in the SBIC Act.

"Management Compensation" means the amounts payable by the Partnership to the General Partner or Investment Adviser/Manager, as provided in Section 3.05.

"Net Losses" means, with respect to any fiscal period, the excess, if any, of:

(i) all expenses and losses incurred during the fiscal period by the Partnership from all sources over

(ii) the aggregate revenue, income and gains realized during the fiscal period by the Partnership from all sources.

For purposes of determining Net Losses:

(A) items will be taken into account to the extent that (1) they are includable as items of income, credit, loss or deduction for Federal income tax purposes (including items described in Section 705(a)(2)(B) of the Code, or treated as so described in Treasury Regulation § 1.704-1(b)(2)(iv)(i)) or, (2) in the case of items of income, they constitute income that is exempt from Federal income tax; and

(B) if any Noncash Asset is distributed in kind, it will be deemed sold at the value established at the most recent valuation of the Noncash Asset under this Agreement (or such other valuation date as is required under the SBIC Act) and any unrealized appreciation or depreciation with respect to the Noncash Asset will be deemed realized and included in the determination of Net Losses.

"Net Profits" means, with respect to any fiscal period, the excess, if any, of:

(i) the aggregate revenue, income and gains realized during the fiscal period by the Partnership from all sources over

(ii) all expenses and losses incurred during the fiscal period by the Partnership from all sources.

For purposes of determining Net Profits:

(A) items will be taken into account to the extent that (1) they are includable as items of income, credit, loss or deduction for Federal income tax purposes (including items described in Section 705(a)(2)(B) of the Code, or treated as so described in Treasury Regulation § 1.704-1(b)(2)(iv)(i)) or, (2) in the case of items of income, constitute income that is exempt from Federal income tax; and

(B) if any Noncash Asset is distributed in kind, it will be deemed sold at the value established at the most recent valuation of the Noncash Asset under this Agreement (or such other valuation date as is required under the SBIC Act) and any unrealized appreciation or depreciation with respect to the Noncash Asset will be deemed realized and included in the determination of Net Profits.

"Noncash Asset" means any Asset of the Partnership other than cash.

"Opening Capital Account," with respect to any fiscal period, means:

(i) with respect to any Partner admitted during the fiscal period, the Partner's initial capital contribution (or in the case of any Partner admitted as a transferee of all or part of the interest in the Partnership of another Partner, with respect to such transferred interest in the Partnership, that portion of the transferor's initial capital contribution transferred to the transferee); and

(ii) with respect to any Partner admitted during any prior fiscal period (other than a Partner who has withdrawn as of the last day of the preceding fiscal period), the Partner's Closing Capital Account for the preceding fiscal period (or in the case of any Partner admitted as a transferee of all or part of the interest in the Partnership of another Partner, with respect to such transferred interest in the Partnership, that portion of the transferor's Closing Capital Account transferred to the transferee).

"Optionor" shall have the meaning set forth in Section 5.15.

"Optionees" shall have the meaning set forth in Section 5.15.

"Optioned Partnership Interest" shall have the meaning set forth in Section 5.15.

"Option Price" shall have the meaning set forth in Section 5.15.

"Organization Expenses" shall mean all organizational and syndication costs, fees, and expenses incurred by or on behalf of the General Partner in connection with the formation, organization, marketing and licensing of the Partnership and the formation and organization of the General Partner, which include, without limitation, all interest expense, accounting and legal fees, any fees associated with placing interests in the Partnership, all costs incurred in connection with making, registering and selling Partnership investments, including but not limited to, travel, meeting, printing, telephone, office and support staff costs, and the cost of meetings held in connection therewith (including reimbursement of the General Partner and the members, officers and employees of the General Partner for such expenses).

"Outstanding Leverage" means the total amount of outstanding securities (including, but not limited to, Debentures) issued by the Partnership that qualify as Leverage and have not been redeemed or repaid as provided in the SBIC Act.

"Parent Fund" means Rand Capital Corporation, a New York corporation and Business Development Company as defined under § 2(a)(48) of the Investment Company Act of 1940.

"Partners" means the General Partner and the Private Limited Partners.

"Partnership" means the limited partnership established by this Agreement.

"Percentage Interest" means the percentage determined for each Partner by dividing (i) the aggregate Capital Contributions credited to such Partner's Capital Account as provided in Section 6.03 below at the time of any relevant calculation, by (ii) the aggregate Capital Contributions credited to the Capital Accounts of all the Partners at such time. The sum of the respective Percentage Interests shall at all times equal one hundred percent (100%).

"Private Limited Partners" means any limited partners of the Partnership.

"Regulatory Capital" has the meaning stated in the SBIC Act.

"Remaining Portion" shall have the meaning set forth in Section 5.15.

"SBA" means the United States Small Business Administration.

"SBA Agreements" has the meaning stated in Section 10.11.

"SBIC" means a small business investment company licensed under the SBIC Act.

"SBIC Act" means the Small Business Investment Act of 1958, as amended, and the rules and regulations thereunder and interpretations thereof promulgated by SBA, as in effect from time to time.

"SEC" means the Securities and Exchange Commission.

"Securities Act" means the Securities Act of 1933, as amended, and the regulations thereunder and interpretations thereof promulgated by the SEC, as in effect from time to time.

"Special Private Limited Partner" has the meaning stated in Section 4.06 and Section 8.03(c).

Section 1.02 Name.

(a) The name of the Partnership will be "Rand Capital SBIC, L.P."

(b) Subject to the prior approval of SBA, the General Partner has the power at any time to:

(i) change the name of the Partnership; and

(ii) qualify the Partnership to do business under any name when the Partnership's name is unavailable for use, or may not be used, in a particular jurisdiction.

(c) The General Partner will give prompt notice of any action taken under this Section to each Partner and SBA.

Section 1.03 Principal Office; Registered Office; and Qualification.

(a) The principal office of the Partnership will be at 2200 Rand Building, Buffalo, NY 14203, or such other place as may from time to time be designated by the General Partner, subject to the approval of SBA.

(b) The registered office of the Partnership in the State of Delaware will be located at 1209 Orange Street, Wilmington, Delaware, 19801. The name of the registered agent for the Partnership will be the Corporation Trust Center. The General Partner may from time to time change the registered agent and registered office of the Partnership.

(c) The General Partner will qualify the Partnership to do business in each jurisdiction where the activities of the Partnership make such qualification necessary.

(d) The General Partner will give prompt notice of any action taken under this Section to each Partner and SBA.

Section 1.04 Commencement and Duration.

(a) The Partnership will commence upon the filing for record of the Certificate of Limited Partnership in the office of the Secretary of State of the State of Delaware.

(b) The Partnership will be dissolved and wound up at the time and in the manner provided for in Article 8.

Section 1.05 Admission of Partners.

(a) No person may be admitted as a General Partner or a Private Limited Partner without subscribing and delivering to the Partnership a counterpart of this Agreement, or other written instrument, which sets forth:

(i) the name and address of the Partner,

(ii) the Commitment of the Partner, and

(iii) the agreement of the Partner to be bound by the terms of this Agreement.

(b) Without the prior approval of SBA, no person may be admitted as:

(i) a General Partner, or

(ii) a Private Limited Partner with an ownership interest of ten percent (10%) or more of the Partnership's capital.

(c) The General Partner will compile, and amend from time to time as necessary,

Schedule A attached to this Agreement, which will list:

(i) the name and address of the General and each Private Limited Partner, and

(ii) the Commitment of the General Partner and each Private Limited Partner to the Partnership.

(d) The addition to the Partnership at any time of one or more Partners will not be a cause for dissolution of the Partnership, and all the Partners will continue to be subject to the provisions of this Agreement in all respects.

Section 1.06 Representations of Partners.

(a) This Agreement is made with the General Partner in reliance upon the General Partner's representation to the Partnership and SBA, that:

(i) it is duly organized, validly existing and in good standing under the laws of the State of Delaware, and is qualified to do business under the laws of each state where such qualification is required to carry on the business of the Partnership;

(ii) it has full power and authority to execute and deliver this Agreement and to act as General Partner under this Agreement;

(iii) this Agreement has been authorized by all necessary actions by it, has been duly executed and delivered by it, and is a legal, valid and binding obligation of it, enforceable according to its terms; and

(iv) the execution and delivery of this Agreement and the performance of its obligations under this Agreement will not conflict with, or result in any violation of, or default under, any provision of any governing instrument applicable to it, or any agreement or other instrument to which it is a party or by which it or any of its properties are bound, or any provision of law, statute, rule or regulation, or any ruling, writ, order, injunction or decree of any court, administrative agency or governmental body applicable to it.

(b) This Agreement is made with each Private Limited Partner in reliance upon each Private Limited Partner's representation to the General Partner, the Partnership and SBA, that:

(i) it has full power and authority to execute and deliver this Agreement and to act as a Private Limited Partner under this Agreement; this Agreement has been authorized by all necessary actions by it; this Agreement has been duly executed and delivered by it; and this Agreement is a legal, valid and binding obligation of it, enforceable against it according to its terms;

(ii) the execution and delivery of this Agreement and the performance of its obligations under this Agreement do not require the consent of any third party not previously obtained, and will not conflict with, or result in any violation of, or default under, any provision of any governing instrument applicable to it, or any agreement or other instrument to which it is a party or by which it or any of its properties are bound, or any provision of law, statute, rule or regulation, or any ruling, writ, order, injunction or decree of any court, administrative agency or governmental body applicable to it;

(iii) if the Private Limited Partner is a bank (as the term is used in the SBIC Act, at 15 U.S.C. § 682(b)), the total amount of such Private Limited Partner's investments in SBICs, including such Private Limited Partner's interest in the Partnership, does not exceed five percent (5%) of such Private Limited Partner's capital and surplus;

(iv) unless otherwise disclosed to the Partnership in writing, the Partner is a citizen or resident of the United States, an entity organized under the laws of the United States or a state within the United States or an entity engaged

in a trade or business within the United States; and

(v) unless otherwise disclosed to the Partnership in writing, the Partner is not subject to Title I of ERISA.

(c) Each Partner who has disclosed to the Partnership in writing that it is not a person described in Section 1.06(b)(iv), agrees to provide the Partnership with any information or documentation necessary to permit the Partnership to fulfill any tax withholding or other obligation relating to the Partner, including but not limited to any documentation necessary to establish the Partner's eligibility for benefits under any applicable tax treaty.

(d) With respect to actions under this Agreement that require the approval of the Private Limited Partners, the Parent Fund shall exercise its rights in a manner that produces the same result that would be produced if (i) the Parent Fund were not a Partner and (ii) each limited partner of the Parent Fund were a Private Limited Partner that had made aggregate Capital Contributions equal to the product of (x) the aggregate Capital Contributions of the Parent Fund and (y) a fraction, the numerator of which equals the aggregate capital contributions made by such limited partner to the Parent Fund and the denominator of which equals the aggregate capital contributions made by all of the partners of the Parent Fund to the Parent Fund.

Section 1.07 Notices With Respect to Representations by Private Limited Partners.

(a) If any representation made by a Private Limited Partner in Section 1.06(b)(i), (ii) or (iii) ceases to be true, then the Private Limited Partner will promptly provide the Partnership with a correct separate written representation as provided in each such Section.

(b) The Partnership will give SBA prompt notice of any corrected representation received from any Private Limited Partner under Section 1.07(a).

Section 1.08 Liability of Partners

(a) Losses, liabilities and expenses incurred by the Partnership during any fiscal year will be allocated among the Partners in accordance with the procedures for allocating Net Losses as provided in Section 6.03.

(b) The General Partner has the liability for the liabilities of the Partnership provided for in the Act and the SBIC Act. The General Partner will not:

(i) be obligated to restore by way of capital contribution or otherwise any deficits in the respective Capital Accounts of the Private Limited Partners should such deficits occur, or

(ii) have any greater obligation with respect to any Outstanding Leverage than is required by the SBIC Act or by SBA.

(c) Except as otherwise required under the Act and the SBIC Act, no Private Limited Partner will be liable for any loss, liability or expense whatsoever of the Partnership. Notwithstanding the preceding sentence, a Private Limited Partner will remain liable for any portion of such Private Limited Partner's Commitment not paid to the Partnership.

(d) If a Private Limited Partner is required to return to the Partnership, for the benefit of creditors of the Partnership, amounts previously distributed to the Private Limited Partner, the obligation of the Private Limited Partner to return any such amount to the Partnership will be the obligation of the Private Limited Partner and not the obligation of the General Partner. No Private Limited Partner will be liable under this Agreement for the obligations under this Agreement of any other Partner.

(e) Nothing in this Agreement limits any liability of any Partner under any agreement between the Partner and SBA.

ARTICLE 2

Purpose and Powers

Section 2.01 Purpose and Powers.

(a) The Partnership is organized solely for the purpose of operating as a small business investment company under the SBIC Act and conducting the activities described under Title III of the SBIC Act. The Partnership has the powers and responsibilities, and is subject to the limitations, provided in the SBIC Act. The operations of the Partnership and the actions taken by the Partnership and the Partners will be conducted and taken in

compliance with the SBIC Act.

(b) Subject to Section 2.01(a), the Partnership may make, manage, own and supervise investments of every kind and character in conducting its business as a small business investment company.

(i) Subject to the provisions of the SBIC Act, the Partnership has all powers necessary, suitable or convenient for the accomplishment of the purposes set forth in Section 2.01(a) and Section 2.01(b), alone or with others, as principal or agent, including without limitation, to engage in any lawful act or activity for which limited partnerships may be organized under the Act.

Section 2.02 Restrictions on Powers.

Notwithstanding any provision of Section 2.01(b), the Partnership will not (i) make investments precluded under 13 C.F.R. § 107.720, including but not limited to foreign investments described therein, (ii) without the prior approval of the SBA, make any investment that exceeds the diversification limitation that is described in 13 C.F.R. § 107.740 or (iii) make investments precluded under 13 C.F.R. § 107.530.

ARTICLE 3

Management

Section 3.01 Authority of General Partner.

(a) The management and operation of the Partnership and the formulation of investment policy is vested exclusively in the General Partner.

(b) The act of the General Partner in carrying on the business of the Partnership will bind the Partnership.

(c) In the case of any General Partner other than a natural person, at any time that the Partnership is licensed as an SBIC, the General Partner will not allow any person to serve as a general partner, director, officer or manager of the General Partner, unless such person has been approved by SBA.

(d) So long as the General Partner remains the general partner of the Partnership:

(i) it will comply with the requirements of the SBIC Act, including, without limitation, 13 C.F.R. § 107.160(a) and (b) as in effect from time to time; and

(ii) in the case of any General Partner other than a natural person, except as set forth in Section 3.01(d)(iii), it will devote all of its activities to the conduct of the business of the Partnership and will not engage actively in any other business, unless its engagement is related to and in furtherance of the affairs of the Partnership.

(iii) The General Partner may, however:

(A) act as the general partner or Investment Adviser/Manager for one or more other SBICs, and

(B) receive, hold, manage and sell Assets received by it from the Partnership (or other SBIC for which it acts as general partner or Investment Adviser/Manager), or through the exercise or exchange of Assets received by it from the Partnership (or other SBIC for which it acts as general partner or Investment Adviser/Manager).

Section 3.02 Authority of the Private Limited Partners.

The Private Limited Partners will take no part in the control of the business of the Partnership, and the Private Limited Partners will not have any authority to act for or on behalf of the Partnership except as is specifically permitted by this Agreement.

Section 3.03 No Investment Adviser/Manager.

The General Partner may not delegate any part of its authority to an Investment Adviser/Manager.

Section 3.04 Restrictions on Other Activities of the General Partner and its Affiliates.

Except as provided in the SBIC Act and as otherwise specifically provided in this Agreement, no provision of this Agreement will be construed to preclude any (i) Partner, or (ii) Affiliate, general partner, member, manager or

stockholder of any Partner, from engaging in any activity whatsoever or from receiving compensation therefor or profit from any such activity. Such activities may include, without limitation, (A) receiving compensation from issuers of securities for investment banking services, (B) managing investments, (C) participating in investments, brokerage or consulting arrangements or (D) acting as an adviser to or participant in any corporation, partnership, limited liability company, trust or other business person.

Section 3.05 Management Compensation.

(a) During the five year period commencing on the date hereof, Management Compensation with respect to each year during such period commencing on the same day and month as the date hereof will be 7.5% of the Partnership's Regulatory Capital.

(b) During the period commencing on the first day following the fifth anniversary hereof, Management Compensation with respect to each year during such period commencing on the same day and month as the date hereof will be 2.5% of the Partnership's Combined Capital.

(c) The Management Compensation shall not be modified in any respect except (i) upon the approval of the Parent Fund and (ii) with the prior written approval of SBA.

(d) If the Partnership fails to pay any Management Compensation provided herein, due to the SBIC Act or otherwise, the unpaid amount shall continue to be due and payable or shall become due and payable at the earliest date on which the payment of such amount or any portion thereof could be made without violation of the SBIC Act. Until paid, the unpaid amount shall accrue interest that shall be compounded on a monthly basis at the highest prime rate reported in The Wall Street Journal, from time to time, during the period of non-payment.

(e) Management Compensation otherwise payable for any quarterly period will be reduced by 100% of all fees described in 13 C.F.R. §§ 107.860 and 107.900.

(f) The Partnership will not pay any Management Compensation with respect to any fiscal year in excess of the amount of Management Compensation approved by SBA.

Section 3.06 Payment of Management Compensation.

(a) The Management Compensation will be paid by the Partnership to the General Partner.

(b) Management Compensation will be paid in advance in four quarterly installments on the first business day of each quarter of each year commencing on the same day and month as the date hereof. The amount to be paid in each such quarterly installment initially shall be determined in accordance with Section 3.05, based upon (i) the amounts of Regulatory Capital the Partnership reasonably expects to have during such fiscal quarter and (ii) during the period starting on the fifth anniversary hereof, the amounts of Leverage, if any, the Partnership reasonably expects to have outstanding during such fiscal quarter; provided, however, that such amount shall be subject to adjustment in accordance with Section 3.06(c). With respect to partial quarters (such as the final quarter of the Partnership), Management Compensation shall be pro rated based on the number of days in such quarters.

(c) Within thirty (30) days after (i) the end of each quarter of each year commencing on the same day and month as the date hereof, and (ii) the date of the Partnership's dissolution, appropriate adjustment (by way of payment or refund) will be made so that Management Compensation paid with respect to such quarter then ended or the period from the end of the last quarter to the date set forth in clause (ii) or (iii) will be equal to Management Compensation that would have resulted had it been calculated on a daily basis under Section 3.05(a) or Section 3.05(b) for such period.

Section 3.07 Partnership Expenses.

(a) The General Partner will pay:

(i) the compensation of all professional and other employees of the Partnership or the General Partner who provide services to the Partnership;

(ii) except as provided in Section 3.07(b), the cost of providing support and general services to the Partnership, including, without limitation:

(A) office expenses,

(B) travel,

(C) business development,

(D) office and equipment rental,

(E) bookkeeping, and

(F) the development, investigation and monitoring of investments; and

(iii) all other expenses of the Partnership not authorized to be paid by the Partnership under Section 3.07(b).

(b) The Partnership will pay the following Partnership expenses:

(i) all interest and expenses payable by the Partnership on any indebtedness incurred by the Partnership;

(ii) all amounts payable to SBA under the SBIC Act, and all amounts payable in connection with any Leverage commitment and any Outstanding Leverage;

(iii) taxes payable by the Partnership to Federal, state, local and other governmental agencies;

(iv) Management Compensation;

(v) expenses incurred in the actual or proposed acquisition or disposition of Assets, including without limitation, accounting fees, brokerage fees, legal fees, transfer taxes and costs related to the registration or qualification for sale of Assets;

(vi) legal, insurance (including any insurance as contemplated in Section 3.10(m)), accounting and auditing expenses;

(vii) all expenses incurred by the Partnership in connection with commitments for or issuance of Leverage;

(viii) fees or dues in connection with the membership of the Partnership in any trade association for small business investment companies or related enterprises; and

(ix) Organization Expenses up to but not exceeding \$300,000.

(c) All Partnership expenses paid by the Partnership will be made against appropriate supporting documentation. The payment by the Partnership of Partnership expenses will be due and payable as billed.

Section 3.08 Valuation of Assets.

(a) The Partnership will adopt written guidelines for determining the value of its Assets. Assets held by the Partnership will be valued by the General Partner in a manner consistent with the Partnership's written guidelines and the SBIC Act. The Valuation Guidelines attached to this Agreement as Exhibit I are the Partnership's written guidelines for valuation.

(b) To the extent that the SBIC Act requires any Asset held by the Partnership to be valued other than as provided in this Agreement, the General Partner will value the Asset in such manner as it determines to be consistent with the SBIC Act.

(c) Assets held by the Partnership will be valued at least annually (or more often, as SBA may require), and will be valued at least semi-annually (or more often, as SBA may require) at any time that the Partnership has Outstanding Leverage.

Section 3.09 Standard of Care.

(a) No Designated Party will be liable to the Partnership or any Partner for any action taken or omitted to be taken by it or any other Partner or other person in good faith and in a manner it reasonably believed to be in or not opposed to the best interests of the Partnership, and, with respect to any criminal action or proceeding, had no reasonable cause to believe its conduct was unlawful.

(b) Neither any Private Limited Partner, nor any member of any Partnership committee or board who is not an Affiliate of the General Partner, will be liable to the Partnership or any Partner as the result of any decision made in good faith by the Private Limited Partner or member, in its capacity as such.

(c) Any Designated Party, any Private Limited Partner and any member of a Partnership committee or board, may consult with independent legal counsel selected by it and will be fully protected, and will incur no liability to the Partnership or any Partner, in acting or refraining to act in good faith in reliance upon the opinion or advice of such counsel.

(d) This Section does not constitute a modification, limitation or waiver of Section 314(b) of the SBIC Act, or a waiver by SBA of any of its rights under Section 314(b).

(e) In addition to the standards of care stated in this Section, this Agreement may also provide for additional (but not alternative) standards of care that must also be met.

Section 3.10 Indemnification.

(a) The Partnership will indemnify and hold harmless, but only to the extent of Assets Under Management (less any Outstanding Leverage not included as a liability in the computation of Assets Under Management), any Designated Party, from any and all Indemnifiable Costs which may be incurred by or asserted against such person or entity, by reason of any action taken or omitted to be taken on behalf of the Partnership and in furtherance of its interests.

(b) The Partnership will indemnify and hold harmless, but only to the extent of Assets Under Management (less any Outstanding Leverage not included as a liability in the computation of Assets Under Management), the Private Limited Partners, and members of any Partnership committee or board who are not Affiliates of the General Partner or any Investment Adviser/Manager from any and all Indemnifiable Costs which may be incurred by or asserted against such person or entity, by any third party on account of any matter or transaction of the Partnership, which matter or transaction occurred during the time that such person has been a Private Limited Partner or member of any Partnership committee or board.

(c) The Partnership has power, in the discretion of the General Partner, to agree to indemnify on the same terms and conditions applicable to persons indemnified under Section 3.10(b), any person who is or was serving, under a prior written request from the Partnership, as a consultant to, agent for or representative of the Partnership as a director, manager, officer, employee, agent of or consultant to another corporation, partnership, limited liability company, joint venture, trust or other enterprise, against any liability asserted against such person and incurred by the person in any such capacity, or arising out of the person's status as such.

(d) No person may be entitled to claim any indemnity or reimbursement under Section 3.10(a), (b) or (c) in respect of any Indemnifiable Cost that may be incurred by such person which results from the failure of such person to act in accordance with the provisions of this Agreement and the applicable standard of care stated in Section 3.09. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, will not, of itself, preclude a determination that such person acted in accordance with the applicable standard of care stated in Section 3.09.

(e) To the extent that a person claiming indemnification under Section 3.10(a), (b) or (c) has been successful on the merits in defense of any action, suit or proceeding referred to in Section 3.10(a), (b) or (c) or in defense of any claim, issue or matter in any such action, suit or proceeding, such person must be indemnified with respect to such matter as provided in such Section. Except as provided in the foregoing sentence and as provided in Section 3.10(h) with respect to advance payments, any indemnification under this Section 3.10 will be paid only upon determination that the person to be indemnified has met the applicable standard of conduct stated in Section 3.09(a) or Section 3.09(b), as applicable.

(f) A determination that a person to be indemnified under this Section has met the applicable standard stated in Section 3.09(a) or Section 3.09(b) may be made by (i) the General Partner, with respect to the indemnification of any person other than a person claiming indemnification under Section 3.10(a), (ii) a committee of the Partnership whose members are not affiliated with the General Partner or any Investment Adviser/Manager with respect to indemnification of any person indemnified under Section 3.10(a) or (iii) at the election of the General Partner, independent legal counsel selected by the General Partner, with respect to the indemnification of any person indemnified under this Section, in a written opinion.

(g) In making any determination with respect to indemnification under subsection (f) above, the General Partner, a committee of the Partnership whose members are not affiliated with the General Partner or any Investment Adviser/Manager or independent legal counsel, as the case may be, is authorized to make the

determination on the basis of its evaluation of the records of the General Partner, the Partnership or any Investment Adviser/Manager to the Partnership and of the statements of the party seeking indemnification with respect to the matter in question and is not required to perform any independent investigation in connection with any determination. Any party making any such determination is authorized, however, in its sole discretion, to take such other actions (including engaging counsel) as it deems advisable in making the determination.

(h) Expenses incurred by any person in respect of any Indemnifiable Cost may be paid by the Partnership before the final disposition of any such claim or action upon receipt of an undertaking by or on behalf of such person to repay such amount unless it is ultimately determined as provided in Section 3.10(e) or (f) that the person is entitled to be indemnified by the Partnership as authorized in this Section 3.10.

(i) The rights provided by this Section 3.10 will inure to the benefit of the heirs, executors, administrators, successors, and assigns of each person eligible for indemnification under this Agreement.

(j) The rights to indemnification provided in this Section 3.10 are the exclusive rights of all Partners to indemnification by the Partnership. No Partner may have any other rights to indemnification from the Partnership or enter into, or make any claim under, any other agreement with the Partnership (whether direct or indirect) providing for indemnification.

(k) The Partnership may not enter into any agreement with any person (including, without limitation, any Investment Adviser/Manager, Partner or any person that is an employee, officer, director, partner or shareholder, or an Affiliate, Associate or Control Person of any Partner) providing for indemnification of any such person (i) except as provided for under this Section 3.10, and (ii) unless such agreement provides for a determination with respect to the indemnification as provided under Section 3.10(f).

(l) The provisions of this Section 3.10 do not apply to indemnification of any person that is not at the expense (whether in whole or in part) of the Partnership.

(m) The Partnership may purchase and maintain insurance on its own behalf, or on behalf of any person or entity, with respect to liabilities of the types described in this Section 3.10. The Partnership may purchase such insurance regardless of whether the person is acting in a capacity described in this Section 3.10 or whether the Partnership would have the power to indemnify the person against such liability under the provisions of this Section.

ARTICLE 4

Small Business Investment Company Matters

Section 4.01 SBIC Act.

(a) The provisions of this Agreement must be interpreted to the fullest extent possible in a manner consistent with the SBIC Act. If any provision of this Agreement conflicts with any provision of the SBIC Act (including, without limitation, any conflict with respect to the rights of SBA or the respective Partners under this Agreement), the provisions of the SBIC Act will control.

Section 4.02 Consent or Approval of, and Notice to, SBA.

(a) The requirements of the prior consent or approval of, and notice to, SBA in this Agreement will be in effect at any time that the Partnership is licensed as an SBIC or has Outstanding Leverage. These requirements will not be in effect if the Partnership is not licensed as an SBIC and does not have any Outstanding Leverage.

(b) Except as provided in the SBIC Act, a consent or approval required to be given by SBA under this Agreement will be deemed given and effective for purposes of this Agreement only if the consent or approval is:

(i) given by SBA in writing, and

(ii) delivered by SBA to the party requesting the consent or approval in the manner provided for notices to such party under Section 10.04.

Section 4.03 Provisions Required by the SBIC Act for Issuers of Debentures.

(a) The provisions of 13 C.F.R. § 107.1810(i) are incorporated by reference in this Agreement as if fully stated

in this Agreement.

(b) **The Partnership and the Partners consent to the exercise by SBA of all of the rights of SBA under 13 C.F.R. § 107.1810(i), and agree to take all actions that SBA may require in accordance with 13 C.F.R. § 107.1810(i).**

(c) **This Section will be in effect at any time that the Partnership has outstanding Debentures, and will not be in effect at any time that the Partnership does not have outstanding Debentures.**

(d) **Nothing in this Section may be construed to limit the ability or authority of SBA to exercise its regulatory authority over the Partnership as a licensed small business investment company under the SBIC Act.**

Section 4.04 Effective Date of Incorporated SBIC Act Provisions.

(a) **Any section of this Agreement which relates to Debentures issued by the Partnership and incorporates or refers to the SBIC Act or any provision of the SBIC Act (including, without limitation, 13 C.F.R. §§ 107.1810(i), 107.1820, and 107.1830 - 107.1850)) will, with respect to each Debenture, be deemed to refer to the SBIC Act or such SBIC Act provision as in effect on the date on which the Debenture was purchased from the Partnership.**

(b) **Section 4.04(a) will not be construed to apply to:**

(i) **the provisions of the SBIC Act which relate to the regulatory authority of SBA under the SBIC Act over the Partnership as a licensed small business investment company; or**

(ii) **the rights of SBA under any other agreement between the Partnership and SBA.**

(c) **The parties acknowledge that references in this Agreement to the provisions of the SBIC Act relating to SBA's regulatory authority refer to the provisions as in effect from time to time.**

Section 4.05 SBA as Third Party Beneficiary.

SBA will be deemed an express third party beneficiary of the provisions of this Agreement to the extent of the rights of SBA under this Agreement and under the Act. SBA will be entitled to enforce the provisions (including, without limitation, the obligations of each Partner to make capital contributions to the Partnership) for its benefit, as if SBA were a party to this Agreement.

Section 4.06 Interest of the General Partner After Withdrawal.

If the General Partner withdraws as a general partner of the Partnership by notice from SBA as provided in the SBIC Act or otherwise, then the entire interest of the General Partner in the Partnership will be converted into an interest as a Special Private Limited Partner on the terms provided in Section 8.03(c).

ARTICLE 5

Partners' Capital Contributions

Section 5.01 Capital Commitments.

The Private Limited Partners and the General Partner commit to make capital contributions to the Partnership in the amounts set forth by their respective names on the signature pages of this Agreement (and its counterparts) executed by each such Partner.

Section 5.02 Capital Contributions by the Private Limited Partners.

(a) **All capital contributions to the Partnership by Private Limited Partners must be in cash, except as provided in this Agreement and approved by SBA.**

(b) The Private Limited Partners will contribute to the capital of the Partnership in cash the aggregate amount that is set forth opposite their respective names on Schedule A payable in such installments, as specified by the General Partner in its sole discretion, from time to time, upon not less than ten (10) business days' prior notice; provided that the time requirement for such notice may be waived by a Limited Partner.

Section 5.03 Capital Contributions by the General Partner.

(a) All capital contributions to the Partnership by the General Partner must be in cash, except as provided in this Agreement and approved by SBA.

(b) The General Partner must pay its Commitment in installments at the same times and in the same percentage amounts as the Private Limited Partners.

(c) If the Commitment of the General Partner is increased as a result of an increase in the Commitment of the Private Limited Partners or the admission of any Additional Private Limited Partner, the amount of the increased Commitment will be payable by the General Partner in installments, the first of which will be due upon the effectiveness of the increased Commitment and each subsequent installment will be due at the same times and in the same percentage amounts as the Private Limited Partners.

(d) When the partnership is liquidated, the General Partner will contribute to the Partnership within the time period provided in Treasury Regulation § 1.704-(1)(b)(2)(ii)(b)(3) an amount equal to any deficit balance in its Capital Account after giving effect to its contribution of its Commitment as provided in Section 5.03(a) and (b).

Section 5.04 No Additional Private Limited Partners.

No Private Limited Partners other than the Parent Fund may be admitted to the Partnership.

Section 5.05 Conditions to the Commitments of the General Partner and the Private Limited Partners.

(a) Notwithstanding any provision in this Agreement to the contrary, on the earlier of (i) the completion of the liquidation of the Partnership or (ii) one year from the commencement of the liquidation, the General Partner and the Private Limited Partners will be obligated to contribute any amount of their respective Commitments not previously contributed to the Partnership, if and to the extent that the other Assets of the Partnership have not been sufficient to permit at that time the redemption of all Outstanding Leverage, the payment of all amounts due with respect to the Outstanding Leverage as provided in the SBIC Act, and the payment of all other amounts owed by the Partnership to SBA.

(b) The provisions of this Section do not apply to the Commitment of any Private Limited Partner whose obligation to make capital contributions has been terminated or who has withdrawn from the Partnership, with the consent of SBA, under a provision of this Article 5 or Article 8 or any agreement, release, settlement or action under any provision of this Agreement. No Private Limited Partner or General Partner has any right to delay, reduce or offset any obligation to contribute capital to the Partnership called under this Section by reason of any counterclaim or right to offset by the Partner or the Partnership against SBA.

Section 5.06 Termination of the Obligation to Contribute Capital.

(a) Any Private Limited Partner may elect to terminate its obligation in whole or in part to make a capital contribution required under this Agreement, or upon demand by the General Partner, will no longer be entitled to make such capital contribution, if the Private Limited Partner or the General Partner obtains an opinion of counsel as provided under Section 5.07 to the effect that making such contribution would require the Private Limited Partner to withdraw from the Partnership under Section 8.06 through Section 8.10.

(b) Upon receipt by the General Partner of a notice and opinion as provided under Section 5.07, unless cured within the period provided under Section 5.08, the Commitment of the Private Limited Partner delivering the opinion will be deemed to be reduced by the amount of such unfunded capital contribution and this Agreement will be deemed amended to reflect a corresponding reduction of aggregate Commitments to the Partnership.

Section 5.07 Notice and Opinion of Counsel.

(a) A copy of any opinion of counsel issued as described in Section 5.06 or Section 8.06 through Section 8.10 must be sent by the General Partner to SBA, together with (i) the written notice of the election of the Private Limited Partner or (ii) the written demand of the General Partner, to which the opinion relates.

(b) An opinion rendered to the Partnership as provided in Section 5.06 or Section 8.06 through Section 8.10 will be deemed sufficient for the purposes of those Sections only if the General Partner and SBA each approve (i) the counsel rendering the opinion, and (ii) the form and substance of the opinion.

Section 5.08 Cure, Termination of Capital Contributions and Withdrawal.

(a) Unless within ninety (90) days after the giving of written notice and opinion of counsel, as provided in Section 5.07, the Private Limited Partner or the Partnership eliminates the necessity for termination of the obligation of the Private Limited Partner to make further capital contributions or for the withdrawal of the Private Limited Partner from the Partnership in whole or in part to the reasonable satisfaction of the Private Limited Partner and the General Partner, the Private Limited Partner will withdraw from the Partnership in whole or in part to the extent required, effective as of the end of the ninety (90) day period.

(b) Subject to the provisions of Section 5.10, in its discretion the General Partner may waive all or any part of the ninety (90) day cure period and cause such termination of capital contributions or withdrawal to be effective at an earlier date as stated in the waiver.

(c) Any distributions made to a Private Limited Partner with respect to such Partner's withdrawal under this Section will be subject to and made as provided in Section 8.11.

Section 5.09 Failure to Make Required Capital Contributions.

The Partnership is entitled to enforce the obligations of each Partner to make the contributions to capital specified in this Agreement. The Partnership has all rights and remedies available at law or equity if any such contribution is not so made.

Section 5.10 Notice and Consent of SBA with respect to Capital Contribution Defaults.

(a) The Partnership must give SBA prompt written notice of any failure by a Private Limited Partner to make any capital contribution to the Partnership required under this Agreement when due, which failure continues beyond any applicable grace period specified in this Agreement.

(b) Unless SBA has given its prior consent or the provisions of subsection (c) of this Section have become applicable, the Partnership will not (i) take any action (including entering into any agreement (whether oral or written), release or settlement with any Partner) which defers, reduces, or terminates the obligations of the Partner to make contributions to the capital of the Partnership, or (ii) commence any legal proceeding or arbitration, which seeks any such deferral, reduction or termination of such obligation. Without the consent of SBA (including SBA's deemed consent under subsection (c) of this Section) no such agreement, release, settlement or action taken will be effective with respect to the Partnership or any Partner.

(c) If the Partnership has given SBA thirty (30) days prior written notice of any proposed legal proceeding, arbitration or other action described under subsection (b) of this Section with respect to any default by a Private Limited Partner in making any capital contribution to the Partnership, and the Partnership has not received written notice from SBA that it objects to the proposed action within the thirty (30) day period, then SBA will be deemed to have consented to the proposed Partnership action.

(d) Any notice given by the Partnership to SBA under this Section must:

(i) be given by separate copies directed to each of the Investment Division and the Office of the General Counsel of SBA;

(ii) explicitly state in its caption or first sentence that the notice is being given with respect to a specified default by a Private Limited Partner in making a capital contribution to the Partnership and a proposed legal proceeding, arbitration, agreement, release, settlement or other action with respect to that default; and

(iii) state the nature of the default, the identity of the defaulting Private Limited Partner, and the nature and terms of the proposed legal proceeding, arbitration, agreement, release, settlement or other action with respect to that default.

Section 5.11 Interest on Overdue Contributions.

In the event that any Private Limited Partner fails to make a contribution required under this Agreement within ten (10) days after the date such contribution is due, then the General Partner may, in its sole discretion, elect to charge such Private Limited Partner interest at an annual rate equal to the then current prime rate published in The Wall Street Journal dated the business day preceding the tenth day after such contribution is due, plus two percent (2%) per annum on the amount due from the date such amount became due until the earlier of (i) the date on which such payment is received by the Partnership from such Private Limited Partner or (ii) the date of any notice given to such Private Limited Partner by the General Partner pursuant to Section 5.12 or Section 5.13 or (iii) the date on which such payment

is received by the Partnership under Section 5.14 or Section 5.15. Any distributions to which such Private Limited Partner is entitled shall be reduced by the amount of such interest, and such interest shall be deemed to be income to the Partnership.

Section 5.12 Termination of a Private Limited Partner's Right to Make Further Capital Contributions.

In the event that any Private Limited Partner (other than the Parent Fund) fails to make a contribution required under this Agreement within ten (10) days after the date such contribution is due, the General Partner may, in its sole discretion (but only with the consent of SBA given as provided in Section 5.10), elect to declare, by notice to such Private Limited Partner, that:

(a) Such Private Limited Partner's Commitment shall be deemed to be reduced to the amount of any contributions of capital timely made pursuant to this Agreement; and

(b) Upon such notice (i) such Private Limited Partner shall have no right to make any capital contribution thereafter (including the contribution as to which the default occurred and any contribution otherwise required to be made thereafter pursuant to the terms of this Agreement) and (ii) this Agreement shall be deemed amended to reflect such reduced Commitment.

Section 5.13 Forfeiture of a Private Limited Partner's Interest in the Partnership.

In the event that any Private Limited Partner (other than the Parent Fund) fails to make a contribution required under this Agreement within ten (10) days after notice by the General Partner to such Private Limited Partner that it has failed to make its contribution on the date such contribution was due, the General Partner may in its sole discretion (but only with the consent of SBA given as provided in Section 5.10) elect to declare, by notice of forfeiture to such Private Limited Partner, that one hundred percent (100%) of the interest of such Private Limited Partner in the Partnership (including amounts in its Capital Account as well as any interest in future profits, losses or distributions of the Partnership) is forfeited, effective as of the date of such Private Limited Partner's failure to make such required contribution. As of the date such notice of forfeiture is given (i) the Private Limited Partner shall cease to be a Partner with respect to such forfeited interest; provided, however, that such forfeited Private Limited Partner shall cease to have any liability for the payment of the forfeited percentage of any capital contributions due at such time or in the future and (ii) the forfeited percentage of such Private Limited Partner's Capital Account shall be held by the Partnership and reallocated among the Capital Accounts of the Partners pro rata in proportion to their respective Percentage Interests (other than such forfeited Private Limited Partner) to be apportioned among such Private Limited Partners in accordance with their respective aggregate capital contributions.

Section 5.14 Withholding and Application of a Private Limited Partner's Distributions.

No part of any distribution shall be paid to any Private Limited Partner (other than the Parent Fund) from which there is then due and owing to the Partnership, at the time of such distribution, any amount required to be paid to the Partnership. At the election of the General Partner, which it may make in its sole discretion, the Partnership may either (i) apply all or part of any such withheld distribution in satisfaction of the amount then due to the Partnership from such Private Limited Partner or (ii) withhold such distribution until all amounts then due are paid to the Partnership by such Private Limited Partner. Upon payment of all amounts due to the Partnership (by application of withheld distributions or otherwise), the General Partner shall distribute any unapplied balance of any such withheld distribution to such Private Limited Partner. No interest shall be payable on the amount of any distribution withheld by the Partnership pursuant to this Section.

Section 5.15 Required Sale of a Private Limited Partner's Interest in the Partnership.

In the event that any Private Limited Partner (other than the Parent Fund) fails to make a contribution required under the Agreement within ten(10) days after notice by the General Partner to such Private Limited Partner that it has failed to make its contribution on the date such contribution was due, unless the General Partner has acted pursuant to Section 5.12 or Section 5.13, the General Partner may, in its sole discretion, (but only with the consent of SBA given as provided in Section 5.10) elect to declare by notice of default to such Private Limited Partner that such Private Limited Partner is in default. If the General Partner so elects to declare such Private Limited Partner in default (such Private Limited Partner being hereinafter referred to as the "Optionor"), then the other Private Limited Partners of the Partnership which are not in default (the "Optionees") and the General Partner shall have the right and option to acquire one hundred percent (100%) of the Partnership interest, which shall include one hundred percent (100%) of the Capital Account (the "Optioned Partnership Interest") of the Optionor on the following terms:

(a) The General Partner shall give the Partners notice promptly after declaration of any such default. Such notice

shall advise each Optionee of the portion of the Optioned Partnership Interest available to it and the price therefor. The portion available to each Optionee shall be that portion of the Optioned Partnership Interest that bears the same ratio to the Optioned Partnership Interest as each Optionee's capital contributions to the Partnership bears to the aggregate capital contributions to the Partnership, exclusive of the capital contributions to the Partnership of the Optionor. The aggregate price for the Optioned Partnership Interest shall be the assumption of the unpaid Commitment obligation (both that portion then due and amounts due in the future) of the Optionor (the "Option Price"). The Option Price for each Optionee shall be prorated according to the portion of the Optioned Partnership Interest purchased by each such Optionee so that the percentage of the unpaid Commitment assumed by each Optionee is the same as the percentage of the Optioned Partnership Interest purchased by such Optionee. The option granted hereunder shall be exercisable by each Optionee in whole only at any time within ten (10) days of the date of the notice from the General Partner by the delivery to the General Partner of (i) a notice of exercise of option, and (ii) the capital contribution due in accordance with Section 5.15 (e)(i). The General Partner shall forward the above notices of exercise of option received to the Optionor.

(b) Should any Optionee not exercise its option within the period provided in subsection (a), the General Partner, within ten (10) days of the end of such period, shall notify the other Optionees who have previously exercised their options in full, which Optionees shall have the right and option ratably among them to acquire the portion of the Optioned Partnership Interest not so acquired (the "Remaining Portion") within ten (10) days of the date of the notice specified in this subsection on the same terms as provided in Section 5.15(a).

(c) The amount of the Remaining Portion not acquired by the Optionees pursuant to Section 5.15(b) may be acquired by the General Partner within ten (10) days of the expiration of the period specified in subsection (b) on the same terms as set forth in Section 5.15(a).

(d) The amount of the Remaining Portion not acquired by the Optionees and the General Partner pursuant to Section 5.15(c) may, if the General Partner deems it in the best interest of the Partnership, be sold to any other persons on terms not more favorable to such purchaser than the Optionees' option (and the General Partner may admit any such third party purchaser as a Private Limited Partner, subject to the approval of SBA, if required under the SBIC Act). Any consideration received by the Partnership for such amount of the Optionor's interest in the Partnership in excess of the Option Price therefor shall be retained by the Partnership and allocated among the Partners' Capital Accounts in proportion to the respective Partners' capital contributions.

(e) Upon exercise of any option hereunder, such Optionee (or the General Partner, if it has exercised its rights pursuant to Section 5.15(c)) shall be deemed to have assumed the portion of the Optionor's unpaid Commitment that constitutes the Option Price for the portion of the Optioned Partnership Interest purchased by such Optionee, and shall be obligated (i) to contribute to the Partnership the portion of the capital contribution then due from the Optionor equal to the percentage of the Optioned Partnership Interest purchased by such Optionee and (ii) to pay the same percentage of any further contributions which would have otherwise been due from such Optionor.

(f) Upon the purchase by the General Partner of any portion of the Optioned Partnership Interest in the Partnership pursuant to Section 5.15(c), the General Partner shall also become a Private Limited Partner to the extent of such interest.

(g) Upon the purchase of any portion of any Optioned Partnership Interest by an Optionee, the General Partner or other person pursuant to this Section, the Optionor shall have no further rights or obligations under this Agreement with respect to such portion.

(h) Upon the purchase of any portion of the Optioned Partnership Interest, for purposes of computing such purchaser's aggregate capital contributions, such purchaser shall be deemed to have aggregate capital contributions (or the aggregate capital contributions of any Optionee, shall be increased by an amount) equal to the percentage of the defaulting Private Limited Partner's aggregate capital contribution which the purchased portion of the Optioned Partnership Interest represents of the defaulting Private Limited Partner's entire Partnership interest, and the aggregate capital contributions of such defaulting Private Limited Partner shall be reduced by a corresponding amount.

ARTICLE 6

Adjustment of Capital Accounts

Section 6.01 Establishment of Capital Accounts.

There will be established on the books of the Partnership an Opening Capital Account for each Partner in

accordance with the definitions and methods of allocation prescribed in this Agreement.

Section 6.02 Time of Adjustment of Capital Accounts.

Allocations will be made to the Opening Capital Account of each Partner in accordance with Section 6.03, as of the following dates:

(i) the close of each fiscal year of the Partnership;

(ii) the day before the date of the admission of an Additional Private Limited Partner or increase in any Private Limited Partner's Commitment;

(iii) the day before the dissolution of the Partnership;

(iv) the date of a distribution; and

(v) such other dates as this Agreement may provide.

Section 6.03 Adjustments to Capital Accounts.

(a) As of the times stated in Section 6.02, allocations will be made to the Opening Capital Accounts of the Partners to arrive at each Partner's Closing Capital Account for the period in the following order and amounts:

(i) The amount of any capital contributions paid by each Partner during such period will be credited to the Partner's Opening Capital Account (other than capital contributions referred to in clause (i) of the definition of "Opening Capital Account" in Article 1); provided, however, that any such capital contribution will be credited to the Partner's Opening Capital Account on the later of the date the capital contribution was due or the date on which the capital contribution was actually received by the Partnership;

(ii) The amount of any distributions made to each Partner during the period will be debited against the Partner's Opening Capital Account;

(iii) Net Profits will be credited and Net Losses will be debited to the Opening Capital Accounts of the Partners in proportion to their respective Percentage Interests.

(b) Notwithstanding the provisions of Section 6.03(a)(iii):

(i) at such time as the Capital Account of the General Partner or any Private Limited Partner is reduced to an amount equal to the aggregate capital contributions of such Partner (less all distributions to such Partner), the balance of all Net Losses will be allocated:

(A) first, to the remaining Capital Accounts of the General Partner and Private Limited Partners which have not been reduced to zero (to be apportioned among them in accordance with their respective positive Capital Accounts); and

(B) second, after the Capital Accounts of all Private Limited Partners have been reduced to zero, then the balance to the General Partner.

(ii) If Net Losses are allocated in accordance with the foregoing clause (i), any Net Profits that are required to be allocated after such special allocation of Net Losses as provided in the foregoing clause will be allocated:

(A) first, to the General Partner until the effect of the special allocation of Net Losses under clause (i)(B) is reversed and eliminated; and

(B) second, to the General Partner and Private Limited Partners to whom the allocation of such Net Losses has been made under clause (i)(A) until the effect of such special allocation of Net Losses has been reversed and eliminated.

(c) To the extent not otherwise accomplished by the provisions of Section 6.03(a) and Section 6.03(b), the Opening Capital Accounts of the Partners will be adjusted to effect any allocation of any item of income, gain, loss, deduction or credit to a Partner required by the Code.

Section 6.04 Tax Matters.

(a) If at the end of a fiscal year of the Partnership, a Private Limited Partner unexpectedly receives an adjustment, allocation, or distribution described in clauses (4), (5) and (6) of Treasury Regulation § 1.704-1(b)(2)(ii) and that adjustment, allocation, or distribution reduces that Private Limited Partner's Opening Capital Account below zero (0), then the Private Limited Partner will be allocated all items of income and gain of the Partnership for that year and for all subsequent fiscal years until the deficit balance has been eliminated as provided in Treasury Regulation § 1.704-1(b)(2)(ii)(d), as quickly as possible. If any such unexpected adjustment, allocation or distribution creates a deficit balance in the Opening Capital Accounts of more than one Private Limited Partner in any fiscal year, all items of income and gain of the Partnership for the fiscal year and all subsequent fiscal years will be allocated among all such Private Limited Partners in proportion to their respective deficit balances until such balances have been eliminated. If any allocation is made pursuant to this paragraph, subsequent allocations shall be made (in a manner consistent with this paragraph) to offset the effects of such prior allocation. This provision is intended to qualify as a "qualified income offset" within the meaning of Treasury Regulation § 1.704-1(b)(2)(ii)(d).

(b) For Federal, state and local income tax purposes, each item of Partnership income, credit, gain or loss will be allocated among the Partners as provided in Section 6.03.

(c) The General Partner has the power to make such allocations and to take such actions necessary under the Code or other applicable law to effect and to maintain the substantial economic effect of allocations made to the Partners under Section 704(b) of the Code. All allocations made and other actions taken by the General Partner under this paragraph will be consistent to the maximum extent possible with the provisions of this Agreement.

(d) The General Partner is the "tax matters partner," as the term is used in the Code.

(e) The General Partner is expressly authorized to (i) elect that the Partnership be classified as a partnership for federal tax purposes, and (ii) to make any election or other action on behalf of the Partnership permitted under the Code with respect to the election of that tax classification.

(f) The General Partner must keep the Partners informed of all administrative and judicial proceedings with respect to Partnership tax returns or the adjustment of Partnership items. Any Partner who enters into a settlement agreement with respect to Partnership items must promptly give the General Partner notice of the settlement agreement and terms that relate to Partnership items.

(g) Anything contained in this Agreement to the contrary notwithstanding, if the Partnership is deemed liquidated within the meaning of Treasury Regulation § 1.704-1(b)(2)(ii)(g) but has not dissolved under Section 8.01(a), then the assets of the Partnership will, after provision for payment to creditors, be deemed distributed to the Partners in accordance with Treasury Regulation § 1.704-1(b)(2)(ii)(b)(2) and immediately recontributed to the Partnership and the General Partner must make the contributions contemplated by Section 5.03(d).

ARTICLE 7

Distributions

Section 7.01 Distributions to Partners.

(a) **The Partnership may make distributions of cash and/or property, if any, at such times as the SBIC Act permits and as are determined under this Agreement.**

(b) **All distributions must be made to the Partners in proportion to their respective Percentage Interests.**

Section 7.02 Distributions of Noncash Assets in Kind.

(a) **Subject to the provisions of the SBIC Act and the provisions of this Section, the Partnership at any time may distribute Noncash Assets in kind.**

(b) **Any distribution of Noncash Assets will be made pro rata among the Partners (based upon the respective amounts which each Partner would be entitled to receive if the distribution were made in cash) with respect to the distribution of each Noncash Asset.**

(c) **Distributions of Noncash Assets in kind before the dissolution of the Partnership will be made only (i) if the Noncash Assets are Distributable Securities or (ii) with the prior approval of the Parent Fund.**

(d) Subject to the SBIC Act, Noncash Assets distributed in kind under this Section 7.02 will be subject to such

conditions and restrictions as are legally required, including, without limitation, such conditions and restrictions required to assure compliance by the Partners and/or the Partnership with the aggregation rules and volume limitations under Rule 144 promulgated under the Securities Act.

Section 7.03 Distributions Violative of the Act Prohibited.

Notwithstanding anything contained in this Agreement to the contrary, no distribution may be made by the Partnership if and to the extent that such distribution would violate Section 17-607 of the Act.

ARTICLE 8

Dissolution, Liquidation, Winding Up and Withdrawal

Section 8.01 Dissolution.

(a) The Partnership will be dissolved upon the first to occur of the following:

(i) subject to Section 8.04 of this Agreement, an event of withdrawal (as defined in Sections 17-101(3) and 17-402 of the Act) of the General Partner;

(ii) the later of:

(A) ten (10) years from the formation of the Partnership; or

(B) two years after all Outstanding Leverage has matured; or

(iii) the determination of the Partners to dissolve and terminate the Partnership as provided in Section 8.01(c).

(b) The Partnership will not dissolve upon the withdrawal, dissolution, bankruptcy, death or adjudication of incompetence or insanity of any Private Limited Partner.

(c) The Parent Fund may elect to dissolve the Partnership by giving notice to each Partner and SBA of the election. Any notice of an election to dissolve the Partnership may only be given:

(i) on or after the tenth (10th) anniversary of the date hereof;

(ii) if all Outstanding Leverage has been repaid or redeemed; and

(iii) if all amounts due the SBA, its agent or trustee have been paid.

Any election to dissolve the Partnership given under this Section 8.01(c) will not be effective until the later of: (A) thirty (30) days from the date the notice is given to all parties or (B) the effective date of dissolution stated in the notice.

(d) The Parent Fund and the General Partner may elect to extend the date set forth in Section 8.01(a)(ii)(A) and Section 8.01(c)(i) at any time within ninety (90) days prior to such date. Such date can be extended by any such election for up to three (3) additional successive periods of one (1) year each.

Section 8.02 Winding Up.

(a) Subject to the SBIC Act and Section 8.03, when the Partnership is dissolved, the property and business of the Partnership will be liquidated by the General Partner or if there is no General Partner or the General Partner is unable to act, a person designated by the Parent Fund.

(b) Within a reasonable period (and subject to the requirements of Treasury Regulation §§ 1.704-1(b)(ii)(g) and 1.704-1(b)(2)(ii)(b)(2)) after the effective date of dissolution of the Partnership, the affairs of the Partnership will be wound up and the Partnership's assets will be distributed as follows:

(i) First, to the payment of the debts and liabilities of the Partnership and the expenses of liquidation;

(ii) Second, to the setting up of any reserves that the General Partner may deem reasonably necessary for any contingent or unforeseen liabilities or obligations of the Partnership or of the Partners arising out of or in connection

with the Partnership;

(iii) Third, to the distribution to each of the Partners of the amounts in their respective Capital Accounts or, if the amount available is less than the aggregate amount of such Capital Accounts, then pro rata to the Partners in proportion to the amounts in their respective Capital Accounts; and

(iv) Any balance remaining shall be distributed among the Partners, pro rata in proportion their respective Percentage Interests.

Section 8.03 Withdrawal of the General Partner.

(a) Except as provided in Section 4.03, the General Partner may not withdraw as the general partner of the Partnership without the approval of the Parent Fund.

(b) To the extent required by the SBIC Act, no transfer of the interest of the General Partner, or any portion of such interest, will be effective without the consent of SBA.

(c) Subject to the limitations set forth in Section 8.03(b), Section 10.01(b), Section 10.01(d), or Section 10.01(f), any person who acquires the interest of the General Partner, or any portion of such interest, in the Partnership, will not be a General Partner but will become a special private limited partner (a "Special Private Limited Partner") upon his written acceptance and adoption of all the terms and provisions of this Agreement. Such person will acquire no more than the interest of the General Partner in the Partnership as it existed on the date of the transfer, but will not be entitled to any priority given to the Private Limited Partners, their successors and assigns, in respect of the interest. No such person will have any right to participate in the management of the affairs of the Partnership or to vote with the Private Limited Partners, and the interest acquired by such person will be disregarded in determining whether any action has been taken by any percentage of the limited partnership interests.

(d) Upon an event of withdrawal of the General Partner without continuation of the Partnership as provided in Section 8.04, the affairs of the Partnership will be wound up in accordance with the provisions of Section 8.02.

Section 8.04 Continuation of the Partnership After the Withdrawal of the General Partner.

Upon the occurrence of an event of withdrawal (as defined in the Act) of the General Partner, the Partnership will not be dissolved, if, within ninety (90) days after the event of withdrawal, the Parent Fund agrees in writing to continue the business of the Partnership and to the appointment of one or more additional general partners (subject to the approval of SBA), effective as of the date of withdrawal of the General Partner.

Section 8.05 Withdrawals of Capital.

Except as specifically provided in this Agreement, withdrawals by a Partner of any amount of its Capital Account are not permitted.

Section 8.06 Withdrawal by ERISA Regulated Pension Plans.

Notwithstanding any other provision of this Agreement, any Private Limited Partner that is (x) an "employee benefit plan" within the meaning of, and subject to the provisions of, ERISA, or (y) any other Person, any of the assets of which constitute "plan assets" of an "employee benefit plan" within the meaning of, and subject to the provisions of, ERISA, may elect to withdraw from the Partnership in whole or in part, or upon demand by the General Partner must withdraw from the Partnership in whole or in part, if either such Private Limited Partner or the General Partner obtains an opinion of counsel to the effect that, as a result of ERISA, (i) the withdrawal of the Private Limited Partner from the Partnership to such extent is required to enable the Private Limited Partner to avoid a violation of, or breach of the fiduciary duties of any person under ERISA (other than a breach of the fiduciary duties of any such person based upon the investment strategy or performance of the Partnership) or any provision of the Code related to ERISA or (ii) all or any portion of the assets of the Partnership (as opposed to the Private Limited Partner's partnership interest) constitute assets of the Private Limited Partner for purposes of ERISA and are subject to the provisions of ERISA to substantially the same extent as if owned directly by the Private Limited Partner.

Section 8.07 Withdrawal by Government Plans Complying with State and Local Law.

Notwithstanding any other provision of this Agreement, any Private Limited Partner that is a "government plan" within the meaning of ERISA may elect to withdraw from the Partnership in whole or in part, or upon

demand by the General Partner must withdraw from the Partnership in whole or in part, if either such Private Limited Partner or the General Partner obtains an opinion of counsel to the effect that as a result of state statutes, regulations, case law, administrative interpretations or similar authority applicable to the "government plan", the withdrawal of such Private Limited Partner from the Partnership to such extent is required to enable the Private Limited Partner or the Partnership to avoid a violation (other than a violation based upon the investment performance of the Partnership) of the applicable state law.

Section 8.08 Withdrawal by Government Plans Complying with ERISA.

Notwithstanding any other provision of this Agreement, any Private Limited Partner that is a "government plan" within the meaning of ERISA may elect to withdraw from the Partnership in whole or in part, if the "government plan" obtains an opinion of counsel to the effect that, as a result of ERISA, (i) the withdrawal of the "government plan" from the Partnership to such extent would be required if it were an "employee benefit plan" within the meaning of, and subject to the provisions of, ERISA, to enable the "government plan" to avoid a violation of, or breach of the fiduciary duties of any person under ERISA (other than a breach of the fiduciary duties of any such person based upon the investment strategy or performance of the Partnership) or any provision of the Code related to ERISA or (ii) all or any portion of the assets of the Partnership would constitute assets of the "government plan" for the purposes of ERISA, if the "government plan" were an "employee benefit plan" within the meaning of, and subject to the provisions of, ERISA and would be subject to the provisions of ERISA to substantially the same extent as if owned directly by the "government plan."

Section 8.09 Withdrawal by Tax Exempt Private Limited Partners.

Notwithstanding any other provision of this Agreement, any Private Limited Partner that is exempt from taxation under Section 501(a) or 501(c)(3) of the Code may elect to withdraw from the Partnership in whole or in part, if the Private Limited Partner obtains an opinion of counsel to the effect that as a result of applicable statutes, regulations, case law, administrative interpretations or similar authority, the withdrawal of the Private Limited Partner from the Partnership to such extent is required to enable the tax exempt Private Limited Partner to avoid loss of its tax exempt status under Section 501(a) or 501(c)(3) of the Code.

Section 8.10 Withdrawal by Registered Investment Companies.

Notwithstanding any other provision of this Agreement, any Private Limited Partner that is an "investment company" subject to registration under the Investment Company Act, may elect to withdraw from the Partnership in whole or in part, or upon demand by the General Partner must withdraw from the Partnership in whole or in part, if either such Private Limited Partner or the General Partner obtains an opinion of counsel to the effect that, as a result of the Investment Company Act, the withdrawal of the Private Limited Partner from the Partnership to such extent is required to enable such Private Limited Partner or the Partnership to avoid a violation of applicable provisions of the Investment Company Act or the requirement that the Partnership register as an investment company under the Investment Company Act.

Section 8.11 Distributions on Withdrawal.

(a) Subject to the provisions of this Section, upon withdrawal under any provision of this Agreement, a Private Limited Partner will have the rights to distributions provided in the Act with respect to distributions to be made to limited partners upon withdrawal from a limited partnership.

(b) The Partnership will not make any distribution to any Partner in connection with its withdrawal under any provision of this Agreement or the Act, unless the distribution is permitted by the SBIC Act and SBA has given its consent to such distribution before the distribution is made.

(c) Except in the case of distributions made as permitted under subsection (b), the right of any Partner to receive any distribution from the Partnership as a result of such Partner's withdrawal, including any right any Partner may have as a creditor of the Partnership with respect to the amount of any such distribution, is subordinate to any amount due to SBA by the Partnership.

ARTICLE 9

Accounts, Reports and Auditors

Section 9.01 Books of Account.

(a) The Partnership must maintain books and records in accordance with the provisions of the SBIC Act regarding financial accounts and reporting and, except as otherwise provided in this Agreement, generally accepted accounting principles.

(b) The books and records of the Partnership must be kept at the principal place of business of the Partnership. Each Partner will have access, upon reasonable notice and during regular business hours, to all books and records of the Partnership for all proper purposes as a Partner of the Partnership. Each Partner will have the right to receive copies of such books and records, subject to payment of the reasonable costs of such copies.

(c) The Partnership will not be required to disclose, however, any confidential or proprietary information received by the Partnership in connection with its investment operations, except for any disclosure to SBA required by the SBIC Act.

Section 9.02 Audit and Report.

(a) The financial statements of the Partnership must be audited and certified as of the end of each fiscal year by a firm of independent certified public accountants selected by the Partnership.

(b) Within ninety (90) days of the end of each fiscal year, the Partnership must prepare and mail to each Partner a report prepared in accordance with the provisions of the SBIC Act regarding financial reporting, setting forth as at the end of the fiscal year:

(i) a balance sheet of the Partnership;

(ii) a statement of operations for the year;

(iii) a statement of cash flows;

(iv) a statement of changes in partners' capital, and such Partner's Closing Capital Account;

(v) a statement of the Assets, valued as provided under this Agreement;

(vi) the amount of such Partner's share in the Partnership's taxable income or loss for the year, in sufficient detail to enable it to prepare its Federal, state and other tax returns;

(vii) any other information the General Partner, after consultation with any Private Limited Partner requesting the same, deems necessary or appropriate;

(viii) upon request by any Partner, such other information as is needed by such Partner in order to enable it to file any of its tax returns; and

(ix) such other information as any Partner may reasonably request for the purpose of enabling it to comply with any reporting or filing requirements imposed by any statute, rule, regulation or otherwise by any governmental agency or authority.

The items set forth in clauses (i), (ii), (iii), (iv), (v) and (vi) of this Section 9.02(b) will be certified by the firm of independent certified public accountants selected by the Partnership

(c) Within forty-five (45) days of the end of each of the fiscal quarters, the Partnership will prepare and mail to each Partner a report of the General Partner prepared in accordance with the provisions of the SBIC Act regarding financial reporting setting forth the information described in Section 9.02(b)(i) - (iv), identifying the securities held by the Partnership and stating the amount of each security held and the cost and value thereof as determined under Section 3.08.

Section 9.03 Fiscal Year.

The fiscal year of the Partnership will be a twelve-month year (except for the first and last partial years, if any) ending on December 31.

ARTICLE 10

Miscellaneous

Section 10.01 Assignability.

(a) No Private Limited Partner may assign, pledge or otherwise grant a security interest in its or his interest in the Partnership or in this Agreement, except with the prior written consent of the General Partner (which consent may be withheld in the absolute discretion of the General Partner).

(b) No General Partner or Private Limited Partner may transfer any interest of ten percent (10%) or more in the capital of the Partnership without the prior approval of SBA.

(c) The General Partner may not assign, pledge or otherwise grant a security interest in its interest in the Partnership or in this Agreement, except with the prior consent of SBA and the prior approval of the Parent Fund.

(d) No transfer of any interest in the Partnership will be allowed if such transfer or the actions to be taken in connection with that transfer would:

(i) result in any violation of the SBIC Act ;

(ii) result in a violation of any law, rule or regulation by the Partnership;

(iii) cause the termination or dissolution of the Partnership;

(iv) cause the Partnership to be classified other than as a partnership for Federal income tax purposes;

(v) result in the transfer of a limited partnership interest with a cost of less than \$20,000 or cause the Partnership to be classified as a "publicly traded partnership" within the meaning of Section 469(k)(2) of the Code or for the purposes of Section 512(c)(2) of the Code;

(vi) result in a violation of the Securities Act;

(vii) require the Partnership to register as an investment company under the Investment Company Act;

(viii) require the Partnership, the General Partner or the Investment Adviser/Manager to register as an investment adviser under the Investment Advisers Act; or

(ix) result in a termination of the Partnership for Federal or state income tax purposes.

(e) If a natural person Private Limited Partner dies or become incapacitated, his or her legal representative will, upon execution of a counterpart of this Agreement, be substituted as a Private Limited Partner, subject to all the terms and conditions of this Agreement.

(f) Any transferee of any interest in the Partnership by a transfer in compliance with this Section will become a substituted Partner under this Agreement upon delivery and execution of a counterpart of this Agreement, will have the same rights and responsibilities under this Agreement as its assignor and will succeed to the Capital Account and balances thereof.

Section 10.02 Binding Agreement.

Subject to the provisions of Section 10.01, this Agreement is binding upon, and inures to the benefit of, the heir, successor, assign, executor, administrator, committee, guardian, conservator or trustee of any Partner.

Section 10.03 Gender.

As used in this Agreement, masculine, feminine and neuter pronouns include the masculine, feminine and neuter; and the singular includes the plural.

Section 10.04 Notices.

(a) All notices under this Agreement must be in writing and may be given by personal delivery, telex, telegram, private courier service or registered or certified mail.

(b) A notice is deemed to have been given:

(i) by personal delivery, telex, telegram, or private courier service, as of the day of delivery of the notice to the addressee; and

(ii) by mail, as of the fifth (5th) day after the notice is mailed.

(c) Notices must be sent to:

(i) the Partnership, at the address of the General Partner in the Certificate of Limited Partnership, or such other address or addresses as to which the Partners have been given notice;

(ii) the Private Limited Partners, at the addresses in Schedule A attached to this Agreement (as Schedule A may be amended from time to time) or such other addresses as to which the Partnership has been given notice; and

(iii) SBA, at the address of the Investment Division of SBA and, if so required under any Section of this Agreement, in duplicate at the address of the Office of the General Counsel of SBA.

Section 10.05 Consents and Approvals.

A consent or approval required to be given by any party under this Agreement will be deemed given and effective for purposes of this Agreement only if the consent or approval is:

(i) given by such party in writing, and

(ii) delivered by such party to the party requesting the consent or approval in the manner provided for notices to such party under Section 10.04.

Section 10.06 Counterparts.

This Agreement and any amendment to this Agreement may be executed in more than one counterpart with the same effect as if the parties executed one counterpart as of the day and year first above written on this Agreement or any such amendment. To be effective, each separate counterpart must be executed by the General Partner.

Section 10.07 Amendments.

(a) **This Agreement may not be amended except by an instrument in writing executed by the Parent Fund and the General Partner, and approved by SBA.**

(b) In addition to the requirements in Section 10.06 and Section 10.07(a), any amendment that:

(i) increases the amount of a Private Limited Partner's Commitment requires that Partner's consent;

(ii) may cause a Private Limited Partner to become liable as a general partner of the Partnership requires the written consent of all Partners;

(iii) amends this Section requires the consent of all Partners; or

(iv) dilutes the relative interest of any Private Limited Partner in the profits or capital of the Partnership or in allocations or distributions attributable to the ownership of such interest requires that Partner's consent;

(c) Each Private Limited Partner consents to:

(i) any amendment of this Agreement or the Certificate of Limited Partnership to comply with or conform to any amendments of applicable laws governing the Partnership; and

(ii) any amendment to this Agreement that the General Partner reasonably determines is necessary or advisable in connection with Partnership's efforts to receive a license to operate as an SBIC; provided, however, that such consent with respect to any such amendment is contingent on the General Partner having reasonably determined that such amendment will not subject any Private Limited Partner (or any limited partner of any Private Limited Partner) to any material adverse economic consequences, alter or waive the right to receive allocations and distributions that otherwise would be made to any Private Limited Partner (or any limited partner of any Private Limited Partner), or alter or waive in any material respect the duties and obligations of the General Partner to the Partnership or any Private Limited Partner (or any limited partner of any Private Limited Partner).

(d) The General Partner must distribute to each Private Limited Partner and SBA a copy of:

- (i) any Certificate of Amendment to the Certificate of Limited Partnership, and**
- (ii) any amendment to this Agreement.**

(e) Copies of any Certificate of Amendment to the Certificate of Limited Partnership, and any amendment to this Agreement must be distributed in the same manner as provided for notices in Section 10.04.

Section 10.08 Power of Attorney.

(a) Each Private Limited Partner appoints the General Partner, and each general partner of the General Partner, as its true and lawful representative and attorney-in-fact, in its name, place and stead, to make, execute, sign and file:

(i) any amendments of this Agreement necessary to reflect an amendment of this Agreement adopted by the Partners under Section 10.07; and

(ii) all instruments, documents and certificates which, from time to time, may be required by the law of the United States of America, the State of Delaware or any other state in which the Partnership determines to do business, or any political subdivision or agency thereof, to execute, implement and continue the valid and subsisting existence of the Partnership and in conformance to the provisions of this Agreement.

(b) The General Partner and its partners, as representatives and attorneys-in-fact, do not have any rights, powers or authority to amend or modify this Agreement when acting in such capacity, except as expressly provided in this Agreement. This power of attorney is coupled with an interest and will continue in full force and effect notwithstanding the subsequent death or incapacity of such party.

Section 10.09 Applicable Law.

This Agreement is governed by, and construed in accordance with, applicable Federal laws and the laws of the State of Delaware.

Section 10.10 Severability.

If any one or more of the provisions contained in this Agreement, or any application of any such provision, is invalid, illegal, or unenforceable in any respect, the validity, legality and enforceability of the remaining provisions contained in this Agreement and all other applications of any such provision will not in any way be affected or impaired.

Section 10.11 Entire Agreement.

This Agreement, and all other written agreements executed by or on behalf of the General Partner and/or the Private Limited Partners and executed or approved by SBA, up to and including the date of this Agreement (such other written agreements, collectively, the "SBA Agreements"), state the entire understanding among the parties relating to the subject matter of this Agreement and the SBA Agreements. Any and all prior conversations, correspondence, memoranda or other writings are merged in, and replaced by this Agreement and the SBA Agreements, and are without further effect on this Agreement and the SBA Agreements. No promises, covenants, representations or warranties of any character or nature other than those expressly stated in this Agreement and the SBA Agreements have been made to induce any party to enter into this Agreement or any SBA Agreement.

IN WITNESS WHEREOF, the parties to this Agreement have executed this Agreement as of the date first written above.

General Partner:

Rand Capital Management, LLC

By: /s/ Allen F. Grum, Jr.

Name: Allen F. Grum, Jr.

Title: President

Commitment Amount:

\$50,000

Private Limited Partner:

Rand Capital Corporation

By: /s/ Allen F. Grum, Jr.

Name: Allen F. Grum, Jr.

Title: President

Commitment Amount:

\$5,000,000

Address of Private Limited Partner:

2200 Rand Building

Buffalo, NY 14203

Federal Tax I.D. Number:

SCHEDULE A

Partners and Commitments

<u>Partners:</u>	<u>Commitments</u>
<u>Private Limited Partner:</u>	
Rand Capital Corporation 2200 Rand Building Buffalo, NY 14203	\$5,000,000
<u>General Partner:</u>	
Rand Capital Management, LLC 2200 Rand Building Buffalo, NY 14203	\$50,000
TOTAL	\$5,050,000

EXHIBIT I

Valuation Guidelines

General

The General Partner has sole responsibility for determining the Asset Value of each of the Loans and Investments and of the portfolio in the aggregate.

Loans and Investments shall be valued individually and in the aggregate at least semi-annually - as of the end of the second quarter of the fiscal year-end and as of the end of the fiscal year. Fiscal year-end valuations are audited as set forth in SBA's Accounting Standards and Financial Reporting Requirements for Small Business Investment Companies.

This Valuation Policy is intended to provide a consistent, conservative basis for establishing the Asset Value of the portfolio. The Policy presumes that Loans and Investments are acquired with the intent that they are to be held until maturity or disposed of in the ordinary course of business.

Interest-Bearing Securities

Loans shall be valued in an amount not greater than cost with Unrealized Depreciation being recognized when value is impaired. The valuation of loans and associated interest receivables on interest-bearing securities should reflect the portfolio concern's current and projected financial condition and operating results, its payment history and its ability to generate sufficient cash flow to make payments when due.

When a valuation relies more heavily on asset versus earnings approaches, additional criteria should include the seniority of the debt, the nature of any pledged collateral, the extent to which the security interest is perfected, the net liquidation value of tangible business assets, and the personal integrity and overall financial standing of the owners of the business. In those instances where a loan valuation is based on an analysis of certain collateralized assets of a business or assets outside the business, the valuation should, at a minimum, consider the net liquidation value of the collateral after reasonable selling expenses. Under no circumstances, however, shall a valuation based on the underlying collateral be considered as justification for any type of loan appreciation.

Appropriate unrealized depreciation on past due interest which is converted into a security (or added to an existing security) should be recognized when collection is doubtful. Collection is presumed to be in doubt when one or both of the following conditions occur: (i) interest payments are more than 120 days past due; or (ii) the small concern is in bankruptcy, insolvent, or there is substantial doubt about its ability to continue as a going concern.

The carrying value of interest bearing securities shall not be adjusted for changes in interest rates.

Valuation of convertible debt may be adjusted to reflect the value of the underlying equity security net of the conversion price.

Equity Securities - Private Companies

Investment cost is presumed to represent value except as indicated elsewhere in these guidelines.

Valuation should be reduced if a company's performance and potential have significantly deteriorated. If the factors which led to the reduction in valuation are overcome, the valuation may be restored.

The anticipated pricing of a Small Concern's future equity financing should be considered as a basis for recognizing Unrealized Depreciation, but not for Unrealized Appreciation. If it appears likely that equity will be sold in the foreseeable future at a price below the Licensee's current valuation, then that prospective offering price should be weighed in the valuation process.

Valuation should be adjusted to a subsequent significant equity financing that includes a meaningful portion of the financing by a sophisticated, unrelated new investor. A subsequent significant equity financing that includes substantially the same group of investors as the prior financing should generally not be the basis for an adjustment in valuation. A financing at a lower price by a sophisticated new investor should cause a reduction in value of the prior securities.

If substantially all of a significant equity financing is invested by an investor whose objectives are in large part strategic, or if the financing is led by such an investor, it is generally presumed that no more than 50% of the increase

in investment price compared to the prior significant equity financing is attributable to an increased valuation of the company.

Where a company has been self-financing and has had positive cash flow from operations for at least the past two fiscal years, Asset Value may be increased based on a very conservative financial measure regarding P/E ratios or cash flow multiples, or other appropriate financial measures of similar publicly-traded companies, discounted for illiquidity. Should the chosen valuation cease to be meaningful, the valuation may be restored to a cost basis, or if of significant deterioration in performance or potential, to a valuation below cost to reflect impairment.

With respect to portfolio companies that are likely to face bankruptcy or discontinue operations for some other reason, liquidating value may be employed. This value may be determined by estimating the realizable value (often through professional appraisals or firm offers to purchase) of all assets and then subtracting all liabilities and all associated liquidation costs.

Warrants should be valued at the excess of the value of the underlying security over the exercise price.

Equity Securities - Public Companies

Public securities should be valued as follows: (a) For over-the-counter stocks, take the average of the bid price at the close for the valuation date and the preceding two days, and (b) for listed stocks, take the average of the close for the valuation date and the preceding two days.

The valuation of public securities that are restricted should be discounted appropriately until the securities may be freely traded. Such discounts typically range from 10% to 40%, but the discounts can be more or less, depending upon the resale restrictions under securities laws or contractual agreements.

When the number of shares held is substantial in relation to the average daily trading volume, the valuation should be discounted by at least 10%, and generally by more.

CERTIFICATE OF LIMITED PARTNERSHIP
OF
RAND CAPITAL SBIC, L.P.

The undersigned, desiring to form a limited partnership pursuant to the Delaware Revised Uniform Limited Partnership Act, 6 Delaware Code, Chapter 17, do hereby certify as follows:

- I. The name of the limited partnership is Rand Capital SBIC, L.P.
- II. The address of the Partnership's registered office in the State of Delaware is Corporation Trust Center, 1209 Orange Street, Wilmington, County of New Castle. The name of the Partnership's registered agent for service of process in the State of Delaware at such address is The Corporation Trust Company.
- III. The name and mailing address of the sole general partner is as follows:

NAME

Rand Capital Management, LLC

MAILING ADDRESS

2200 Rand Building
Buffalo, NY 14203

IN WITNESS WHEREOF, the undersigned have executed this Certificate of Limited Partnership of Rand Capital SBIC, L.P., as of January 11, 2002.

By: Rand Capital Management, LLC
General Partner

By: /s/ Allen F. Grum, Jr.
Allen F. Grum, Jr.
Member

**Rand Capital Management, LLC
(A Delaware Limited Liability Company)**

LIMITED LIABILITY COMPANY AGREEMENT

Dated as of January 16, 2002

LIMITED LIABILITY COMPANY AGREEMENT

RAND CAPITAL MANAGEMENT, LLC

This LIMITED LIABILITY COMPANY AGREEMENT (this "**Agreement**") of Rand Capital Management, LLC, a Delaware limited liability company (the "**Company**"), is entered into this 16th day of January, 2002, by the Member set forth on Schedule A attached hereto as such Schedule A may be amended from time to time pursuant to this Agreement. The Member agrees as follows:

RECITALS

WHEREAS, on January 14, 2002, an authorized person filed a Certificate of Formation forming the Company as a limited liability company under the Delaware Limited Liability Company Act, 6 Del. C. Section 18-101 *et seq.* (as amended from time to time, the "**Act**"), with the Secretary of State of the State of Delaware (as such certificate may be amended from time to time by additional filings with the Secretary of State of the State of Delaware, the "**Certificate**"); and

WHEREAS, the Member has agreed to enter into this Agreement to continue the Company for the sole purpose of managing one or more small business investment companies licensed under the Small Business Investment Act of 1958, as amended (each, an "**SBIC**"), and to operate the Company in accordance with the terms and subject to the conditions set forth in this Agreement.

NOW, THEREFORE, for and in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Member, intending legally to be bound, agrees as follows:

**ARTICLE 1
DEFINITIONS**

As used herein, the following capitalized terms shall have the meanings specified in this Article unless the context otherwise specifies. Other terms are defined in the text of this Agreement; and, throughout this Agreement, those terms shall have the meanings respectively ascribed to them. Section references, unless otherwise specified, are references to sections of this Agreement.

"**Act**" means the Delaware Limited Liability Company Act, 6 Del. C. Section 18-101 *et seq.*, as amended from time to time.

"**Affiliate**" means, with respect to any Person, any other Person that directly or indirectly controls, is controlled by, or is under common control with that Person. For purposes of this definition, a Person shall be deemed to control an

entity of which he is an officer, director or general partner or in which such Person is the beneficial owner of ten percent (10%) or more of the outstanding voting securities.

"**Agreement**" means this written Limited Liability Company Agreement of the Company, which is binding on the Member, as such Agreement may be amended in writing from time to time by the Member.

"**Book Value**" means, with respect to any Company asset, the asset's adjusted basis for federal income tax purposes, except that the Book Values of all Company assets shall be adjusted to equal their respective Fair Market Values, in accordance with the rules set forth in Section 1.704-1(b)(2)(iv)(f) of the Regulations, except as otherwise provided in this Agreement, immediately prior to: (a) the date of the acquisition of any additional Interest by any new or existing Member in exchange for more than a de minimis Capital Contribution; (b) the date of the actual distribution of more than a de minimis amount of Company property (other than a pro rata distribution) to a Member; or (c) the date of the actual liquidation of the Company within the meaning of Section 1.704-1(b)(2)(ii)(g) of the Regulations; *provided* that adjustments pursuant to clauses (a) and (b) above shall be made only if the Member determines in its sole discretion that such adjustments are necessary or appropriate to reflect the relative economic interests of the Member. The Book Value of any Company asset distributed to the Member shall be adjusted immediately prior to such distribution to equal its Fair Market Value. The Book Value of any Company asset shall be adjusted to reflect any write-down that constitutes a disposition of such asset.

"**Capital Contribution**" means, with respect to each Member, any contribution to the capital of the Company by such Member as provided in this Agreement.

"**Certificate**" means the Company's Certificate of Formation as filed with the Secretary of State of Delaware, as such Certificate may be amended from time to time by additional filings with the Secretary of State of Delaware.

"**Code**" means the Internal Revenue Code of 1986, as amended, or any corresponding provision of any succeeding law.

"**Company**" means Rand Capital Management, LLC, a Delaware limited liability company.

"**Conditions of Transfer**" shall have the meaning set forth in **Section 6.1(a)**.

"**Fair Market Value**" of an asset means its fair market value as determined in accordance with the investment guidelines provided in the Fund Agreement.

"**Fund**" means Rand Capital SBIC, L.P., a Delaware limited partnership.

"**Fund Agreement**" means the Agreement of Limited Partnership of the Fund, as amended from time to time.

"**Indemnified Party**" shall have the meaning set forth in **Section 5.4**.

"**Interest**" means all of the Member's rights and interests in the Company in its capacity as a member of the Fund.

"**Investment Company Act**" means the Investment Company Act of 1940, as amended, or any corresponding provision of any succeeding law.

"**Management Committee**" shall have the meaning set forth in **Section 5.2**.

"**Member**" means that Member set forth in Schedule A and any additional substitute Member duly accepted pursuant to the terms of this Agreement, provided no such Member has dissociated from the Company pursuant to this Agreement or the Act.

"**Person**" means an individual, a general partnership, a limited partnership, a domestic or foreign limited liability company, a trust, an estate, an association, a corporation, or any other legal or commercial entity.

"**Property**" means all properties and assets, whether tangible or intangible, that the Company may own or otherwise have an interest in from time to time whether held in the name of the Company or in the name of the Member, manager, agent or other nominee if the Member, manager, agent or nominee is identified or holds himself out as a nominee for the Company.

"**Rand**" means Rand Capital Corporation, a New York corporation and business development company as defined in Section 2(a)(48) of the Investment Company Act.

"**Regulations**" means the income tax regulations, including any temporary regulations, from time to time promulgated under the Code.

"**SBA**" means the U.S. Small Business Administration.

"**SBIC**" means a small business investment company licensed under the Small Business Investment Act of 1958, as amended.

"**Tax Matters Member**" shall have the meaning set forth in Section 8.5.

"**Transfer**" means, when used as a noun, any voluntary sale, hypothecation, pledge, assignment, attachment or other transfer, and, when used as a verb, means voluntarily to sell, hypothecate, pledge, assign or otherwise transfer.

ARTICLE 2 GENERAL PROVISIONS

2.1 ORGANIZATION. The Member formed the Company as a Delaware limited liability company by filing the Certificate with the Secretary of State of the State of Delaware on January 14, 2002.

2.2 NAME. The name of the Company is Rand Capital Management, LLC. The Company may do business under that name and under any other name or names approved by the Member. If the Company does business under a name other than that set forth in its Certificate, then the Company shall file a trade name certificate as required by law.

2.3 PURPOSE. The Company is organized solely to serve as the general partner of Rand Capital SBIC, L.P., a Delaware limited partnership (the "**Fund**"), which is applying for a license from the SBA to operate as an SBIC, and to operate, manage and maintain the Fund pursuant to the Agreement of Limited Partnership of the Fund, as amended from time to time (the "**Fund Agreement**"), and, subject to Section 3.01 of the Fund Agreement, one or more additional SBICs that may be formed and licensed in the future, and in furtherance thereof to engage in any lawful act or activity for which a limited liability company may be organized under the Act. In furtherance of the Company's purpose, the Company shall make the initial cash contribution, and the additional contributions, stated in the Fund Agreement.

2.4 TERM. The Company began upon the filing of the Certificate and shall terminate thirty (30) days following the termination of the Fund, unless the term is extended by the Member.

2.5 PRINCIPAL OFFICE. The principal office of the Company shall be at 2200 Rand Building, Buffalo, NY 14203, or at any other place designated by the Member.

2.6 RESIDENT AGENT. The name and address of the Company's initial resident agent in the State of Delaware is The Corporation Trust Company, 1209 Orange Street, Wilmington, Delaware 19801. Any change in the resident agent or the resident agent's business or residence address shall be timely filed with the Secretary of State of Delaware.

2.7 MEMBER. The name, present mailing address and maximum Capital Contributions of the Member are set forth on Schedule A hereto.

ARTICLE 3 CAPITAL

3.1 CAPITAL CONTRIBUTIONS.

a. The current maximum Capital Contributions required to be made by the Member pursuant to this **Section 3.1** is set forth on Schedule A hereto.

b. Except as otherwise provided in this **Section 3.1**, the Member shall not be required to contribute any capital to the Company. The Member shall not have any personal liability for any obligation of the Company.

c. In the event that the Company is required to contribute capital to the Fund, the Member shall make a Capital Contribution to the Company in such amount.

d. Each contribution of capital to the Company shall be made by means of a check or by wire transfer of funds to an account designated by the Company.

3.2 NO INTEREST ON CAPITAL CONTRIBUTIONS. The Member shall not be paid interest on its Capital Contributions.

3.3 RETURN OF CAPITAL CONTRIBUTIONS. Except as otherwise provided in this Agreement, the Member shall not have the right to receive any return of any Capital Contribution. If the Member is entitled to receive a return of a Capital Contribution, the Company may distribute cash, notes, Property or a combination thereof to the Member in return of the Capital Contribution.

ARTICLE 4 DISTRIBUTIONS

4.1 DISTRIBUTIONS GENERALLY. Distributions of cash and/or securities received by the Company shall be made to the Member from time to time as determined by the Company in its sole and absolute discretion.

4.2 DISTRIBUTIONS IN KIND. If any assets of the Company are distributed in kind to the Member, those assets shall be valued on the basis of their Fair Market Value. The profit or loss for each unsold asset shall be determined as if the asset had been sold at its Fair Market Value, and the profit or loss shall be allocated as provided in **Section 4.1**.

ARTICLE 5 MANAGEMENT: RIGHTS, POWERS AND DUTIES

5.1 MANAGEMENT.

a. Subject to **Section 5.2**, the Company shall be managed by the Member, which shall have the right, power and authority, to manage, operate and control the business and affairs of the Company and to do or cause to be done any and all acts, at the expense of the Company, deemed by the Member to be necessary or appropriate to effectuate the purposes of the Company. No other person may manage the Company without the prior approval of the SBA and the Member. Except as otherwise provided in the Agreement (including **Section 5.2**), all decisions and determinations with respect to the management or operation of the Company shall be made by the Member.

b. Without limiting the foregoing, the Member may make a decision or determination with respect to the management or operation of the Company in its discretion with respect to the following matters:

- i. open, maintain and close accounts for the Company and the Fund;
- ii. retain and dismiss investment bankers, attorneys, accountants, consultants, custodians, contractors, nominees and other agents of the Company and the Fund;
- iii. execute on behalf of the Company, as general partner of the Fund, any agreement between the Company and the Fund, or any amendment or termination thereof, where the amount at issue is less than \$25,000;
- iv. enter into, make and perform contracts, agreements and other undertakings on behalf of the Company or the Fund with third parties where the amount at issue is less than \$25,000; and
- v. expend any sum of money in an amount less than \$10,000.

c. To the extent any action by the Company has been appropriately authorized in accordance with this **Article 5**, the Member shall have the right to act for and bind the Company to such action.

d. The Member's board of directors shall at all times be comprised of a majority of individuals who are not "interested persons" (as defined in Section 2(a)(19) of the Investment Company Act) of the Company or the Member. If at any time the Member's board of directors fails to meet this standard, the Member will take action within 90 days to correct that condition.

5.2 MANAGEMENT COMMITTEE. There is hereby established a management committee of the Company (the "**Management Committee**"), which initially shall consist of Allen F. Grum, Jr. and Daniel P. Penberthy. The Management Committee shall have the power to cause the Company to make investment decisions on behalf of the Fund, including decisions to acquire or sell or otherwise dispose of investments. All decisions of the Management Committee shall require the unanimous consent of its members. A person may be added to the Management Committee only with the prior written approval of the Member and the SBA. In addition, the Member may remove any or all of the members of the Management Committee in its discretion and with the approval of the SBA. If the Member removes all of such members according to this **Section 5.2**, then the Member may perform the duties described in this **Section 5.2** or appoint one or more Persons to perform such duties, in either case with the approval of the SBA. When making investment decisions, the members of the Management Committee and the Member shall meet the standard of care set forth in Section 3.09 of the Fund Agreement.

5.3 DUTIES OF CARE. The Member shall exercise its best judgment in carrying out its obligations hereunder. The Member, its Affiliates and the members of the Management Committee shall not be liable to the Company or to one another for any loss suffered by the Company or the Member which arises out of any action or omission of the Member, its Affiliates or a member of the Management Committee, provided that the action taken or omitted to be taken by the Member, Affiliate or member of the Management Committee was taken or omitted to be taken in good faith and in a manner the Member, its Affiliate or member of the Management Committee reasonably believed to be in or not opposed to the best interests of the Company, and, with respect to any criminal action or proceeding, had no reasonable cause to believe its conduct was unlawful.

5.4 INDEMNIFICATION. Except as otherwise required by law or the provisions of this Agreement, the Company shall indemnify the Member and its owners, directors, officers, employees or agents and the members of the Management Committee (each, an "**Indemnified Party**") against any losses, liabilities, damages or expenses (including amounts paid for attorneys' fees, judgments and settlements in connection with any threatened, pending or completed action, suit or proceeding) to which any of such Persons may directly or indirectly become subject for action taken or omitted to be taken consistent with the duty of care set forth in **Section 5.3**; *provided, however*, that no Indemnified Party shall be entitled to collect any amounts pursuant to the provisions of this **Section 5.4** unless such Indemnified Party has previously exhausted such Indemnified Party's claim for indemnification from the Fund for such losses, liabilities, damages or expenses pursuant to the provisions in Section 3.10 of the Fund Agreement.

5.5 AGREEMENTS WITH MEMBER. The Company may acquire Property from or lease or sell Property to, borrow money from or lend money to, enter into any agreement or contract with, or reimburse for reasonable out-of-pocket expenses incurred in connection with business of the Company, the Member, any Affiliate of the Member or other Person related to the Member, or any member of the Management Committee on such arms-length terms and conditions as the Member shall determine to be appropriate.

ARTICLE 6 TRANSFER OF INTERESTS

6.1 TRANSFERS.

a. The Member may not Transfer an Interest unless all of the following conditions ("**Conditions of Transfer**") are satisfied:

- i. the Transfer will not require registration of Interests under any federal or state securities laws;
- ii. the transferee delivers to the Company a written instrument agreeing to be bound by the terms of this Agreement;
- iii. the Transfer will not result in the termination of the Company pursuant to Code Section 708;
- iv. the Transfer will not result in the Company being subject to the Investment Company Act of 1940, as amended; and
- v. the transferor or the transferee delivers the following information to the Company: (1) the transferee's taxpayer identification number; and (2) the transferee's initial tax basis in the Interest.

b. If the Conditions of Transfer are satisfied, then the Member may Transfer all, but not less than all, of its Interest; *provided, however*, that the transferee shall be admitted as a Member and be entitled to exercise the rights of a Member only, if applicable under the SBIC Act, the consent of the SBA has been obtained and the transferee has executed and delivered this Agreement.

c. A transferee that is not admitted as a Member shall have, with respect to the transferred Interest, the economic rights to receive distributions and allocations, and shall have the obligation to make capital contributions pursuant to **Section 3.1** but shall not be entitled to vote on matters coming before the Members, participate in the management of the Company, act as an agent of the Company, or have any other non-economic rights of a "member" of the Company.

d. The Member hereby acknowledges the reasonableness of the prohibition contained in this **Section 6.1** in view of the purposes of the Company. The Transfer of any Interest in violation of the prohibition contained in this **Section 6.1** shall be deemed invalid, null and void, and of no force or effect.

e. The Member and the transferee of the Member's Interest shall be jointly and severally obligated to reimburse the Company for all reasonable expenses (including attorneys' fees and expenses) of any Transfer or proposed Transfer

of the Member's Interest, whether or not consummated.

f. The transferee of the Member's Interest shall be treated as having made all of the Capital Contributions made by, and received all of the distributions received by the transferor of such Interest.

ARTICLE 7 DISSOLUTION

7.1 EVENTS OF DISSOLUTION.

The Company shall be dissolved and shall commence the winding up of its affairs upon the occurrence of any of the following events: (i) at the time specified by the Member; or (ii) the occurrence of any other event that, under the Act (taking into account the applicable provisions of this Agreement), would cause the dissolution of the Company or that would make it unlawful for the business of the Company to be continued. Notwithstanding the foregoing, the Company shall not be dissolved at any time prior to the dissolution of the Fund.

7.2 PROCEDURE FOR WINDING UP AND DISSOLUTION . If the Company is dissolved, the Member shall wind up its affairs. On winding up of the Company, the assets of the Company, subject to applicable provisions of the Act, shall be distributed in the following manner and order:

- a. First, to the payment of the expenses of liquidation;
- b. Second, in satisfaction of the debts and liabilities of the Company owing to creditors of the Company other than members of the Company;
- c. Third, to the setting up of any reserves that the Member may deem reasonably necessary for any contingent or unforeseen liabilities or obligations of the Company;
- d. Fourth, in satisfaction of the debts and liabilities of the Company owing to creditors of the Company that are members of the Company; and
- e. Thereafter, to the Member.

7.3 FILING OF CERTIFICATE OF CANCELLATION. If the Company is dissolved, the Member shall promptly file a Certificate of Cancellation with the Secretary of State of Delaware.

ARTICLE 8 BOOKS, RECORDS, ACCOUNTING AND TAX ELECTIONS

8.1 BANK ACCOUNTS. All funds of the Company shall be deposited in a bank account or accounts maintained in the Company's name. The Member shall determine the institution or institutions at which the accounts will be opened and maintained, the types of accounts, and the Persons who will have authority with respect to the accounts and the funds therein.

8.2 BOOKS AND RECORDS.

a. The Member shall keep or cause to be kept complete and accurate books and records of the Company and supporting documentation of the transactions with respect to the conduct of the Company's business. The records shall include, but not be limited to, complete and accurate information regarding the state of the business and financial condition of the Company, copies of the Certificate and this Agreement and all amendments to the Certificate and this Agreement; a current list of the name and last known business, residence, or mailing addresses of the Member; and the Company's federal, state, or local tax returns.

b. The books and records shall be maintained in accordance with sound accounting practices and shall be available at the Company's Principal Office for examination by the Member or the Member's duly authorized representative at any and all reasonable times during normal business hours.

8.3 ANNUAL ACCOUNTING PERIOD AND FISCAL YEAR. The annual accounting period of the Company and the fiscal year of the Company shall be the calendar year, subject to the requirements and limitations of the Code.

8.4 REPORTS. Within ninety (90) days after the end of each fiscal year of the Company, the Member shall cause to be sent to each Person who was a Member at any time during the accounting year then ended: (i) an annual compilation report, prepared by the Company's independent accountants in accordance with standards issued by the American

Institute of Certified Public Accountants; and (ii) a report summarizing the fees and other remuneration paid by the Company to the Member or any Affiliate in respect of the fiscal year. In addition, within seventy-five (75) days after the end of each fiscal year of the Company, the Member shall cause to be sent to each Person who was a Member at any time during the fiscal year then ended, that tax information concerning the Company which is necessary for preparing the Member's income tax returns for that year. At the request of the Member, and at the Member's expense, the Member shall cause an audit of the Company's books and records to be prepared by independent accountants for the period requested by the Member.

8.5 TAX MATTERS MEMBER. The Member shall be the Company's tax matters Member (the "**Tax Matters Member**"). The Tax Matters Member shall have all the powers and responsibilities provided to a tax matters partner in Code Section 6221 *et seq.* The Tax Matters Member shall keep the Company informed of all notices from government taxing authorities which may come to the attention of the Tax Matters Member. The Company shall pay and be responsible for all reasonable third-party costs and expenses incurred by the Tax Matters Member in performing those duties. The Member shall be responsible for any costs incurred by the Member with respect to any tax audit or tax-related administrative or judicial proceeding against the Member, even though it relates to the Company.

8.6 TAX ELECTIONS. The Tax Matters Member shall have the authority to make all Company elections permitted under the Code, including, without limitation, elections of methods of depreciation and elections under Code Section 754.

ARTICLE 9 GENERAL

9.1 ENTIRE AGREEMENT; AMENDMENT.

a. This Agreement (together with the Certificate) contains the entire agreement by the Member, in such capacity, relative to the formation, operation and continuation of the Company. This Agreement supersedes all prior written and oral statements, including any prior representation, statement, condition or warranty.

b. This Agreement may be modified or amended only by the Member and, if required by the Small Business Investment Act of 1958, as amended, and the regulations thereunder, with the prior written consent of the SBA.

c. Upon the advice of counsel to the Company, this Agreement or the Certificate may be amended by the Member from time to time to make such amendments which, in the opinion of counsel, are necessary or advisable to ensure (i) the classification of the Company as a partnership for federal income tax purposes and (ii) the limited liability of the Member (in its capacity as such); provided that any such amendments (x) shall be in writing, (y) shall not reduce the rights of any Member that has not consented to the amendment to receive distributions from the Company and (z) shall be delivered to each Member and to each assignee of a Member who has not been admitted as a Member.

9.2 ARBITRATION. Any dispute, controversy or claim arising out of, in connection with, or relating to this Agreement or any breach or alleged breach thereof shall be determined and settled by arbitration in Buffalo, New York, pursuant to the rules then in effect of the American Arbitration Association. Any award shall be final, binding and conclusive upon the parties, and a judgment rendered thereon may be entered in any court having jurisdiction thereof. This **Section 9.2** shall not apply to the SBA.

9.3 WAIVER OF DEFAULT. No consent or waiver, express or implied, by the Company with respect to any breach or default by the Member hereunder shall be deemed or construed to be a consent or waiver with respect to any other breach or default by the Member of the same provision or any other provision of this Agreement. Failure on the part of the Company to complain of any act or failure to act of the Member or to declare the Member in default shall not be deemed or constitute a waiver by the Company of any rights hereunder.

9.4 NO THIRD PARTY RIGHTS. None of the provisions contained in this Agreement shall be for the benefit of or enforceable by any third parties, including creditors of the Company.

9.5 SEVERABILITY. In the event any provision of this Agreement is held to be illegal, invalid or unenforceable to any extent, the legality, validity and enforceability of the remainder of this Agreement shall not be affected thereby and shall remain in full force and effect and shall be enforced to the greatest extent permitted by law.

9.6 BINDING AGREEMENT. Subject to the restrictions on the disposition of Interests herein contained, the provisions of this Agreement shall be binding upon, and inure to the benefit of, the parties hereto and their respective heirs, personal representatives, executors, successors and permitted assigns.

9.7 HEADINGS. The headings of the Sections of this Agreement are for convenience only and do not define, limit or describe the scope of this Agreement or the intent of any of the terms or provisions hereof.

9.8 COUNTERPARTS. This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original and all of which shall constitute one (1) agreement that is binding upon all of the parties hereto, notwithstanding that all parties are not signatories to the same counterpart.

9.9 GOVERNING LAW. All questions concerning the construction, validity, and interpretation of this Agreement and the performance of the obligations imposed by this Agreement shall be governed by the law of the State of Delaware applicable to transactions to be entirely performed therein.

9.10 USAGE. Any word or term used in this Agreement in any form shall be masculine, feminine, neuter, singular or plural, as proper reading requires.

9.11 ASSURANCES. The Member shall execute all such certificates and other documents and shall do all such filing, recording, publishing and other acts as the Member deems appropriate to comply with the requirements of law for the formation and operation of the Company and to comply with any laws, rules and regulations relating to the acquisition, operation or holding of the Property of the Company.

9.12 NOTIFICATIONS. Any notice, demand, consent, election, offer, approval, request or other communication (collectively, a "notice") required or permitted under this Agreement must be in writing and either delivered personally or sent by certified or registered mail, postage prepaid, return receipt requested. Any notice to be given hereunder by the Company shall be given by the Member. A notice to the Company must be addressed to the Company's principal office. A notice delivered personally will be deemed given only when acknowledged in writing by the person to whom it is delivered. A notice that is sent by mail will be deemed given three (3) business days after it is mailed. Any party may designate, by notice to all of the others, substitute addresses or addressees for notices; and, thereafter, notices are to be directed to those substitute addresses or addressees.

9.13 JURISDICTION AND VENUE. Any suit brought by the Member involving any dispute or matter arising under this Agreement may only be brought in a United States District Court in New York or in any New York state court having jurisdiction over the subject matter of the dispute or matter. The Member hereby consents to the exercise of personal jurisdiction by any such court with respect to any such proceeding. The SBA is not subject to this **Section 9.13.**

(Signature Page to Follow)

IN WITNESS WHEREOF, the Member has caused this Agreement to be duly executed as of the date first written above.

The Member

Rand Capital Corporation

By: /s/ Allen F. Grum, Jr.

Name: Allen F. Grum, Jr.

Title: President

:

SCHEDULE A

MEMBERS, MAXIMUM CONTRIBUTIONS

<u>Name and Address of Member</u>	<u>Maximum Contribution</u>	<u>Ownership Percentage</u>
Rand Capital Corporation 2200 Rand Building Buffalo, NY 14203	\$50,000	100%

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SCHEDULE A MEMBERS and MAXIMUM CONTRIBUTIONS

**CERTIFICATION OF FORMATION
OF
RAND CAPITAL MANAGEMENT, LLC**

THIS CERTIFICATE OF FORMATION ("Certificate") is made as of this 11th day of January, 2002 by Allen F. Grum, Jr., acting as Organizer, whose address is 2200 Rand Building, Buffalo, NY 14203 and who is at least eighteen years of age.

EXPLANATORY STATEMENT

Allen F. Grum, Jr., desiring to organize a limited liability company under and pursuant to the provisions of the Delaware Limited Liability Company Act (6 Del. C Section 18-101, et seq.) ("Act"), hereby forms a limited liability company for the purposes and on the terms and conditions hereinafter set forth (the "Company"), and hereby certifies to the Secretary of State of Delaware as follows:

1. The name of the limited liability company is Rand Capital Management, LLC.
2. The address of its registered office in the State of Delaware is Corporation Trust Center, 1209 Orange Street, in the City of Wilmington, County of New Castle. The name of its registered agent at such address is The Corporation Trust Company.
3. The purposes for which the company is formed are as follows:

To engage solely in the business of serving as the General Partner of Rand Capital SBIC, LP, which is applying for a license from the Small Business Administration to operate as a Small Business Investment Company in accordance with the Small Business Investment Company Act, and to perform any and all activities necessary and proper in connection therewith and convenient or incidental thereto.

4. The United States Small Business Administration must approve any person who will serve as an officer, director or manager of the Company.

IN WITNESS WHEREOF, the undersigned have executed this Certificate of Formation of Rand Capital Management, LLC this 11th day of January, 2002.

WITNESS:

/s/ Elspeth A. Doneldson

/s/ Allen F. Grum, Jr.

Allen F. Grum, Jr.
Authorized Person

EXHIBIT A

ENTITY INSTITUTIONAL INVESTORS

<u>Name and Address</u>	<u>Qualifying Subsection of Section (1) and Type of Entity</u>	<u>Capital Contribution</u>	<u>Paid-In Capital</u>	<u>Unfunded Commitment</u>
Rand Capital Corporation 2200 Rand Building Buffalo, New York 14203	(viii)	<u>\$5,000,000</u>	<u>\$5,000,000</u>	<u>\$0</u>
Total:		<u>\$5,000,000</u>	<u>\$5,000,000</u>	<u>\$0</u>

APPLICANT'S

INDIVIDUAL INSTITUTIONAL INVESTORS

<u>Name and Address</u>	<u>Qualifying Subsection of Section (2)</u>	<u>Capital Contribution</u>	<u>Paid-In Capital</u>	<u>Unfunded Commitment</u>
N/A	N/A	N/A	N/A	N/S

APPLICANT'S

OTHER PARTNERS

<u>Name and Address</u>	<u>Capital Contribution</u>	<u>Paid-In Capital</u>	<u>Unfunded Commitment</u>
Rand Capital Management, LLC	<u>\$50,000</u>	<u>\$0</u>	<u>\$50,000</u>
Total:	<u>\$50,000</u>	<u>\$0</u>	<u>\$50,000</u>

AGGREGATE

PARTNERSHIP TOTALS

<u>Name and Address</u>	<u>Capital Contribution</u>	<u>Paid-In Capital</u>	<u>Unfunded Commitment</u>
(a) All Institutional Investors	<u>\$5,000,000</u>	<u>\$5,000,000</u>	<u>\$0</u>
(b) All Partners	<u>\$0</u>	<u>\$0</u>	<u>\$50,000</u>
PARTNERSHIP TOTAL	<u>\$5,000,000</u>	<u>\$5,000,000</u>	<u>\$50,000</u>

Exhibit 21

SUBSIDIARIES OF RAND CAPITAL CORPORATION

1. Rand Capital SBIC, L.P. formed under Delaware Law on January 16, 2002.
2. Rand Capital Management, LLC formed under Delaware Law on January 16, 2002.