SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

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SCHEDULE 13D

Under the Securities Exchange Act of 1934

(Amendment No. )1

NETWORK-1 SECURITY SOLUTIONS, INC.

(Name of issuer)

COMMON STOCK, $.01 PAR VALUE

(Title of class of securities)

64121N-10-9

(CUSIP number)

STEVEN WOLOSKY, ESQ.
OLSHAN GRUNDMAN FROME ROSENZWEIG & WOLOSKY LLP
505 Park Avenue
New York, New York 10022
(212) 753-7200

(Name, address and telephone number of person authorized to receive notices and communications)

October 2, 2001

(Date of event which requires filing of this statement)

If the filing person has previously filed a statement on Schedule 13G to report the acquisition which is the subject of this Schedule 13D, and is filing this schedule because of Rule 13d-1(b)(3) or (4), check the following box |_|.

Note. six copies of this statement, including all exhibits, should be filed with the Commission. See Rule 13d-1(a) for other parties to who copies are to be sent.

(Continued on following pages)

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1 The remainder of this cover page shall be filled out for a reporting person's initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter disclosures provided in a prior cover page.

The information required on the remainder of this cover page shall not be deemed to be "filed" for the purpose of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, see the Notes).



1 NAME OF REPORTING PERSONS
S.S. OR I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS

FALCONSTOR SOFTWARE, INC.

| | | |
|---|---|---|
| 2 | CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP* | (a) \|_\| (b) \|_\| |
| 3 | SEC USE ONLY | |
| 4 | SOURCE OF FUNDS* WC | |
| 5 | CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEM 2(d) OR 2(e) | \|_\| |
| 6 | CITIZENSHIP OR PLACE OR ORGANIZATION UNITED STATES | |
| NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH | 7 SOLE VOTING POWER 4,339,740* | |
| | 8 SHARED VOTING POWER -0- | |
| | 9 SOLE DISPOSITIVE POWER 4,339,740* | |
| | 10 SHARED DISPOSITIVE POWER -0- | |
| 11 | AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON 4,339,740* | |
| 12 | CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES CERTAIN SHARES* | \|_\| |
| 13 | PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11) 40.2% | |
| 14 | TYPE OF REPORTING PERSON* CO | |

* Assumes the conversion of all Series E Convertible Preferred Stock held by the Reporting Person only into Common Stock and the exercise of Warrants to purchase 2,169,870 shares of Common Stock held by the Reporting Person. Does not include the exercise or conversion of any other derivative security of the



Issuer. If all derivative securities are included in the numerator and denominator, the Reporting Person would own 19.3% of the Issuer on a fully diluted basis.



The following constitutes the initial Schedule 13D filed by FalconStor Software,

Inc. ("FalconStor").

Item 1. Security and Issuer.

This statement relates to the shares of common stock, $.01 par value (the "Common Stock ") of Network-1 Security Solutions, Inc. (the "Issuer"). The Issuer's principal executive offices are located at 1601 Trapelo Road, Reservoir Place, Waltham, Massachusetts 02451.

Item 2. Identity and Background.

FalconStor is a company incorporated in Delaware with a business address of 125 Baylis Road, Suite 140, Melville, New York 11747. FalconStor is a provider of storage networking infrastructure software and is managed by its Board of Directors.

The directors and executive officers of FalconStor are ReiJane Huai, Lawrence S. Dolin, Steven H. Owings, Steven R. Fischer, Jacob Ferng and Wayne Lam. The business address of Messrs. Huai, Dolin, Owings, Fischer, Ferng and Lam is c/o FalconStor's business address given above.

Messrs. Huai, Dolin, Owings, Fischer, Ferng and Lam are citizens of the United States of America.

In accordance with the provisions of General Instruction C to Schedule 13D, information concerning the executive officers and directors of FalconStor is included in Schedule A hereto and is incorporated by reference herein.

The Reporting Person and its directors and executive officers have not been criminally convicted in the past five years. They have not also been a party to a civil proceeding of a judicial or administrative body of competent jurisdiction which resulted in a judgement, decree or final order enjoining future violations of, or prohibiting or mandating activities subject to, Federal or State securities laws or finding any violations with respect to such laws.

Item 3. Source and Amount of Funds or Other Consideration.

On October 2, 2001, FalconStor acquired 1,084,935 shares of Series E Convertible Preferred Stock (the "Series E Preferred Stock") of the Issuer which are initially convertible into 2,169,870 shares of Common Stock of the Issuer. In connection with such purchase, FalconStor also received warrants (the "Warrants") to purchase 2,169,870 shares of Common Stock at an exercise price of $1.27 per share, exercisable commencing October 2, 2001. In addition, the Reporting Person received additional warrants (the "Additional Warrants") to purchase 500,000 shares of Common Stock, exercisable commencing October 2, 2002. The aggregate purchase price of the 1,084,935 shares of Series E Preferred Stock, acquired by FalconStor is $2,300,062.20. FalconStor paid for such securities by using its working capital.



Item 4. Purpose of Transaction.

The Reporting Person acquired the Series E Preferred Stock, the Warrants and Additional Warrants for investment purposes. It presently has no plans or proposals which would relate to or result in any of the matters set forth in subparagraphs (a) - (j) of Item 4 of Schedule 13D.

Item 5. Interest in Securities of the Issuer.

(a) In calculating the aggregate percentage of shares of Common Stock reported owned by FalconStor, the denominator is based upon 6,467,547 shares of Common Stock outstanding, which is the total number of shares of Common Stock outstanding as of August 16, 2001 as reported in the Issuer's Quarterly Report on Form 10-QSB for the quarterly period ended June 30, 2001 and an additional 4,339,740 shares of Common Stock to reflect the conversion and exercise of all Series E Preferred Stock and Warrants held by FalconStor into Common Stock. Except as indicated in the next paragraph, FalconStor has sole voting power with respect to the shares of Common Stock that it will receive upon conversion of the Series E Preferred Stock.

For so long as the holders of the outstanding shares of Series E Preferred Stock own at least 10% of the voting stock of the Issuer, and FalconStor owns any outstanding shares of Series E Preferred Stock, FalconStor agrees, for all actions to be voted upon by the holders of the Series E Preferred Stock, to vote all of its outstanding shares of Series E Preferred Stock, and all of its outstanding shares, if any, of Common Stock issued upon the conversion or exercise of its Series E Preferred Stock, Warrants and Additional Warrants, in the same manner as the holders of the majority of the Series E Preferred Stock excluding the Series E Preferred Stock owned by FalconStor.

As of the close of business on October 11, 2001, FalconStor beneficially owns 4,339,740 shares of Common Stock, constituting approximately 40.2% of the shares of Common Stock outstanding. Such amount does not include 500,000 shares of Common Stock issuable upon the exercise of the Additional Warrants. In addition, such amount does not include the exercise or conversion of any derivative securities of the Issuer not held by FalconStor. If all of such derivative securities were exercised or converted, FalconStor would own 19.3% of the shares of Common Stock outstanding.

The only transaction in the last 60 days by FalconStor was the purchase of the Series E Preferred Stock, the Warrants and Additional Warrants on October 2, 2001. Such purchase was made pursuant to a private transaction.



Item 6. Contracts, Arrangements, Understandings or Relationships With Respect to Securities of the Issuer.

See Item 5 and the Securities Purchase Agreement referred to in Item 7 for a description of the voting agreement between FalconStor, the Issuer and the other holders of the Series E Preferred Stock of the Issuer.

Item 7. Material to be Filed as Exhibits.

1. Securities Purchase Agreement dated as of October 2, 2001 between the Issuer and the Investors of the Series E Preferred Stock including FalconStor. Such Securities Purchase Agreement contains the voting agreement referred to in Items 5 and 6 hereof.



SIGNATURES

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After reasonable inquiry and to the best of his knowledge and belief, the undersigned certifies that the information set forth in this statement is true, complete and correct.

Dated: October 11, 2001 FALCONSTOR SOFTWARE, INC.

By: /s/ Jacob Ferng
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Name: Jacob Ferng
Title: Vice President/Chief Financial Officer



SCHEDULE A

Information Concerning Directors and Executive Officers of FalconStor

FalconStor is managed by its Board of Directors. Information concerning its Board of Directors and Executive Officers is given below:

ReiJane Huai is a Director, President and Chief Executive Officer of FalconStor.

Jacob Ferng is a Vice President and Chief Financial Officer of FalconStor.

Wayne Lam is Vice President, Marketing of FalconStor.

Steven H. Owings is a Director of FalconStor. Mr. Owings served as the chief executive officer of ScanSource, Inc., a value-added distributor of POS and bar code products, from December 1992 to January 2000. Mr. Owings currently serves as chairman of the board of directors of ScanSource, Inc.

Lawrence S. Dolin is a Director of FalconStor and is currently chairman, president and chief executive officer of Noteworthy Medical Systems, Inc., a provider of computerized patient record software. Mr. Dolin is also a general partner of Mordo Partners, an investment management partnership and a director of Morgan's Foods, Inc.

Steven R. Fischer is a Director of FalconStor and is currently president of Transamerica Business Capital Corporation, which specializes in secured lending for mergers, acquisitions and restructuring. Mr. Fischer is also a Director of ScanSource, Inc.

SECURITIES PURCHASE AGREEMENT
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AGREEMENT, dated as of October 2, 2001, by and between Network-1 Security Solutions, Inc., a Delaware corporation with principal offices at 1601

Trapelo Road, Waltham, MA 02451 (the "Company"), and the Investors signatory hereto (collectively, the "Investors").

WHEREAS, each of the Investors and the Company desire that the Investors purchase (i) up to an aggregate of 3,191,037 shares of Series E Convertible Preferred Stock (the "Series E Preferred Stock") at a purchase price of $2.12 per share, equal to two (2) times the average closing price of the Company's common stock, par value $.01 per share (the "Common Stock"), as reported on The Nasdaq Small Cap Market for the five (5) trading days prior to two (2) trading days before the date hereof (the "Purchase Price"), and (ii) warrants to purchase up to 6,382,074 shares of Common Stock (the "Common Stock Purchase Warrants"), at an exercise price of $1.27 per share, or 60% of the Purchase Price, on the terms and subject to the conditions set forth herein. The shares of Common Stock issuable upon conversion of the Series E Preferred Stock and exercise of the Common Stock Purchase Warrants and the Additional Warrants (as defined below) are collectively referred to herein as the "Underlying Securities."

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto agree as follows:

## ARTICLE I.

### Issuance of Series E Preferred Stock and Warrants

I.1 Agreement to Purchase and Sell. At the initial closing provided for in Section I.2(a), the Company will issue and sell to each Investor and, subject to the terms and conditions of this Agreement, each Investor will purchase from the Company (i) the Series E Preferred Stock which shall have such rights, powers and preferences as set forth in the Certificate of Designations, Preferences and Other Rights and Qualifications attached as Exhibit A hereto (the "Certificate of Designations"), and (ii) the Common Stock Purchase Warrants in the form of Exhibit B attached hereto, in the amounts opposite such Investor's name and in consideration for payment by each Investor to the Company of the Purchase Price as indicated on Schedule 1.1 hereto. The Investors will be afforded Registration Rights with respect to the Underlying Securities in accordance with the Registration Rights Agreement attached hereto as Exhibit C (the "Registration Rights" together with the Common Stock Purchase Warrants and the Additional Warrants (as defined below), Certificate of Designations and the License and Distribution Agreement referenced in Section I.3 hereof, the "Ancillary Documents"). Any Investor who purchases $2.0 million or more of Series E Preferred Stock shall receive additional five (5) year warrants to purchase 500,000 shares of Common Stock, at the same exercise price of the Common Stock Purchase Warrants (the "Additional Warrants").

The Common Stock Purchase Warrants and the Additional Warrants are collectively referred to as the "Warrants."

I.2 The Closing. (a) The initial closing of the issuance of the Series E Preferred Stock and Warrants (the "Initial Closing") shall take place at the offices of Olshan Grundman Frome Rosenzweig & Wolosky LLP, 505 Park Avenue, New York, New York 10022-1170, on the date that this Agreement is executed by the parties hereto (the time and date of the Closing being hereto referred to as the "Initial Closing Date"). On the Initial Closing Date there will be delivered to the Investors the Series E Preferred Stock and Warrants to be purchased by them in accordance with Schedule 1.1 hereto and the other terms hereof against delivery by the Investors of checks payable to the order of the Company (or wire transfers) in the full amount of the Purchase Price. Prior to the Initial Closing Date, the Certificate of Designations shall be filed with the Secretary of State, State of Delaware.

(b) Subject to the terms and provisions of this Agreement, if any of the securities offered hereby are not sold at the Initial Closing, the Company may at any time within sixty (60) days following the Initial Closing, sell the remaining securities at the same purchase price as the securities purchased and sold at the Initial Closing (the "Subsequent Closings"). Any such Subsequent

Closing shall be upon the same terms and conditions as those in the Initial Closing, and such additional investors shall become parties to this Agreement and the Registration Rights Agreement. Any such additional investors shall be deemed to be an "Investor" for all purposes under this Agreement.

I.3 License and Distribution Agreement. Simultaneous with the execution of this Agreement, the Company and FalconStor Software, Inc. ("FalconStor") shall enter into a License and Distribution Agreement pursuant to which FalconStor will be granted a non-exclusive ten (10) year license to market, distribute, resell and sublicense the Company's products. The form of the License and Distribution Agreement is attached hereto as Exhibit D.

## ARTICLE II.

## Representations, Warranties, and Agreements of the Company

The Company represents and warrants to, and agrees with, the Investors as follows:

II.1 Corporate Organization and Qualification. The Company is a corporation duly organized, validly existing and in good standing under the laws of its jurisdiction of incorporation, and is qualified to transact business and is in good standing as a foreign corporation in every jurisdiction in which its ownership, leasing, licensing or use of property or assets or the conduct of its business makes such qualification necessary, except in such jurisdictions where the failure to be so qualified or in good standing would not have a material adverse effect on the business, results of operations, financial condition or prospects of the Company. The Company has no subsidiaries except for Network-1 Acquisition Corp. (which does not conduct any business or own any material assets) and has no investment, whether by way of ownership of stock or other securities or by loan,



advance or otherwise, in any corporation, partnership, firm, association or other business entity. The Company has all required power and authority to own its property and to carry on its business as now conducted and proposed to be conducted.

II.2 Validity of Transaction. The Company has all requisite power and authority to execute, deliver and perform this Agreement and the Ancillary Documents, and to issue the Series E Preferred Stock and Warrants to the Investors. All necessary corporate proceedings of the Company have been duly taken to authorize the execution, delivery and performance of this Agreement, the Ancillary Documents, the Series E Preferred Stock and Warrants and to authorize the issuance and sale of the Series E Preferred Stock and Warrants, and upon conversion of the Series E Preferred Stock and exercise of the Warrants, to authorize the issuance of the Underlying Securities to the Investors. This Agreement, the Ancillary Documents, the Series E Preferred Stock and Warrants have been duly authorized, executed and delivered by the Company, are the legal, valid and binding obligations of the Company, and are enforceable as to the Company in accordance with their respective terms, except as may be limited by applicable bankruptcy, reorganization, insolvency, moratorium or other similar laws or by legal or equitable principles relating to or limiting creditors' rights generally or as rights to indemnification may be limited by applicable securities laws. Except as to filings which may be required under applicable state securities regulations, no consent, authorization, approval, order, license, certificate, or permit of or from, or declaration or filing with, any Federal, state, local or other governmental authority or of any court or other tribunal is required by the Company in connection with the transactions contemplated hereby. No consent of any party to any contract, agreement, instrument, lease, license, arrangement or understanding to which the Company is a party, or by which any of its properties or assets is bound, is required for the execution, delivery or performance by the Company of this Agreement, the Ancillary Documents, the Series E Preferred Stock, Warrants and the issuance of the Underlying Securities. The execution, delivery, and performance of this Agreement, the Ancillary Documents, the Series E Preferred Stock and Warrants by the Company will not violate, result in a breach of, conflict with or (with or without the giving of notice or the passage of time or both) entitle any party to terminate or call a default under any such contract, agreement, instrument,

lease, license, arrangement or understanding, or violate or result in a breach of any term of the Certificate of Incorporation or By-laws of the Company, or violate, result in a breach of, or conflict with any law, rule, regulation, order, judgment or decree binding on the Company or to which any of its operations, business, properties or assets is subject. The registration rights granted to the Investors, in accordance with the Registration Rights Agreement, do not violate any of the terms and conditions of the registration rights previously granted by the Company to other holders of the Company's securities or any other agreements to which the Company is a party. The shares of Common Stock issuable upon conversion of the Series E Preferred Stock and exercise of the Warrants are duly authorized, have been reserved for issuance upon conversion of the Series E Preferred Stock and upon exercise of the Warrants in accordance with the terms thereof, will be validly issued, fully paid, and nonassessable, will not have been issued in violation of any preemptive right of stockholders or rights of first refusal and the Investors will have good title to the Underlying Securities, free and clear of all liens, security interests, pledges, charges, encumbrances, stockholders agreements and voting trusts.



II.3 Capitalization. The authorized capital stock of the Company consists of 25,000,000 shares of Common Stock and 5,000,000 shares of preferred stock, par value $.01 per share, of which 3,500,000 shares have been designated Series E Convertible Preferred Stock, having the designations, dividend rights, voting powers, conversion rights, rights on liquidation or dissolution and other preferences or other special rights, and the qualifications, limitations or restrictions thereof, set forth in the Certificate of Designations. Immediately prior to the Initial Closing, the Company shall have 6,467,458 shares of Common Stock and 231,054 shares of Series D Preferred Stock outstanding. All issued and outstanding shares of Common Stock and Series D Preferred Stock have been validly issued and are fully paid and nonassessable and have not been issued in violation of any Federal or state securities laws. Except for the obligation of the Company to issue (a) the Underlying Securities upon conversion of the Series E Preferred Stock, and upon exercise of the Warrants, (b) the securities issuable upon conversion of the Series D Preferred Stock outstanding, (c) upon the exercise of the options, warrants and convertible securities (except for outstanding Series D Preferred Stock referenced above) that are currently outstanding to purchase 2,374,398 shares of Common Stock (excluding the options issued under the Company's Stock Option Plan as set forth in the following clause (d)), and (d) upon the exercise of options to purchase 1,369,273 shares of Common Stock issued under the Company's Stock Option Plan, there are not, as of the date hereof, any outstanding or authorized subscriptions, options, warrants, calls, rights, commitments or any other agreements obligating the Company to issue (i) any additional shares of its capital stock or (ii) any securities convertible into, or exercisable or exchangeable for, or evidencing the right to subscribe for, any shares of its capital stock except (as set forth in the Disclosure Schedule) for (i) securities to be issued as a result of anti-dilution protection relating to the outstanding Series D Preferred Stock and certain outstanding warrants issued in connection with the Company's December 1999 private financing and (ii) in accordance with a consulting arrangement with Sage Alliance. Other than the Company's Stock Option Plan, the Company has not adopted or authorized any plan for the benefit of its officers, employees, or directors which require or permit the issuance, sale, purchase, or grant of any shares of the Company's capital stock, any securities convertible into, or exercisable or exchangeable for, or evidencing the right to subscribe for any shares of the Company's capital stock or any phantom shares or any stock appreciation rights. The Company is under no obligation (contingent or otherwise) to purchase or otherwise acquire or retire any shares of its capital stock, except as may be provided with respect to options outstanding under the Stock Option Plan.

II.4 Financial Statements. The financial statements of the Company, including the notes thereto, as they appear in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2000 (the "10-KSB") and the Company's Quarterly Report on Form 10-QSB for the quarterly period ended June 30, 2001 (the "10-QSB"), respectively (the "Financials"), fairly present, in all material respects, the financial position and results of operations of the Company at the dates thereof and for the periods covered thereby, subject, in the case of interim periods, to year-end adjustments and normal recurring accruals and to the extent that such Financials may not include footnotes. Such

Financials have been prepared in conformity with generally accepted accounting principles ("GAAP"), consistently applied throughout the periods involved except as may otherwise



be stated therein and except that the notes in the interim financial statements may be abbreviated and do not contain all of the information that is contained in the notes to the audited financial statements. The Company has no material liabilities or obligations, contingent, direct, indirect or otherwise except (i) as set forth in the latest balance sheet included in the Financials or the footnotes thereto (the date of such balance sheet being referred to as the "Balance Sheet Date"), and (ii) those incurred in the ordinary course of business since the Balance Sheet Date.

II.5 No Undisclosed Liabilities. The Company does not have any liabilities or obligations of any nature required to be set forth in the Financials under GAAP, whether or not accrued, contingent or otherwise, and there is no existing condition, situation or set of circumstances which may result in such a liability or obligation, except (a) liabilities or obligations of the Company reflected in its Securities and Exchange Commission (the "SEC") filings and in the Financial Statements or (b) liabilities and obligations which are not, individually or in the aggregate, reasonably expected to have a material adverse effect on the Company.

II.6 Legal Proceedings. Except as set forth in the Disclosure Schedule annexed hereto as Schedule 1.2, there are no actions, suits, proceedings, claims or hearings of any kind or nature existing or pending or, to the best knowledge of the Company, threatened and, to the best knowledge of the Company, no investigations or inquiries, before or by any court, or other governmental authority, tribunal or instrumentality (or, to the Company's best knowledge, any state of facts that would give rise thereto), pending or threatened against the Company, or involving the properties of the Company, that, individually or in the aggregate as to any matter covered by this Section II.6, are reasonably likely to result in any material adverse effect on the Company or that might adversely affect the transactions or other acts contemplated by this Agreement or the Ancillary Documents or the validity or enforceability of this Agreement or the Ancillary Documents.

II.7 SEC Filings. The Company has filed all forms, reports, statements and other documents required to be filed with (i) the SEC including, without limitation, (A) all Annual Reports on Form 10-KSB, (B) all Quarterly Reports on Form 10-QSB, (C) all Reports on Form 8-K, (D) all other reports or registration statements and (E) all amendments and supplements to all such reports and registration statements (collectively referred to as the "SEC Reports") and (ii) any other applicable state securities authorities (all such forms, reports, statements and other documents in (i) and (ii) of this Section II.7 being referred to herein, collectively, as the "Reports"). The Reports (i) were prepared in all material respects in accordance with the requirements of applicable law (including, with respect to the SEC Reports, the Securities Act of 1933, as amended (the "Securities Act"), and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as the case may be, and the rules and regulations of the SEC thereunder applicable to such SEC Reports) and (ii) did not at the time they were filed contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading. In addition, since the last quarterly report of the Company on Form 10-QSB filed with the SEC, there have been no material events that require disclosure under the Exchange Act.



II. 8 Finder or Broker. Neither the Company nor anyone acting on behalf of the Company has negotiated with any finder, broker or intermediary or similar person in connection with the transactions contemplated herein.

II. 9 Taxes. The Company has filed all federal tax returns and all state and municipal and local tax returns (whether relating to income, sales,

franchise, withholding, real or personal property or other types of taxes) required to be filed under the laws of the United States and applicable states, and has paid in full all taxes which have become due pursuant to such returns or claimed to be due by any taxing authority or otherwise due and owing; provided, however, that the Company has not paid any tax, assessment, charge, levy or license fee that it is contesting in good faith and by proper proceedings and adequate reserves for the accrual of same are maintained if required by GAAP. The Company believes that each of the tax returns heretofore filed by the Company correctly and accurately reflects the amount of its tax liability thereunder. The Company has withheld, collected and paid all levies, assessments, license fees and taxes to the extent required.

## ARTICLE III.

### Representations, Warranties, and Agreements of the Investors

Each of the Investors, severally and not jointly, represents and warrants to, and agrees with, the Company as follows:

III.1 Organization. Such Investor (if not an individual) is duly organized under the laws of the state of its jurisdiction of organization and has full power and authority to enter into this Agreement and to consummate the transactions set forth herein. The address set forth on Schedule 1.1 hereof is such Investor's true and correct business, residence or domicile address.

### III.2 Accredited Investor, Experience, Access to Information, etc.

(a) Such Investor and, to the knowledge of such Investor, each limited partner of such Investor in the case of an Investor which is a limited partnership, and each partner of such Investor in the case of an Investor which is a general partnership, is an "accredited investor," as that term is defined in Rule 501 of Regulation D promulgated under the Securities Act;

(b) Such Investor and, to the knowledge of such Investor, the shareholders of the general partner of such Investor, if any, and each of the limited partners of such Investor, if any, have had substantial experience in investing in private transactions like this one, are capable of evaluating the merits and risks of an investment in the Company and understands that an investment in the Series E Preferred Stock and Warrants is speculative and involves a high degree of risk and should not be purchased by any one who cannot afford the loss of their entire investment. Such Investor has carefully considered the Risk Factors set forth in Exhibit E hereof; and



(c) Such Investor acknowledges that it has had a full opportunity to discuss the business, management and financial affairs of the Company with the Company's management. Such Investor has reviewed the Company's Annual Report on Form 10-KSB for the year ended December 31, 2000 and the Company's Quarterly Report on Form 10-QSB for the quarterly period ended June 30, 2001 and all additional requested documents from the Company and has had a full opportunity to ask questions of, and receive answers from, the officers of the Company concerning the terms and conditions of this Agreement, the purchase of the Series E Preferred Stock and Warrants, the business, operations, market potential, capitalization, financial condition and prospects of the Company, and all other matters deemed relevant by the Investor. Such Investor acknowledges that it has had an opportunity to evaluate all information regarding the Company as it has deemed necessary or desirable in connection with the transactions contemplated by this Agreement, has independently evaluated the transactions contemplated by this Agreement and has reached its own decision to enter into this Agreement.

III.3 Investment Intent. Such Investor is acquiring the Series E Preferred Stock and Warrants and the Underlying Securities for its or his own account for investment and not with a view to, or for sale in connection with, any public distribution thereof in violation of the Securities Act. Such Investor understands that none of the shares of Series E Preferred Stock and

Warrants or the Underlying Securities have been registered for sale under the Securities Act or qualified under applicable state securities laws and that the shares of Series E Preferred Stock and Warrants and the Underlying Securities are being offered and sold to such Investor pursuant to one or more exemptions. Such Investor understands that it must bear the economic risk of its investment in the Company for an indefinite period of time, as the Series E Preferred Stock and Warrants and the Underlying Securities cannot be sold unless subsequently registered under the Securities Act and qualified under state securities laws, unless an exemption from such registration and qualification is available. Such Investor acknowledges that no public market for the Series E Preferred Stock or Warrants of the Company presently exists and none may develop in the future.

III.4 Transfer of Securities. Such Investor will not sell or otherwise dispose of any Series E Preferred Stock and Warrants or Underlying Securities unless (a) a registration statement with respect thereto has become effective under the Securities Act and such Series E Preferred Stock and Warrants and Underlying Securities have been qualified under applicable state securities laws or (b) there is presented to the Company notice of the proposed transfer and, if it so requests, a legal opinion reasonably satisfactory to the Company that such registration and qualification is not required; provided, however, that no such registration or qualification or opinion of counsel shall be necessary for a transfer by such Investor (i) to any entity controlled by, or under common control with, such Investor, (ii) to a shareholder, partner or officer of such Investor, (iii) to a shareholder, partner or officer of the general partner of such Investor, (iv) to the spouse, lineal descendants, estate or a trust or for the benefit of any of the foregoing or (v) by operation of law, provided the transferee agrees in writing to be subject to the terms hereof to the same extent as if he were such Investor. Such Investor consents that any transfer agent of the Company may be instructed not to transfer any Series E Preferred Stock and Warrants or Underlying Securities unless it receives satisfactory



evidence of compliance with the foregoing provisions, and that there may be endorsed upon any certificate (or other instrument) representing such securities (and any certificates issued in substitution therefor) the following legend calling attention to the foregoing restrictions on transferability of such shares, stating in substance:

> "THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR THE SECURITIES LAWS OF ANY STATE AND MAY NOT BE SOLD OR TRANSFERRED IN THE ABSENCE OF SUCH REGISTRATION OR ANY EXEMPTION THEREFROM UNDER SUCH ACT AND LAWS, IF APPLICABLE. THE COMPANY, PRIOR TO PERMITTING A TRANSFER OF THESE SECURITIES, MAY REQUIRE AN OPINION OF COUNSEL OR OTHER ASSURANCES SATISFACTORY TO IT AS TO COMPLIANCE WITH OR EXEMPTION FROM SUCH ACT AND LAWS"

The Company shall, upon the request of any holder of Series E Preferred Stock, Warrants or Underlying Securities and the surrender of such securities, issue a new stock certificate and Warrants without such legend if (A) the Warrants or stock evidenced by such certificate has been effectively registered under the Securities Act and qualified under any applicable state securities law and sold by the holder thereof in accordance with such registration and qualification, or (B) such holder shall have delivered to the Company a legal opinion reasonably satisfactory to the Company to the effect that the restrictions set forth herein are no longer required or necessary under the Securities Act or any applicable state law.

III.5 Authorization. All actions on the part of such Investor necessary for the authorization, execution, delivery and performance by such Investor of this Agreement have been taken. This Agreement has been duly authorized, executed and delivered by such Investor, is the legal, valid and binding obligations of such Investor, and are enforceable as to such Investor in accordance with their respective terms, except as may be limited by applicable bankruptcy, reorganization, insolvency, moratorium or other similar laws or by legal or equitable principles relating to or limiting creditors' rights generally or as rights to indemnification may be limited by applicable securities laws.

III.6 Finder or Broker. Neither such Investor nor any person acting on behalf of such Investor has negotiated with any finder, broker, intermediary or similar person in connection with the transactions contemplated herein.



ARTICLE IV

Indemnification

IV.1 Indemnification by Investors. (a) Each Investor, severally and not jointly, agrees to indemnify and hold harmless the Company, its officers and directors, employees, agents and representatives and affiliates and each other person, if any, who controls any thereof, against any loss, liability, claim, damage and expense whatsoever (including, but not limited to, any and all expenses whatsoever reasonably incurred in investigating, preparing or defending against any litigation commenced or threatened or any claim whatsoever) arising out of or based upon any untruth, inaccuracy, or breach of any of the representations, warranties, covenants or agreements of such Investor contained in this Agreement or in any other document furnished by such Investor to any of the foregoing in connection with this transaction.

IV.2 Indemnification by the Company. The Company agrees to indemnify and hold harmless the Investors, its officers and directors, employees, agents, representatives and affiliates and each other person, if any, who controls any thereof, against any loss, liability, claim, damage and expense whatsoever (including, but not limited to, any and all expenses whatsoever reasonably incurred in investigating, preparing or defending against any litigation commenced or threatened or any claim whatsoever) arising out of or based upon any untruth, inaccuracy, or breach of any of the representations, warranties, covenants or agreements of the Company contained in this Agreement or in any other document furnished by the Company to any of the foregoing in connection with this transaction.

IV.3 Notices of Claims. Promptly after receipt by an indemnified party of notice of the commencement of any action or proceeding involving a claim referred to in Section IV.1 and IV.2, such indemnified party will, if a claim in respect thereof is to be made against an indemnifying party, give written notice to the latter of the commencement of such action; provided, however, that the failure of any indemnified party to give notice as provided herein shall not relieve the indemnifying party of its obligations under Section IV hereof, except to the extent that the indemnifying party is actually prejudiced by such failure to give notice. In case any such action is brought against an indemnified party, the indemnifying party shall be entitled to participate in and to assume the defense thereof, jointly with any other indemnifying party similarly notified to the extent that it may wish, with counsel reasonably satisfactory to such indemnified party, and after notice from the indemnifying party to such indemnified party of its election so to assume the defense thereof, the indemnifying party shall not be liable to such indemnified party for any legal or other expenses subsequently incurred by the latter in connection with the defense thereof other than reasonable costs of investigation; provided, however, that if the indemnified party reasonably believes it is advisable for it to be represented by separate counsel because there exists a conflict of interest between its interests and those of the indemnifying party with respect to such claim, or there exist defenses available to such indemnified party which may not be available to the indemnifying party, or if the indemnifying party shall fail to assume responsibility for such defense, the indemnified party may retain counsel satisfactory to it and the indemnifying party shall pay all fees and expenses of such counsel. No indemnifying party shall be liable for any settlement of any action or proceeding effected without its written consent, which consent shall not be unreasonably withheld or delayed. No indemnifying party shall, without the consent of the indemnified party, consent to entry of any judgment or enter into any settlement which does not include as an unconditional term thereof the giving by the claimant or plaintiff to such indemnified party of a release from

all liability in respect to such claim or litigation or which requires action other than the payment of money by the indemnifying party. Each indemnified party shall furnish such information regarding itself or the claim in question as an indemnifying party may reasonably request in writing and as shall be reasonably requested in connection with the defense of such claim and litigation resulting therefrom.

IV. 4 Contribution. If the indemnification provided for in Section IV.1 and IV.2 shall for any reason be held by a court of competent jurisdiction to be unavailable to an indemnified party in respect of any loss, claim, damage or liability, or any action in respect thereof, then, in lieu of the amount paid or payable under Section IV.1 or IV.2 hereof, the indemnified party and the indemnifying party shall contribute to the aggregate losses, claims, damages and liabilities (including legal or other expenses reasonably incurred in connection with investigating the same), (a) in such proportion as is appropriate to reflect the relative fault of the Company and the Investors in connection with the statement or omissions which resulted in such loss, claim, damage or liability, or action in respect thereof, as well as any other relevant equitable consideration (the relative fault of the Company and such Investors to be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission or alleged omission to state a material fact relates to information supplied by the Company or the Investors and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission) or (b) if the allocation provided by clause (a) above is not permitted by applicable law, in such proportion as shall be appropriate to reflect the relative benefits received by the Company and the Investors from the offering of the securities. No person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from any person who was not guilty of such fraudulent misrepresentation. In addition, no person shall be obligated to contribute hereunder any amounts in payment of any settlement of any action or claim effected without such person's consent, which consent shall not be unreasonably withheld or delayed.

## ARTICLE V
## Additional Provisions

V.1 CEO Hiring. Immediately following the Initial Closing, the Company agrees to use its best efforts to hire a new Chief Executive Officer. The holders of a majority of the Series E Preferred Stock shall have the right to approve the hiring of a new Chief Executive Officer.

V.2 Board Observer Rights. Following the Initial Closing, Wheatley Partners II, L.P., ("Wheatley") shall have the right to send two (2) representatives (who need not be the same individuals from meeting to meeting) to observe each meeting of the Board of Directors. The Company agrees to give Wheatley written notice of each such meeting and to provide Wheatley with an agenda no later than it gives such notice and provides such items to the directors.

V.3 FalconStor Voting Agreement. For so long as the holders of the outstanding shares of Series E Preferred Stock own at least 10% of the voting stock of the Company, and FalconStor owns any outstanding shares of Series E



Preferred Stock, FalconStor agrees, for all actions to be voted upon by the holders of the Series E Preferred Stock, to vote all of its outstanding shares of Series E Preferred Stock, and all of its outstanding shares, if any, of Common Stock issued upon the conversion or exercise of its Series E Preferred Stock, Common Stock Purchase Warrants and Additional Warrants, in the same manner as the holders of the majority of the Series E Preferred Stock excluding the Series E Preferred Stock owned by FalconStor.

V.4 Investment Banking Firms and Public Relations Firms. Following the Initial Closing the Company shall hire investment banking firms and public relations firms satisfactory to Wheatley.

V.5 Communications. All notices or other communications hereunder shall be in writing and shall be given by registered or certified mail (postage prepaid and return receipt requested), by an overnight courier service which obtains a receipt to evidence delivery or by telex or facsimile transmission (provided that written confirmation of receipt is provided), addressed as set forth below:

If to the Company:

Network-1 Security Solutions, Inc.
1601 Trapelo Road
Waltham, MA 02451
Attention: Murray P. Fish, President and Chief Financial Officer

With a copy to:
Olshan Grundman Frome Rosenzweig & Wolosky LLP
505 Park Avenue
New York, New York 10022-1170
Attention: Sam Schwartz, Esq.

If to the Investors, at their respective addresses as set forth on Schedule 1.1 hereto, or such other address as any party may designate to the other in accordance with the aforesaid procedure and with a copy to: Morrison Cohen Singer & Weinstein, LLP, 750 Lexington Avenue, New York, New York 10022, Attn: Michael Reiner, Esq., counsel to the Investors. All notices and other communications sent by overnight courier service shall be deemed to have been given as of the next business day after delivery thereof to such courier service, those given by telex or facsimile transmission shall be deemed given when sent, and all notices and other communications sent by mail shall be deemed given as of the third business day after the date of deposit in the United States mail.

V.6 Successors and Assigns. The Company may not sell, assign, transfer or otherwise convey any of its rights or delegate any of its duties under this Agreement, except to a corporation which has succeeded to substantially all of the business and assets of the Company and has assumed in writing its obligations under this Agreement, and this Agreement shall be



binding on the Company and such successor. This Agreement shall be binding upon, inure to the benefit of, and be enforceable by, the Investors and their successors and assigns.

V.7 Amendments and Waivers. Neither this Agreement nor any term hereof may be changed or waived (either generally or in a particular instance and either retroactively or prospectively) absent the written consent of the holders of a majority of the Series E Preferred Stock then outstanding.

V.8 Survival of Representations, Etc. The representations, warranties, covenants and agreements made herein or in any certificate or document executed in connection herewith shall survive the execution and delivery of this Agreement and the issuance and delivery of the Series E Preferred Stock, Warrants and Underlying Securities to the Investors and shall in no way be affected by any investigation of the subject matter thereof made by or on behalf of the Investor or the Company.

V.9 Delays or Omissions; Waiver. No delay or omission to exercise any right, power or remedy accruing to either the Company or the Investors upon any breach or default by the other under this Agreement shall impair any such right, power or remedy nor shall it be construed to be a waiver of any such breach or default, or any acquiescence therein or in any similar breach or default thereafter occurring; nor shall any waiver of any single breach or default be deemed a waiver of any other breach or default theretofore or thereafter occurring.

V.10 Entire Agreement. This Agreement (together with the exhibits attached hereto) contains the entire understanding of the parties with respect to their respective subject matter and all prior negotiations, discussions, commitments and understandings heretofore had between them with respect thereto are merged herein and therein.

V.11 Expenses. The Company shall, at the Closing and upon receipt of an invoice, reimburse reasonable fees and expenses of Morrison Cohen Singer & Weinstein LLP, counsel to the Investors.

V.12 Headings. All article and section headings herein are inserted for convenience only and shall not modify or affect the construction or interpretation of any provision of this Agreement.

V.13 Counterparts; Governing Law. This Agreement may be executed in any number of counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument. This Agreement shall be governed by, and construed in accordance with, the laws of the State of New York, without giving effect to conflict of laws.

V.14 Further Actions. At any time and from time to time, each party agrees, without further consideration, to take such actions and to execute and deliver such documents as may be reasonably necessary to effectuate the purposes of this Agreement.



V.15 Gender. As the context so requires, terms herein in the masculine form shall be construed to include the feminine form as well as neuter.



IN WITNESS WHEREOF, this Agreement has been duly executed on the date herein above set forth.

NETWORK-1 SECURITY SOLUTIONS, INC.

By: /s/ Murray P. Fish
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Murray P. Fish
President and Chief Financial Officer

INVESTORS