

HARRIS & HARRIS GROUP INC /NY/
Form 40-APP
April 23, 2010

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

APPLICATION FOR A CERTIFICATION PURSUANT TO SECTION 851(e) OF THE
INTERNAL REVENUE CODE OF 1986, AS AMENDED.

HARRIS & HARRIS GROUP, INC.

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April 23, 2010

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

In the Matter of:

Harris & Harris Group, Inc.

1450 Broadway
24th Floor
New York, NY 10018

APPLICATION FOR A CERTIFICATION
PURSUANT TO SECTION 851(e) OF THE
INTERNAL REVENUE CODE OF 1986, AS
AMENDED.

INTRODUCTION

Harris & Harris Group, Inc. (“Applicant”) hereby applies to the Securities and Exchange Commission (the “Commission”), pursuant to Section 851(e) of the Internal Revenue Code of 1986, as amended (the “Code”), for a certification that Applicant is principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available.

Applicant proposes to qualify as a “regulated investment company” under Section 851(a) of the Code for the fiscal year ended December 31, 2009. The certification being sought is a prerequisite to qualification, pursuant to the provisions of Section 851(e) of the Code, as a regulated investment company under Section 851(a).

I. GENERAL DESCRIPTION OF APPLICANT

Applicant was incorporated under the laws of the State of New York in August 1981 and operates as an internally managed business development company. Applicant's securities were first registered with the Commission pursuant to Section 12 of the Securities Exchange Act of 1934, as amended, in 1982. In 1992, Applicant registered with the Commission as a closed-end, non-diversified management investment company under the Investment Company Act of 1940, as amended (the "1940 Act"). On July 26, 1995, Applicant elected to become regulated as a business development company ("BDC") pursuant to Section 54(a) of the 1940 Act (the "BDC election").

Applicant's investment portfolio consists primarily of equity investments in companies that are principally engaged in the development, commercialization and integration of products enabled by nanotechnology and microsystems that are applied in industries such as computer software and hardware, telecommunications, medical devices, pharmaceuticals, biotechnology, electronics, semiconductors and advanced materials. Many of Applicant's portfolio companies are privately held, thinly capitalized, unproven companies with no operating history. As of December 31, 2009, Applicant had total assets of approximately \$136.1 million.

The Commission has previously issued certifications pursuant to Section 851(e) of the Code that Applicant was, for the fiscal years ended December 31, 1997 and December 31, 1999 through December 31, 2008, principally engaged in the furnishing of capital to other corporations, which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available.¹

¹ Harris & Harris Group, Inc., Investment Company Act Release Nos. 28761 (June 9, 2009); 28294 (May 30, 2008); 27870 (June 20, 2007); 27398 (June 16, 2006); 26908 (June 15, 2005); 26467 (June 15, 2004); 25990 (Apr. 2, 2003); 25454 (Mar. 7, 2002); 24888 (Mar. 8, 2001); 24314 (Feb. 24, 2000); 23102 (Apr. 6, 1998).

II. LEGAL ANALYSIS

A. Applicable Law

Section 851 of the Code sets forth the general requirements a corporation must satisfy in order to qualify for treatment as a regulated investment company under Subchapter M of the Code (a “RIC”). A RIC is defined in Section 851(a) as “any domestic corporation . . . which, at all times during the taxable year . . . is registered under the . . . [1940 Act] as a management company or unit investment trust or . . . has in effect an election under such Act to be treated as a business development company.” Section 851 also imposes certain conditions and limitations upon entities seeking to qualify as RICs. Section 851(b)(3)(A) provides that an investment company or BDC seeking to qualify for treatment as a RIC must, as of the close of each quarter of the taxable year, have at least 50 percent of the value of its total assets represented by

cash and cash items (including receivables), Government securities and securities of other regulated investment companies, and . . . other securities for purposes of this calculation limited, except and to the extent provided in subsection [851](e), in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the taxpayer and to not more than 10 percent of the outstanding voting securities of such issuer

The 1940 Act generally imposes no similar diversification requirements.

Section 851(e) provides an exemption from the diversification requirements of Subchapter M for certain investment companies furnishing capital to certain development corporations. In pertinent part, Section 851(e) provides that

[i]f the . . . Commission determines, in accordance with regulations issued by it, and certifies to the Secretary not earlier than 60 days prior to the close of the taxable year of a management company or a business development company . . . that such investment company is principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological developments, new processes, or products not previously generally available, such investment company may, in the computation of 50 percent of the value of its assets under subparagraph (A) of subsection (b)(3) for any quarter of such taxable year, include the value of any securities of an issuer, whether or not the investment company owns more than 10 percent of the outstanding voting securities of such issuer, the basis of which, when added to the basis of the investment company for securities of such issuer previously acquired, did not exceed 5 percent of the value of the total assets of the investment company at the time of the subsequent acquisition of securities.

B. Need for Relief

Applicant's board of directors has determined that it would be in the best interests of Applicant and its shareholders for Applicant to qualify for treatment as a RIC for the fiscal year ended December 31, 2009. Since its BDC election, Applicant has invested a substantial percentage of its total assets in early-stage development, or start-up, companies (the portfolio companies are more fully described below) in a broad range of industry segments that are primarily engaged in the development, commercialization and integration of products enabled by nanotechnology and microsystems that are applied in industries such as computer software and hardware, telecommunications, medical devices, pharmaceuticals, biotechnology, electronics, semiconductors and advanced materials (each a "Portfolio Company" and together the "Portfolio Companies"). Given the inherent nature of start-up and early-stage development companies, many of the Portfolio Companies are thinly capitalized, unproven companies that lack management depth and have no operating history. As a consequence, Applicant, in addition to providing capital to the Portfolio Companies, may also assist with the development of financial plans for the companies, recruiting and hiring management, as well as providing management expertise. Given Applicant's level of involvement in many of the Portfolio Companies, Applicant may, from time to time, own a majority of the equity securities of a given Portfolio Company. Thus, without the relief requested, Applicant may be unable to satisfy the requirements of Section 851(b)(3)(A). This result would have a deleterious impact on Applicant's shareholders by reducing Applicant's income without achieving any concomitant policy objective.

1. Investment Portfolio

As stated above, Applicant has invested a substantial portion of its assets in early stage companies primarily engaged in the development, commercialization and integration of products enabled by nanotechnology and microsystems that are applied in industries such as computer software and hardware, telecommunications, medical devices, pharmaceuticals, biotechnology, electronics, semiconductors and advanced materials. Applicant believes that most of those companies satisfy the requirements of section 851(e) of the Code. In reaching this conclusion, the Applicant generally has relied upon information provided by the Portfolio Companies themselves and others, including but not limited to, offering circulars, prospectuses, analyst reports, internal company memoranda, patent applications and similar documents. In addition, Applicant generally is represented on the boards of directors of the Portfolio Companies through member or observer status and also has direct access to senior management of those companies through contractual information rights.

The following table shows the composition of Applicant's total assets as of the end of each calendar quarter of 2009:

	3/31/2009	6/30/2009	9/30/2009	12/31/2009
A. Investments in "eligible portfolio companies" described in Section 2(a)(46) of the 1940 Act and believed by the Applicant to be engaged in the business activities required by Section 851(e) of the Code	\$ 56,021,868	\$ 60,943,801	\$ 66,639,006	\$ 75,316,751
B. Investments in "eligible portfolio companies" described in Section 2(a)(46) of the 1940 Act and treated by Applicant as not engaged in the business activities required by Section 851(e) of the Code*	\$ 1,853	0	0	0
C. Investments that do not qualify under Section 55(a) of the 1940 Act, but as to which the issuers are believed by Applicant to be engaged in the business activities required by Section 851(e) of the Code**	\$ 2,769,967	\$ 3,016,010	\$ 3,410,609	\$ 2,706,730
D. Investments that do not qualify under Section 55(a) of the 1940 Act and treated by Applicant as not covered by Section 851(e) of the Code	-	-	-	-
E. Cash, cash items and securities as set forth in Section 55(a)(6) of the 1940 Act, collectively "Cash Equivalents"	\$ 51,582,213	\$ 47,666,894	\$ 68,467,410	\$ 57,559,046
Total Investments and Cash Equivalents	\$ 110,375,901	\$ 111,626,705	\$ 138,517,025	\$ 135,582,527
Other Assets	\$ 834,237	\$ 729,142	\$ 619,408	\$ 526,574
Total Assets	\$ 111,210,138	\$ 112,355,847	\$ 139,136,433	\$ 136,109,101

* As of March 31, 2009, the sole investment in this category was Exponential Business Development Company.

** As of December 31, 2009, the investments in this category were D-Wave Systems Inc., and Orthovita, Inc.

As demonstrated above, as of December 31, 2009, 97.6% of Applicant's total assets consisted of assets of the type set forth in paragraphs 1 through 6 of Section 55(a) of the 1940 Act. Such assets comprise 98.0% of Applicant's invested assets.

2. Portfolio Companies

As reflected in the table above, companies engaged in the type and degree of business activities described in Section 851(e) of the Code, excluding the investments in issuers described in Categories B. and D. above, ("Development Companies") comprised the following percentages of the total assets less Cash Equivalents of Applicant at the end of each of the calendar quarters of 2009: March 31, 98.6%; June 30, 98.9%; September 30, 99.1%; and December 31, 99.3%. The Development Companies are discussed below. Unless otherwise indicated below, information is provided as of December 31, 2009.

Adesto Technologies Corporation ("Adesto")(Category A) -- Adesto develops semiconductor-related products enabled at the nanoscale. The company's technology addresses several problems that limit the capabilities of certain traditional electronic components, including the ability to scale the devices as standard chip dimensions shrink, the ability to increase speed of operation and the ability to decrease power consumption.

Percentage of Equity held by Applicant² -- 14.6%

Investment Value/Percentage of Applicant's Total Assets -- \$4,620,000 / 3.4%

Date of Initial Investment -- February 20, 2007

² Percentage of Equity for all portfolio companies held by Applicant is reported on voting equity basis.

Ancora Pharmaceuticals Inc. (“Ancora”)(Category A) -- Ancora develops synthetic carbohydrates for pharmaceutical markets and for internal drug development programs. Ancora’s scalable technology enables rapid milligram to kilogram production of synthetic carbohydrates for use in drug discovery and industrial applications.

Percentage of Equity held by Applicant – 95.2%

Investment Value/Percentage of Applicant’s Total Assets -- \$1,257,006 / less than 1%

Date of Initial Investment -- May 3, 2007

BioVex Group Inc. (“BioVex”)(Category A) -- BioVex develops novel biologics for treatment of cancer and infectious diseases. BioVex is a Phase III clinical-stage company built on oncolytic virus technology that replicates and spreads within solid tumors, causing the death of cancer cells, accompanied by the induction of a systemic immune response.

Percentage of Equity held by Applicant – 2.4%

Investment Value/Percentage of Applicant’s Total Assets -- \$1,691,683 / 1.24%

Date of Initial Investment -- September 27, 2007

BridgeLux, Inc. (“BridgeLux”)(Category A) -- BridgeLux develops chips for high-power, indium gallium nitride light emitting diodes and arrays that are used in various solid-state lighting applications. BridgeLux technology permits a highly reliable epitaxy structure and a robust chip and array design that are necessary for the requirement of long lumen maintenance under severe operating conditions such as high current density and high thermal stress that adversely affect most high-power devices.

Percentage of Equity held by Applicant – 5.4%

Investment Value /Percentage of Applicant’s Total Assets -- \$4,833,209 / 3.6%

Date of Initial Investment -- May 20, 2005

Cambrios Technology Corp. (“Cambrios”)(Category A) -- Cambrios develops materials that can be deposited from solution onto any substrate to create flexible, transparent conductive surfaces. Metallic nanowires are used as the conductive medium because they minimize the absorption and scattering of visible light.

Percentage of Equity held by Applicant – 5.7%

Investment Value/Percentage of Applicant’s Total Assets -- \$1,554,891 / 1.14%

Date of Initial Investment -- November 9, 2004

CFX Battery, Inc. (“CFX”)(Category A) – CFX, formerly Lifco, Inc., is developing primary and rechargeable batteries using a novel variation of existing battery chemistry that is enabled by nanotechnology. The company hopes to use its proprietary nanotechnology to deliver low-cost batteries with superior performance, safety and weight. On February 28, 2008, Lifco merged with CFX Battery, Inc., to form CFX Battery, Inc.

Percentage of Equity held by Applicant – 10.64%

Investment Value/Percentage of Applicant’s Total Assets -- \$4,122,378 / 3.0%

Date of Initial Investment -- June 21, 2007

Cobalt Technologies, Inc. ("Cobalt") (Category A) -- Cobalt is developing biobutanol, a next-generation biofuel. Cobalt's proprietary technologies in microbial physiology, strain development, fermentation and low-energy fuel separation enable it to produce a new generation of fuels that burn cleaner, are more cost-effective, and enhance environmental sustainability. By optimizing productivity, titer and yield, it is seeking to make biobutanol an affordable gasoline substitute that can meet the immediate needs of the transportation industry.

Percentage of Equity held by Applicant – 1.7%

Investment Value /Percentage of Applicant's Total Assets -- \$375,000 / less than 1%

Date of Initial Investment -- October 7, 2008

Crystal IS, Inc. ("Crystal IS")(Category A) -- Crystal IS is commercializing patented technology for the cost-effective production of high-power, high-temperature, and compound semiconductor devices on aluminum nitride substrates. The nitride semiconductor industry provides devices that are used in water purification, stoplights, high storage capacity DVDs, military applications, biotechnology, information technology, wireless communication, lighting, and high-power microwave devices.

Percentage of Equity held by Applicant – 18.7%

Investment Value /Percentage of Applicant's Total Assets -- \$0 / 0%

Date of Initial Investment -- September 21, 2004

D-Wave Systems, Inc. (“D-Wave”)(Category C) -- D-Wave develops high-performance quantum computing systems for commercial use in logistics, bioinformatics, life and physical sciences, quantitative finance and electronic design automation.

Percentage of Equity held by Applicant -- 3.1%

Investment Value /Percentage of Applicant’s Total Assets -- \$2,480,335 / 1.8%

Date of Initial Investment -- April 19, 2006

Ensemble Discovery Corporation (“Ensemble”)(Category A) -- Ensemble develops DNA Programmed Chemistry (“DPC”) for the discovery of new classes of therapeutics. DPC provides unprecedented control of chemical reactivity, enabling the synthesis of diverse libraries of compounds for use in drug discovery.

Percentage of Equity held by Applicant -- 5.34%

Investment Value/Percentage of Applicant’s Total Assets -- \$1,825,506 / 1.34%

Date of Initial Investment -- June 6, 2007

Enumeral Technologies, Inc. (“Enumeral”)(Category A) – Enumeral develops high-value opportunities in immunology including therapeutic discovery, immune profiling and personalized medicine. The company's proprietary technology enables the isolation and study of chemicals and proteins produced by individual cells simultaneously in a highly parallel format.

Percentage of Equity held by Applicant -- 0%

Investment Value/Percentage of Applicant’s Total Assets -- \$250,438 / less than 1%

Date of Initial Investment -- December 23, 2009