

FALCONSTOR SOFTWARE INC
Form DEF 14A
March 29, 2013

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

SCHEDULE 14A
(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

(Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Under Rule 14a-12

FALCONSTOR SOFTWARE, INC.
(Name of Registrant as Specified in Its Charter)

(Name of Persons(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

.. Fee paid previously with preliminary materials:

.. Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount previously paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

FALCONSTOR SOFTWARE, INC.

March 29, 2013

To Our Stockholders:

We invite you to attend our annual stockholders' meeting on Thursday, May 9, 2013 at our worldwide headquarters located at 2 Huntington Quadrangle, Suite 2S01, Melville, New York, at 9:00 a.m.

We are pleased to furnish proxy materials to stockholders primarily over the Internet. This process expedites stockholders' receipt of proxy materials, while significantly lowering the costs of our annual meeting and conserving natural resources. On March 29, 2013, we mailed our stockholders a notice containing instructions on how to access our 2013 Proxy Statement and 2012 Annual Report and vote online. The notice also included instructions on how you can receive a paper copy of your annual meeting materials, including the notice of annual meeting, proxy statement, and proxy card. If you received your annual meeting materials by mail, the notice of annual meeting, proxy statement, and proxy card from our Board of Directors were enclosed. If you received your annual meeting materials via e-mail, the e-mail contained voting instructions and links to the proxy statement and the annual report on the Internet, both of which are available at <http://proxy.falconstor.com>.

This booklet includes a formal notice of the meeting and the proxy statement. The proxy statement tells you more about the agenda and procedures for the meeting. It also describes how our Board of Directors operates and gives personal information about our director nominees.

Only stockholders of record at the close of business on March 15, 2013 will be entitled to vote at the annual meeting. Even if you only own a few shares, we want your shares to be represented at the annual meeting. We urge you to complete, sign, date, and return your proxy card promptly in the enclosed envelope.

Sincerely yours,

James P. McNiel
President & Chief Executive Officer

Eli Oxenhorn
Chairman of the Board of Directors

FALCONSTOR SOFTWARE, INC.

2 Huntington Quadrangle

Melville, NY 11747

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To Be Held May 9, 2013

To Our Stockholders:

The 2013 Annual Meeting of Stockholders (“Annual Meeting”) of FalconStor Software, Inc. (the “Company”), a Delaware corporation, will be held at the Company’s headquarters at 2 Huntington Quadrangle, Suite 2S01, Melville, New York, commencing at 9:00 a.m. (EDT) on Thursday, May 9, 2013, to consider and to vote on the following matters described in this notice and the accompanying Proxy Statement:

- 1) To elect two directors to the Company’s Board of Directors to three-year terms and until the directors’ successors are elected and qualified;
- 2) To approve the FalconStor Software, Inc., 2013 Outside Directors Equity Compensation Plan;
- 3) To ratify the appointment of KPMG LLP as our independent registered public accounting firm for fiscal 2013; and
- 4) Any other matters that properly come before the meeting.

At the Annual Meeting, the Company intends to nominate James P. McNiel and Barry Rubenstein for election to the Board of Directors. Mr. McNiel and Mr. Rubenstein are currently members of the Company’s Board of Directors. For more information concerning the nominees, please see the Proxy Statement.

The Board of Directors has fixed the close of business on March 15, 2013 as the record date for determination of stockholders entitled to vote at the Annual Meeting or any adjournment thereof, and only record holders of common stock at the close of business on that day will be entitled to vote. At the record date, 47,920,737 shares of common stock were outstanding.

To assure representation at the annual meeting, stockholders are urged to return a proxy as promptly as possible. You may return the proxy by signing, dating and returning the enclosed proxy card in the enclosed postage-prepaid envelope, or online at www.proxyvote.com, or by telephone. If returning your proxy by online vote or telephone, please follow the instructions on the Voting Information Form. Any stockholder attending the annual meeting may vote in person even if he or she previously returned a proxy.

If you plan to attend the Annual Meeting in person, we would appreciate your response by indicating so when returning the proxy.

Important Notice Regarding the Availability of Proxy Materials for the Stockholder Meeting to be held on May 9, 2013. The proxy statement and the annual report to security holders are available at <http://proxy.falconstor.com>.

By Order of the Board of Directors,

Seth R. Horowitz
Secretary

Melville, NY
March 29, 2013

FALCONSTOR SOFTWARE, INC.
2 Huntington Quadrangle
Melville, New York 11747

2013 PROXY STATEMENT

GENERAL INFORMATION

This proxy statement contains information related to the annual meeting of stockholders of FalconStor Software, Inc., to be held on Thursday, May 9, 2013 beginning at 9:00 a.m. (EDT), at the Company's headquarters at 2 Huntington Quadrangle, Suite 2S01, Melville, New York, and at any postponements or adjournments thereof.

ABOUT THE MEETING

What is the Purpose of the Annual Meeting

At the Company's annual meeting, stockholders will hear an update on the Company's operations, have a chance to meet some of its directors and executives and will act on the following matters:

- 1) To elect two directors to the Company's Board of Directors to three-year terms and until the directors' successors are elected and qualified;
- 2) To approve the FalconStor Software, Inc., 2013 Outside Directors Equity Compensation Plan;
- 3) To ratify the appointment of KPMG LLP as our independent registered public accounting firm for fiscal 2013; and
- 4) Any other matters that properly come before the meeting.

Who May Vote; Provision of Materials

Stockholders of FalconStor Software, Inc., as recorded in our stock register on March 15, 2013 (the "Record Date"), may vote at the meeting. As of this date, we had 47,920,737 shares of common stock eligible to vote. We have only one class of voting shares. All shares in this class have equal voting rights of one vote per share.

We are pleased to furnish proxy materials to stockholders primarily over the Internet. This process expedites stockholders' receipt of proxy materials, while significantly lowering the costs of our annual meeting and conserving natural resources. On March 29, 2013, we mailed our stockholders a notice containing instructions on how to access our 2013 Proxy Statement and 2012 Annual Report and vote online. The notice also included instructions on how you can receive a paper copy of your annual meeting materials, including the notice of annual meeting, proxy statement, and proxy card. If you received your annual meeting materials by mail, the notice of annual meeting, proxy statement, and proxy card from our Board of Directors were enclosed. If you received your annual meeting materials via e-mail, the e-mail contained voting instructions and links to the proxy statement and the annual report on the Internet, both of which are available at <http://proxy.falconstor.com>.

How to Vote

You may vote in person at the meeting or by proxy. We recommend that you vote by proxy even if you plan to attend the meeting. You can always change your vote at the meeting. To vote by proxy, you can mail the enclosed card, you can call the phone number on the Voting Instruction Form you received, or you can vote at www.proxyvote.com. If voting by phone or by the internet, have your Voting Instruction Form in hand and follow the instructions.

How Proxies Work

Our Board of Directors is asking for your proxy. Giving us your proxy means you authorize us to vote your shares at the meeting in the manner you direct. You may vote for or against the proposals or abstain from voting.

Proxies submitted will be voted by the individuals named on the proxy card in the manner you indicate. If you give us your proxy but do not specify how you want your shares voted, they will be voted in accordance with the Board of Directors recommendations, i.e., in favor of our director nominees, in favor of the approval of our 2013 Outside Directors Equity Compensation Plan, and in favor of the ratification of the appointment of KPMG LLP as our independent registered public accounting firm.

You may receive more than one proxy or voting card depending on how you hold your shares. If you hold shares through someone else, such as a stockbroker, you may get materials from them asking how you want to vote. The latest proxy card we receive from you will determine how we will vote your shares.

Revoking a Proxy

There are three ways to revoke your proxy. First, you may submit a new proxy with a later date up until the existing proxy is voted. Second, you may vote in person at the meeting. Last, you may notify our Chief Financial Officer in writing at 2 Huntington Quadrangle, Suite 2S01, Melville, New York 11747.

Quorum

In order to carry on the business of the meeting, we must have a quorum. This means at least a majority of the outstanding shares eligible to vote must be represented at the meeting, either by proxy or in person. Shares that we own are not voted and do not count for this purpose.

Votes Needed

The director nominees receiving a plurality of the votes cast during the meeting will be elected to fill the seats of our directors. For the other proposal to be approved, we require the favorable vote of a majority of the votes cast. Only votes for or against a proposal count. Votes that are withheld from voting on a proposal will be excluded entirely and will have no effect in determining the quorum or the plurality or the majority of votes cast. Abstentions and broker non-votes count for quorum purposes only and not for voting purposes. Broker non-votes occur when a broker returns a proxy but does not have the authority to vote on a particular proposal. Brokers that do not receive instructions are not entitled to vote on the election of the directors or the approval of our 2013 Outside Directors Equity Compensation Plan. Brokers are entitled to vote on the ratification of the auditors.

Attending in Person

Only stockholders, their proxy holders, and our invited guests may attend the meeting. For security purposes, all persons attending the meeting must bring identification with photo. If you wish to attend the meeting in person but

you hold your shares through someone else, such as a stockbroker, you must bring proof of your ownership to the meeting. For example, you could bring an account statement showing that you owned FalconStor Software, Inc., shares as of March 15, 2013 as acceptable proof of ownership.

SECURITY OWNERSHIP OF CERTAIN
BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information concerning ownership of the Common Stock of FalconStor Software, Inc., outstanding at March 15, 2013, by (i) each person known by the Company to be the beneficial owner of more than five percent of its Common Stock, (ii) each director and nominee for director, (iii) each of the Named Executive Officers identified in the summary compensation table, and (iv) all directors, nominees for director and Named Executive Officers of the Company as a group.

Name and Address of Beneficial Owner (1)	Shares Beneficially Owned	Percentage of Class (2)	
The Estate of ReiJane Huai (3) 3 Carlisle Drive Old Brookville, NY 11545	9,558,660	19.9	%
Barry Rubenstein (4) 68 Wheatley Road Brookville, NY 11545	2,725,538	5.7	%
Marilyn Rubenstein (5) c/o Barry Rubenstein 68 Wheatley Road Brookville, NY 11545	2,725,538	5.7	%
Eli Oxenhorn (6) 56 The Intervale Roslyn Estates, NY 11576	1,166,000	2.4	%
Irwin Lieber (7) 80 Cuttermill Road Suite 311 Great Neck, NY 11021	1,880,117	3.9	%
Steven R. Fischer (8)	145,000	*	
Alan W. Kaufman (9)	145,000	*	
Seth Horowitz (10)	182,800	*	
James P. McNiel (11)	1,466,307	3.0	%
Bernard Wu (12)	514,020	1.1	%
Louis J. Petrucelly (13)	113,900	*	
All Directors, Nominees for Director and Executive Officers as a Group (14) (9 persons)	8,338,682	16.6	%

*Less than one percent

(1) A person is deemed to be the beneficial owner of voting securities over which the person has voting power or that can be acquired by such person within 60 days after the record date upon the exercise of options, warrants or convertible securities, or upon the lapse or the removal of all restrictions on shares of restricted stock. Each beneficial owner's percentage ownership is determined by assuming that options, warrants or convertible securities that are held by such person (but not those held by any other person) and that are currently exercisable (i.e., that are exercisable within 60 days from the date hereof) have been exercised. Unless otherwise noted, we believe that all persons named in the table have sole voting and investment power with respect to all shares beneficially owned by them.

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- (2) Based upon shares of common stock outstanding at the Record Date, March 15, 2013, of 47,920,737.
- (3) Based upon information contained in Forms 4 filed by Mr. Huai prior to his death in September, 2011, and certain other information. Consists of (i) 9,517,660 shares of common stock held by Mr. Huai and (ii) 41,000 shares of common stock held by The 2002 ReiJane Huai Revocable Trust, of which Mr. Huai is a trustee. Mr. Huai disclaimed beneficial ownership of the securities held by The 2002 ReiJane Huai Revocable Trust, except to the extent of his equity interest therein.
- (4) Based upon information contained in Forms 4 and a report on Schedule 13D, (the "Woodland 13D"), filed jointly by Barry Rubenstein, Marilyn Rubenstein, Brookwood Partners, L.P. ("Brookwood"), Seneca Ventures ("Seneca"), Woodland Partners ("Woodland Partners"), Woodland Venture Fund ("Woodland Fund"), and Woodland Services Corp. ("Woodland Services") with the Securities and Exchange Commission ("SEC"), as well as certain other information. Consists of (i) 709,300 shares of common stock held by Mr. Rubenstein, (ii) 187,900 shares of common stock held by Brookwood, (iii) 131,323 shares of common stock held by Seneca, (iv) 957,257 shares of common stock held by Woodland Partners, (v) 436,800 shares of common stock held by Woodland Venture, (vi) 100,000 shares of common stock held by the Barry Rubenstein Rollover IRA account, (vii) 35,000 shares of common stock held by the Barry Rubenstein IRA account, (viii) 100,000 shares of common stock held in a joint account by Barry Rubenstein and Marilyn Rubenstein, Mr. Rubenstein's spouse, (ix) 16,700 shares of restricted stock, (x) 50,000 shares of Common Stock held by Barry Rubenstein issuable upon exercise of options that are currently exercisable or that will be exercisable within 60 days of March 15, 2013, and (xi) 1,258 shares of common stock held by Marilyn Rubenstein. Mr. Rubenstein disclaims beneficial ownership of the securities held by Brookwood, Seneca, Woodland Partners, Woodland Fund, Woodland Services, and Mr. Rubenstein's spouse, Marilyn Rubenstein, except to the extent of his respective equity interest therein.
- (5) Based upon information contained in the Woodland 13D and certain other information. Consists of (i) 1,258 shares of common stock held by Mrs. Rubenstein, (ii) 187,900 shares of common stock held by Brookwood, (iii) 131,323 shares of common stock held by Seneca, (iv) 957,257 shares of common stock held by Woodland Partners, (v) 436,800 shares of common stock held by Woodland Venture, (vi) 100,000 shares of common stock held in a joint account by Marilyn Rubenstein and Barry Rubenstein, Mrs. Rubenstein's spouse, (vii) 100,000 shares of common stock held by the Barry Rubenstein Rollover IRA account, (viii) 35,000 shares of common stock held by the Barry Rubenstein IRA account, (ix) 709,300 shares of common stock held by Barry Rubenstein, (x) 16,700 shares of restricted stock held by Barry Rubenstein, and (xi) 50,000 shares of Common Stock held by Barry Rubenstein issuable upon exercise of options that are currently exercisable or that will be exercisable within 60 days of March 15, 2013. Mrs. Rubenstein disclaims beneficial ownership of the securities held by Brookwood, Seneca, Woodland Partners, Woodland Fund, Woodland Services, and Mrs. Rubenstein's spouse, Barry Rubenstein, except to the extent of her respective equity interest therein.
- (6) Based on information contained in Forms 3 and 4 filed by Mr. Oxenhorn and certain other information. Consists of (i) 1,009,300 shares of common stock held by Mr. Oxenhorn, (ii) 90,000 shares of Common Stock held by the Eli Oxenhorn Family Limited Partnership (the "EOFLP"), (iii) 16,700 shares of restricted stock, and (iv) 50,000 shares of Common Stock issuable upon exercise of options that are currently exercisable or that will be exercisable within 60 days of March 15, 2013. Mr. Oxenhorn disclaims beneficial ownership of the securities held by the EOFLP, except to the extent of his respective equity interests therein.

- (7)Based on information contained in Forms 3, 4 and 5 filed by Mr. Lieber and certain other information. Consists of (i) 1,646,417 shares of common stock held by Mr. Lieber, (ii) 3,000 shares of common stock held in a joint account by Madeline Lieber and Irwin Lieber, Mr. Lieber's spouse, (iii) 164,000 shares of common stock held by Buckland Focus Fund ("Buckland") which Mr. Lieber is a General Partner, (iv) 16,700 shares of restricted stock, and (v) 50,000 shares of Common Stock issuable upon exercise of options that are currently exercisable or that will be exercisable within 60 days of March 15, 2013. Mr. Lieber disclaims beneficial ownership of the securities held by Buckland, except to the extent of his respective equity interests therein.
- (8)Based on information contained in Forms 4 filed by Mr. Fischer and certain other information. Consists of (i) 34,900 shares of common stock held by Mr. Fisher, (ii) 20,100 shares of restricted stock and (iii) 90,000 shares of common stock issuable upon exercise of options that are currently exercisable or that will be exercisable within 60 days of March 15, 2013.
- (9)Based on information contained in Forms 4 filed by Mr. Kaufman and certain other information. Consists of (i) 34,900 shares of common stock held by Mr. Kaufman, (ii) 20,100 shares of restricted stock and (iii) 90,000 shares of common stock issuable upon exercise of options that are currently exercisable or that will be exercisable within 60 days of March 15, 2013.
- (10)Based on information contained in Forms 4 filed by Mr. Horowitz and certain other information. Consists of (i) 80,000 shares of common stock held by Mr. Horowitz and (ii) 102,800 shares of common stock issuable upon exercise of options that are currently exercisable or that will be exercisable within 60 days of March 15, 2013.
- (11)Based on information contained in Forms 4 filed by Mr. McNiel and certain other information. Consists of (i) 163,107 shares of common stock held by Mr. McNiel and (ii) 1,303,200 shares of common stock issuable upon exercise of options that are currently exercisable or that will be exercisable within 60 days of March 15, 2013.
- (12)Based on information contained in Forms 4 filed by Mr. Wu and certain other information. Consists of (i) 246,020 shares of common stock held by Mr. Wu and (ii) 268,000 shares of common stock issuable upon exercise of options that are currently exercisable or that will be exercisable within 60 days of March 15, 2013.
- (13)Based on information contained in Forms 3 and 4 filed by Mr. Petrucelly and certain other information. Consists of (i) 12,950 shares of common stock held by Mr. Petrucelly, (ii) 2,550 shares of restricted stock and (iii) 98,400 shares of common stock issuable upon exercise of options that are currently exercisable or that will be exercisable within 60 days of March 15, 2013.
- (14)Consists of (i) 6,143,432 shares of common stock held by all directors, nominees for director and executive officers as a group, (ii) 92,850 shares of restricted stock, and (iii) 2,102,400 shares of common stock issuable upon exercise of options that are currently exercisable or that will be exercisable within 60 days of March 15, 2013.

Section 16(a) Beneficial Ownership Reporting Compliance

Based solely upon a review of Forms 3, 4, and 5, and amendments thereto furnished to the Company during the fiscal year ended December 31, 2012, the Company is not aware of any director, officer, or beneficial owner of more than 10 percent of any class of Company equities who failed to file on a timely basis any reports required by Section 16(a) of the Exchange Act, during the fiscal year ended December 31, 2012.

BOARD OF DIRECTORS

Independence

In accordance with the Company's Corporate Governance Guidelines, and the Nasdaq Stock Market corporate governance listing standards (the "Nasdaq Standards"), a majority of the Company's directors must be independent as determined by the Board. In making its independence determinations for directors, the Board looks to the Nasdaq Standards.

Under the Nasdaq Standards, a director is independent if: the director is not employed, nor is the director a family member of anyone employed as an executive officer by the Company or any parent or subsidiary; the director is not, and does not have a family member who is, a partner of the Company's outside auditor or a former partner or employee of the outside auditor who worked on the Company's audit during the past three years; the director has not, and does not have a family member who has, accepted more than \$120,000 during the current or past three fiscal years from the Company or any of its affiliates (other than compensation paid to a family member who is an employee of the Company (other than an Executive Officer of the Company)); the director is not, nor is any family member of the director, a partner in, or a controlling stockholder or an executive officer of, any organization to which the Company made, or from which the Company received, payments for property or services that exceed five percent of the recipient's consolidated gross revenues or \$200,000, whichever is more; and the director is not, and does not have any family member who is, an executive officer of another company where any of the Company's executive officers serve on the other company's compensation committee.

The Board of Directors currently consists of six directors, five of whom, Messrs. Fischer, Kaufman, Lieber, Oxenhorn and Rubenstein are independent. Mr. McNiel is a non-independent management director who does not sit on any of our Board committees.

Board Leadership Structure

Our governance documents provide the Board with flexibility to select the appropriate leadership structure for the Company.

The positions of Chairman of the Board and Chief Executive Officer are split. Jim McNiel serves as Chief Executive Officer and Eli Oxenhorn serves as Chairman of the Board of Directors.

Several factors ensure that we have a strong and independent Board. All directors, with the exception of Mr. McNiel are independent as defined under the Nasdaq's listing standards, and all committees of our Board are composed entirely of independent directors. In addition, the Nominating and Corporate Governance Committee and our Board have assembled a Board comprised of talented and dedicated directors with a wide range of expertise and skills. The Board regularly meets in executive session without management present.

Diversity

The Nominating and Corporate Governance Committee's evaluation of director nominees takes into account their ability to contribute to the diversity of, background, experience and point of views represented on the Board, and the committee will review its effectiveness in balancing these considerations when assessing the composition of the Board.

Role in Risk Management

The Board oversees that the assets of the Company are properly safeguarded, that the appropriate financial and other controls are maintained, and that the Company's business is conducted wisely and in compliance with applicable laws and regulations and proper governance. Included in these responsibilities is the Board of Directors' oversight of the various risks facing the Company. In this regard, the Board seeks to understand and oversee critical business risks. The Board does not view risk in isolation. Risks are considered in virtually every business decision and as part of the Company's business strategy. The Board recognizes that it is neither possible nor prudent to eliminate all risk. Indeed, purposeful and appropriate risk-taking is essential for the Company to be competitive on a global basis. The Board has implemented a risk governance framework to:

1. understand critical risks in the Company's business and strategy;
2. allocate responsibilities for risk oversight among the full Board and its Committees;
3. evaluate the Company's risk management processes and see they are functioning adequately;
4. facilitate open communication between management and Directors; and
5. foster an appropriate culture of integrity and risk awareness.

While the Board oversees risk management, Company management is charged with managing risk. The Company has robust internal processes and a strong internal control environment to identify and manage risks and to communicate with the Board. These include a Code of Business Conduct, regular training of salespeople on risks and appropriate conduct, and a comprehensive internal and external audit process. The Board and the Audit Committee monitor and evaluate the effectiveness of the internal controls and the risk management program at least annually. Management communicates routinely with the Board, Board Committees and individual Directors on the significant risks identified and how they are being managed. Directors are free to, and indeed often do, communicate directly with senior management. The Board implements its risk oversight function both as a whole and through Committees. Much of the work is delegated to various Committees, which meet regularly and report back to the full Board. All Committees play significant roles in carrying out the risk oversight function. In particular:

- The Audit Committee oversees risks related to the Company's financial statements, the financial reporting process, accounting and legal matters, currency fluctuation and hedging, and investments. The Audit Committee oversees the internal audit function and the Company's ethics programs, including the Codes of Business Conduct. The Audit Committee members meet separately with the independent auditing firm.
- The Compensation Committee evaluates the risks and rewards associated with the Company's compensation philosophy and programs. Management discusses with the Compensation Committee the procedures that have been put in place to identify and mitigate potential risks in compensation.

As a result of certain events involving the Company in 2010, the Audit Committee, the Compensation and the Board instituted new controls in the areas of financial reporting, compensation, equity grants and expenses.

Meetings

The Board of Directors met on twelve occasions during the fiscal year ended December 31, 2012. In addition to the meetings, the members of the Board of Directors sometimes take action by unanimous written consent in lieu of a meeting, which is permitted. All Directors attended at least 75% of the meetings of the Board of Directors during the

times they were Directors.

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Committees

The Board of Directors currently has three committees: the Audit Committee; the Compensation Committee; and the Nominating and Corporate Governance Committee. Each of these committees has a charter. These charters are available on the Company's website at:

<http://www.falconstor.com/BoardCommittees>.

Audit Committee

The Audit Committee consists of Messrs. Fischer (Chair), Lieber and Rubenstein. The Audit Committee is appointed by the Board to assist the Board in monitoring (1) the integrity of the financial statements of the Company, (2) the qualifications and independence of the independent registered public accounting firm engaged to audit the Company's consolidated financial statements, (3) the performance of the Company's internal audit function and independent auditors, (4) the integrity of management and information systems and internal controls, and (5) the compliance by the Company with legal and regulatory requirements.

Each member of the Audit Committee is required to be "independent" as defined in the Nasdaq Standards and in Section 301 of the Sarbanes-Oxley Act of 2002 (the "Act") and Rule 10A-3 of the Securities Exchange Act of 1934, as amended. The Board has determined that each member of the Audit Committee is "independent" under these standards. In addition, the Board has determined that, as required by the Nasdaq Standards, each member of the Audit Committee was able to read and to understand financial statements at the time of his appointment to the Audit Committee.

The Board has further determined that Mr. Fischer meets the definition of "audit committee financial expert," and therefore meets comparable Nasdaq Standard requirements, because he has an understanding of financial statements and generally accepted accounting principles ("GAAP"); has the ability to assess GAAP in connection with the accounting for estimates, accruals, and reserves; has experience in analyzing and evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the Company's financial statements; has an understanding of internal controls and procedures for financial reporting; and has an understanding of audit committee functions. Mr. Fischer acquired these attributes through education and experience consistent with the requirements of the Act.

The Audit Committee met six times during the fiscal year ended December 31, 2012. All members of the Audit Committee attended at least 75% of the meetings of the committee during the fiscal year ended December 31, 2012.

The Company's Board of Directors has adopted, and annually reviews, an Audit Committee Charter and Guidelines for Pre-Approval of Independent Auditor Services. As indicated above, a copy of the Company's Audit Committee Charter is available on the Company's website at:

<http://www.falconstor.com/BoardCommittees>.

Compensation Committee

The Compensation Committee consists of Messrs. Kaufman, Lieber (Chair) and Oxenhorn. The Compensation Committee is appointed by the Board (i) to discharge the responsibilities of the Board relating to compensation of the Company's executives, (ii) to produce the annual report that is required by the rules of the Securities and Exchange Commission to be included in the Company's annual proxy statement, and (iii) to administer, and to approve awards under, the Company's equity-based compensation plans for employees. Under the Compensation Committee Charter, all members of the Compensation Committee are required to be "independent" as defined in the Nasdaq Standards. The

Board has determined that all of the current members of the Compensation Committee are “independent” under these standards.

The Compensation Committee met fourteen times during the fiscal year ended December 31, 2012. All members of the Compensation Committee attended at least 75% of the meetings of the committee during the fiscal year ended December 31, 2012.

Nominating and Corporate Governance Committee

The Nominating and Corporate Governance Committee consists of Messrs. Kaufman (Chair), Oxenhorn and Rubenstein. The Nominating and Corporate Governance Committee is appointed by the Board: (i) to identify individuals qualified to become Board members, (ii) to recommend to the Board director candidates for each annual meeting of stockholders or as necessary to fill vacancies and newly created directorships and (iii) to perform a leadership role in shaping the Company's corporate governance policies, including developing and recommending to the Board a set of corporate governance principles. Under the Nominating and Corporate Governance Committee Charter, all members of the Nominating and Corporate Governance Committee are required to be "independent" as defined in the Nasdaq Standards. The Board has determined that all of the current members of the Nominating and Corporate Governance Committee are "independent" under these standards.

The Nominating and Corporate Governance Committee met one time during the fiscal year ended December 31, 2012. All members of the Nominating and Corporate Governance Committee attended at least 75% of the meetings of the committee during the fiscal year ended December 31, 2012.

Nominating Procedures and Director Qualifications

The Nominating and Corporate Governance Committee has adopted the following policies regarding nominations and director qualifications:

I. Consideration of Nominees Recommended by Stockholders

The Committee recognizes that qualified candidates for nomination for Director can come from many different sources, including from the Company's stockholders. The Committee will therefore consider any nominee who meets the minimum qualifications set forth below.

To propose a nominee, a stockholder must provide the following information:

1. The stockholder's name and, if different, the name of the holder of record of the shares.
2. The stockholder's address and telephone number.
3. The name of the proposed nominee.
4. The address and phone number of the proposed nominee.
5. A listing of the proposed nominee's qualifications.

6. A statement by the stockholder revealing whether the proposed nominee has assented to the submission of her/his name by the stockholder.

7. A statement from the stockholder describing any business or other relationship with the nominee.
- 8.

A statement from the stockholder stating why the stockholder believes the nominee would be a valuable addition to the Company's Board of Directors.

The stockholder should submit the required information to:

Nominating and Corporate Governance Committee
c/o General Counsel
FalconStor Software, Inc.
2 Huntington Quadrangle
Suite 2S01
Melville, NY 11747

With a copy to:

Director Human Resources
FalconStor Software, Inc.
2 Huntington Quadrangle
Suite 2S01
Melville, NY 11747

If any information is missing, the proposed nominee will not be considered.

II. Qualifications for Candidates

The Committee believes that the Company and its stockholders are best served by having directors from diverse backgrounds who can bring different skills to the Company. It is therefore not possible to create a rigid list of qualifications for Director candidates. However, absent unique circumstances, the Committee expects that each candidate should have the following minimum qualifications:

- Substantial experience with technology companies. This experience may be the result of employment with a technology company or may be gained through other means, such as financial analysis of technology companies;
 - The highest level of personal and professional ethics, integrity and values;
 - An inquiring and independent mind;
 - Practical wisdom and mature judgment;
- Expertise that is useful to the Company and complementary to the background and experience of other Board members, so that an optimal balance of Board members can be achieved and maintained;
- Willingness to devote the required time to carrying out the duties and responsibilities of Board membership;
- Commitment to serve on the Board for several years to develop knowledge about the Company's business;
- Willingness to represent the best interests of all stockholders and to objectively appraise management performance; and
- Involvement only in activities or interests that do not conflict with the director's responsibilities to the Company and its stockholders.

At any time, the Committee may be looking for director candidates with certain qualifications or skills to replace departing directors or to complement the skills of existing directors and to add to the value of the Board of Directors.

III. Identification and Evaluation of Candidates

Candidates for director may come from many different sources including, among others, recommendations from current directors, recommendations from management, third-party search organizations, and stockholders.

In each instance, the Committee will perform a thorough examination of the candidate. An initial screening will be performed to ensure that the candidate meets the minimum qualifications set forth above and has skills that would enhance the Board of Directors. Following the initial screening, if the candidate is still viewed as a potential nominee, the Committee will perform additional evaluations including, among other things, some or all of the following: Detailed resume review; personal interviews; interviews with employer(s); and interviews with peer(s).

All candidates will be reviewed to determine whether they meet the independence standards of the Nasdaq Standards. Failure to meet the independence standards may be a disqualifying factor based on the Board of Director's composition at the time. Even if failure to meet the independence standards is not by itself disqualifying, it will be taken into account by the Committee in determining whether the candidate would make a valuable contribution to the Board of Directors.

Contacting the Board of Directors

Stockholders and others may contact FalconStor's Board of Directors by sending a letter to:

Board of Directors
FalconStor Software, Inc.
2 Huntington Quadrangle, Suite 2S01
Melville, NY 11747

or by clicking on the "Contact FalconStor's Board of Directors" link on the FalconStor Corporate Governance home page at: <http://www.falconstor.com/ContactBoard>.

Communications directed to the Board of Directors are screened by the Company's Legal and/or Investor Relations departments. Routine requests for Company information are handled by the appropriate Company department. Other communications are reviewed to determine if forwarding to the Board of Directors is necessary or appropriate. The Board of Directors receives a quarterly summary of all communications that are not forwarded to the Board's attention. All communications are kept on file for one year for any Director who wishes to view them.

Attendance at Annual Meetings

The Company's policy is that, except for unusual circumstances, all board members should attend the Company's Annual Meetings of Stockholders. All board members attended the Company's 2012 Annual Meeting of Stockholders.

PROPOSAL NO. 1 ELECTION OF DIRECTORS

The Company's bylaws authorize the Board of Directors to fix the number of directors and provide that the directors shall be divided into three classes, with the classes of directors serving for staggered, three-year terms.

The Company currently has six Directors.

Nominees

James P. McNiel and Barry Rubenstein were nominated by the Company's Nominating and Corporate Governance Committee as the Board of Directors' nominees for director. Mr. McNiel and Mr. Rubenstein are currently directors of the Company. It is proposed that Mr. McNiel and Mr. Rubenstein be elected to serve until the Annual Meeting of Stockholders to be held in 2016 and until their successors are elected and shall have qualified.

Unless authority is specifically withheld, proxies will be voted for the election of Mr. McNiel and Mr. Rubenstein to serve as a director of the Company for a term which will expire at the Company's 2016 Annual Meeting of Stockholders and until a successor is elected and qualified. If any one or more of such nominees should for any reason become unavailable for election, the persons named in the accompanying form of proxy may vote for the election of such substitute nominees as the Board of Directors may propose. The accompanying form of proxy contains a discretionary grant of authority with respect to this matter.

Name	Position	Age	Director Since
James P. McNiel	Director Nominee	50	2011
Barry Rubenstein	Director Nominee	69	2009

James P. McNiel has been President and Chief Executive Officer of the Company since January 11, 2011. From September 28, 2010 to January 11, 2011, Mr. McNiel was Interim President and Interim Chief Executive Officer of the Company. From December 2009 to September, 2010, Mr. McNiel was a Vice President and Chief Strategy Officer of the Company. From 2006 to 2010, Mr. McNiel was President and Chief Executive Officer of Fifth Generation Systems, Inc., a social media software company. From 1997 to 2006, Mr. McNiel was a General Partner of Pequot Ventures where he managed successful investments in Netegrity, NetGear, OutlookSoft, and other technology companies. Mr. McNiel is a director of Interfusio, Ltd. Mr. McNiel is a graduate of the Wharton School Advanced Management Program and obtained a Certificate of Finance for Technology Executives from the Sloan School of Management. Mr. McNiel has been a Director of the Company since January 11, 2011.

The following experience, qualifications, attributes and/or skills led the Board to conclude that Mr. McNiel should serve as a director: his leadership role at the Company; his performance at the Company; his history with software and other technology companies; and his service on other company and not-for-profit boards.

Barry Rubenstein has been involved as a founder or primary, Series A round investor, in technology companies since 1969. Mr. Rubenstein was a founder, or founding consultant, to several technology companies, including Applied Digital Systems, Inc. (1969), Novell, Inc. (1983), Cheyenne Software, Inc. (1983), and Scan Source (1993). From 1985 to 1987, he served as Chairman and CEO of Cheyenne Software. Mr. Rubenstein currently serves or has previously served on the Boards of several technology companies including: US Web, Inc., Picazo Communications, Inc. (now part of Intel, Inc.), Fatwire Corporation (now part of Oracle), Certpoint, Inc., and Broadcastr.com. Mr. Rubenstein holds a BS in Electrical Engineering from City College of New York and an MS in Computer Sciences from New York University. Mr. Rubenstein is a principal of the following Venture Capital Partnerships - Wheatley Partners, Wheatley New York, Wheatley MedTech. Mr. Rubenstein was a director of a predecessor of the Company from February 2000 through August 2001, Chairman of the predecessor from July 2000, through August, 2000, and President of the predecessor from February 2000 through July 2000. Mr. Rubenstein has been a Director of the Company since November, 2009.

The following experience, qualifications, attributes and/or skills led the Board to conclude that Mr. Rubenstein should serve as a director: his professional background and experience; his current and previously held senior-executive level positions; his service on other public and private company boards; and his extensive experience in technology, software, storage and related industries.

Continuing Directors

The names of the directors, whose terms expire at the 2014 and 2015 Annual Meetings of Stockholders of the Company, who are currently serving their terms, are set forth below:

Name	Position	Age	Director Since
Steven Fischer	Director	66	2001
Alan W. Kaufman	Director	73	2005
Irwin Lieber	Director	73	2009
Eli Oxenhorn	Director	65	2009

Steven R. Fischer is a private investor. From July 2004 through July 2008, he was president of Capital One Leverage Finance Corp. and its predecessor entity. From February 2004 until July 2004, he was a consultant to financial institutions. From 1992 to February 2004, he held multiple executive management and financial positions, including most recently President, with Transamerica Business Capital Corporation, a member of the Transamerica Finance Corporation family of companies, specializing in secured lending for mergers, acquisitions and restructurings. From 1981 to 1992, he served as Vice President and Regional Manager of Citibank, N.A. Since 1995, he has served as a director of ScanSource, Inc., a value-added distributor of POS and bar code products. Beginning in 2001 he served on the board of advisors of Keltic Financial LLC., a privately held finance company that funds middle market companies. He holds a B.S. in Economics and Accounting from Queens College and an M.B.A. from Baruch College. Mr. Fischer has been a Director of the Company since August 2001, and his term as a director of the Company expires in 2014.

The following experience, qualifications, attributes and/or skills led the Board to conclude that Mr. Fischer should serve as a director: his professional background and experience; his previously held senior-executive level positions; his service on other public and private company boards, FalconStor board experience, board attendance and participation; and his extensive experience in public company finance and analysis.

Alan W. Kaufman is an experienced technology executive with over thirty five years of experience in the computer and software industries. He was a director of Applucent Technologies from October 2002 to May 2009. He was a director of NetIQ Corporation from August 1997 until its merger with Attachment Corporation in August 2006. Mr. Kaufman served as a director of QueryObject Systems Corp. from October 1997 to March 2002. He also served as QueryObject Systems' Chairman of the Board from May 1998 to October 1999, and as President and Chief Executive Officer from October 1997 to December 1998, when he retired. From December 1996 to October 1997, Mr. Kaufman was an independent consultant. From April 1986 to December 1996, Mr. Kaufman held various positions at Cheyenne Software. Mr. Kaufman was the founding president of, and was on the Board of Directors of, the New York Software Industry Association. He is on the Advisory Board of the CUNY (City University of New York) Institute for Software Design and Development. Mr. Kaufman holds a B.S. in electrical engineering from Tufts University. Mr. Kaufman has been a director of the Company since May 2005, and his term as a Director of the Company expires in 2015.

The following experience, qualifications, attributes and/or skills led the Board to conclude that Mr. Kaufman should serve as a director: his professional background and experience, current and previously held senior-executive level positions; his service on other public and private company boards; FalconStor board experience, board attendance and participation; and his extensive experience in technology and sales and marketing.

Irwin Lieber is a general partner and co-founder of Wheatley Partners and Chairman of GeoCapital LLC. Mr. Lieber formed GeoCapital, an investment management company focused on small capitalization companies in a variety of industries, including technology, in 1979. Mr. Lieber was also a founding General Partner of GeoCapital Ventures, a fund investing in information services and software companies. He currently serves, or previously has served, on the Boards of Merlot Communications, Softlink, Evoke Software, Band Digital, Cheyenne Software, Seniors 4 Living, Inc., Tried Systems, Inc., CertPoint Systems, Inc., and Blackbook, Inc. Mr. Lieber is a Chartered Financial Analyst and holds a M.S. in Electrical Engineering from Syracuse University. Mr. Lieber was a director of a predecessor of the Company from 2000 through August 2001. Mr. Lieber has been a Director of the Company since November, 2009, and his term as a Director of the Company expires in 2015.

The following experience, qualifications, attributes and/or skills led the Board to conclude that Mr. Lieber should serve as a director: his professional background and experience; his service on other public and private company boards; and expertise in public company finance and analysis.

Eli Oxenhorn is a private investor in emerging-growth technology companies and has served as an adviser to Wheatley Partners. From 1985 to 1987, Mr. Oxenhorn served as President, and from 1987 to 1994, Mr. Oxenhorn served as Chairman and CEO, of Cheyenne Software, Inc., which he built into a billion-dollar industry leader in providing backup and archiving solutions for networked computers. Mr. Oxenhorn has also held several senior management positions at Gates/FA, including Chairman of the Board from 1987 to 1989. From 1974 to 1983, Mr. Oxenhorn held various senior technology positions at Warner Communications. Mr. Oxenhorn is a director of CertPoint Systems, Inc. Mr. Oxenhorn has been Director of the Company since November, 2009, and his term as a Director of the Company expires in 2014. Mr. Oxenhorn has been Chairman of the Board of the Company since September 2010, and his term as a Director of the Company expires in 2014.

The following experience, qualifications, attributes and/or skills led the Board to conclude that Mr. Oxenhorn should serve as a director: his professional background and experience; his current and previously held senior-executive level positions; his service on other public and private company boards; and his extensive experience in technology, software, storage and related industries.

Recommendation of the Board of Directors

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE ELECTION OF THE NOMINEES.

Directors who are also employees receive no compensation for serving on the Company's Board of Directors. Non-employee directors are reimbursed for all travel and other expenses incurred in connection with attending Board and Committee meetings.

For 2012, the cash fee for the Chairman of the Board was set at \$45,000.

For 2012, the cash fee for all other outside directors was set at a base amount of \$26,500 per director. The chairperson of the Audit Committee received an additional \$10,000 per annum and the chairperson of any other Board committee received an additional \$5,000 per annum. In addition, outside directors received \$3,000 per annum for each committee on which they serve in a capacity other than chairperson. Cash director fees were paid quarterly in arrears. Because all directors are expected, absent unusual circumstances, to attend all meetings of the Board and all meetings of the

committees on which they serve, outside directors typically do not receive any payment based on attendance at meetings. If circumstances require an unusually large number of meetings, the Company may compensate outside directors with additional cash in recognition of the increased time devoted to Company matters.

Non-employee directors also were eligible to receive grants of options to purchase Company common stock or restricted shares of Company common stock under the FalconStor Software, Inc., 2010 Outside Directors Equity Compensation Plan (the "2010 Plan"). Initially, 400,000 shares were reserved under the 2010 Plan. The 2010 Plan expired in 2013 and accordingly the Company is seeking stockholder approval for a proposal to adopt the 2013 Outside Directors Equity Compensation Plan. On May 7, 2012, each of the non-employee directors was awarded options to purchase 10,000 shares of Company common stock under the 2010 Plan. The options vest 33%, 33% and 34% on the first three anniversaries of the grant, or immediately if the non-employee director's term in office expires and the director is not nominated for another term.

The table below sets forth the compensation received by our non-employee directors for the year 2012.

Name	Fees Earned or Paid in Cash (1)	Stock Awards (2)	Total
Steven R. Fischer	\$ 36,400	\$ 32,100	\$ 68,500
Alan W. Kaufman	\$ 34,405	\$ 32,100	\$ 66,505
Irwin Lieber	\$ 34,405	\$ 32,100	\$ 66,505
Eli Oxenhorn (3)	\$ 50,861	\$ 32,100	\$ 82,961
Barry Rubenstein	\$ 32,411	\$ 32,100	\$ 64,511

(1) Fees were earned in 2012 and paid in both 2012 and 2013.

(2) The Company granted 10,000 shares of restricted stock to each non-employee director on May 7, 2012 at a grant date fair value of \$3.21 per share, that vest over three-years at 33%, 33% and 34%, respectively. The dollar amounts in the table represent the total grant date fair value of the award in accordance with the authoritative guidance issued by the Financial Accounting Standards Board (“FASB”) on stock compensation.

(3) On May 6, 2011, Mr. Oxenhorn opted to participate in the FalconStor Software, Inc. Director Compensation Deferral Plan (the “Deferral Plan”). Under the Deferral Plan, Mr. Oxenhorn elected to defer 100% of his earned 2011 and 2012 director fees. Any deferred payments will be made in a single lump sum within 60 days of May 31, 2013 and 2014, respectively, or if earlier, within 60 days of Mr. Oxenhorn’s separation from service, disability or death.

MANAGEMENT

Executive Officers of the Company

The following table contains the names, positions and ages of the executive officers of the Company who are not directors.

Name	Position	Age
Seth Horowitz	Vice President, General Counsel and Secretary	49
Louis Petrucelly	Vice President, Chief Financial Officer and Treasurer	38
Bernard Wu	Vice President, Business Development	55

Seth Horowitz has served as Vice President, General Counsel and Secretary of the Company since January 2003. From March 2002 through December 2002, Mr. Horowitz served as Corporate Counsel to the Company. Before joining the Company, Mr. Horowitz held positions with NewView Technologies, Inc., Reliance Group Holdings, Inc., and Fried, Frank, Harris, Shriver & Jacobson. Mr. Horowitz also served as a clerk to The Honorable Milton Pollack. Mr. Horowitz received his J.D. from Columbia Law School and he received his A.B. from Harvard College.

Louis J. Petrucelly has served as Chief Financial Officer, Vice President, and Treasurer of the Company since August 7, 2012. From May 25, 2012, through August 7, 2012, Mr. Petrucelly was Acting Chief Financial Officer, Vice President of Finance and Treasurer of the Company. Mr. Petrucelly joined the Company in March 2007 as Director of Financial Reporting and served as the Company's Director of Finance from March 2008 through May 2012. Mr. Petrucelly has more than 15 years of experience in multi-dimensional corporate finance, operations, and accounting. Prior to joining FalconStor, he was the Corporate Controller for Granite Broadcasting Corporation and held several senior financial management positions with PASSUR Aerospace, Inc., including Chief Financial Officer. He began his career with Ernst & Young, LLP. Mr. Petrucelly received his B.S. from the C.W. Post Campus of Long Island University.

Bernard Wu has served as Vice President of Business Development of the Company and its predecessor entity since November 2000. From 1998 to October 2000, Mr. Wu was Senior Vice President of sales and marketing for the Internet Outsourcing Division of Trend Micro, a leading Internet security software company. Mr. Wu had worldwide responsibility for defining, launching, and managing OEM, service, and alliance partnerships with ISPs, ASPs, telecommunication carriers, and other software companies for the purpose of offering network-based security services. Prior to that, Mr. Wu had 15 years' experience in various executive and managerial positions at companies such as Intel, Seagate, Conner Peripherals, and Computer Associates/Cheyenne in areas including product development, marketing, and OEM/channel sales of RAID, optical, and tape-based storage management software and subsystems. In 1996 he co-authored a patent in the area of SCSI enclosure management services which has been widely adopted in the industry. Mr. Wu has a BS/MS in engineering from the University of California at Berkeley and an MBA from University of California at Los Angeles Anderson School of Management.

Code of Ethics

In May, 2004, the Company adopted a Code of Ethics that applies to the Company's principal executive, financial and accounting officers. The Code of Ethics is available at: <http://www.falconstor.com/CodeOfEthics>.

EXECUTIVE COMPENSATION

A. COMPENSATION DISCUSSION AND ANALYSIS

This section discusses the compensation programs for our Chief Executive Officer, our Chief Financial Officer, and our other Executive Officers (each a “Named Executive Officer” or “NEO”).

Roles and Responsibilities

Our Compensation Committee is responsible for, among other things, the establishment and review of compensation policies and programs for our Named Executive Officers and ensuring that these NEOs are compensated in a manner consistent with the objectives and principals set forth below.

The Compensation Committee makes all compensation decisions for our Named Executive Officers. The Committee is responsible for negotiating the terms of an employment agreement with our Chief Executive Officer and for annually evaluating his performance. Our Chief Executive Officer annually reviews the performance of each of the other NEOs and presents to the Compensation Committee his recommendations, including salary adjustments and incentive compensation. The Compensation Committee may exercise its discretion in modifying any recommended salary adjustments or awards to these executives. The Committee also considers benchmark competitive compensation market data, the compensation of other Company executives, and the Named Executive Officers’ levels of responsibility, prior experience, breadth of knowledge and job performance when making compensation decisions for all of our Named Executive Officers.

The role of Company management is to provide reviews and recommendations for the Compensation Committee’s consideration and to manage operational aspects of the Company’s compensation programs, policies, and governance. Direct responsibilities include, but are not limited to, (i) providing an ongoing review of the effectiveness of the compensation programs, including competitiveness and alignment with the Company’s objectives, (ii) recommending changes, if necessary, to ensure achievement of all program objectives and (iii) recommending equity awards for officers and employees. Management also prepares tally sheets which set out all components of total compensation for our Named Executive Officers, including salary, incentive compensation and outstanding equity awards. The results of any reviews, and the recommendations, are provided to the compensation committee in written form. The Company’s Chief Financial Officer, in conjunction with the CEO, typically discusses the information with the compensation committee. The Compensation Committee, from time to time, gets advice from the Company’s General Counsel on legal, compliance and regulatory issues related to the compensation of the NEOs.

Compensation Objectives

For all Named Executive Officers, compensation is intended to be performance-based. Our Compensation Committee believes that compensation paid to executive officers should be closely aligned with our performance on both a short-term and long-term basis to create value for shareholders, and that such compensation should assist us in attracting and retaining key executives critical to our long-term success.

In establishing compensation for our Named Executive Officers, the following are the Compensation Committee's objectives:

- Attract and retain individuals of superior ability and managerial talent;
- Ensure officers’ compensation is aligned with our corporate strategies and business objectives, and the long-term interests of our stockholders; and

- Enhance the officers' incentive to maximize stockholder value, as well as promote retention of key people, by providing a portion of total compensation for management in the form of direct ownership in us through stock options and grants of restricted stock.

To achieve these objectives, our overall compensation program aims to pay our Named Executive Officers competitively, consistent with our success and their contribution to that success. To accomplish this we rely on programs that provide compensation in the form of both cash and equity. Although our Compensation Committee has not adopted any formal guidelines for allocating total compensation between cash and equity, the Compensation Committee considers the balance between providing short-term incentives and long-term parallel investment with stockholders to align the interests of management with stockholders.

Components of Executive Compensation

The principal components of compensation for our Named Executive Officers are:

- Base salary;
- Non-equity incentive plan compensation;
- Long-term equity incentives; and
- Other benefits

Base salary

We provide our Named Executive Officers and other employees with base salary to compensate them for services rendered during the fiscal year. We believe that our base salaries are competitive and we generally target our executive officer base salaries against the 50th — 75th percentile of comparable companies. In some circumstances it may be necessary to provide compensation above these levels; these circumstances include the need to retain key individuals, to reward individual performance, and/or to attract individuals with the necessary skillset. Salaries for the Named Executive Officers are suggested by Company management and reviewed and approved by the Compensation Committee.

Salaries for the Named Executive Officers are typically reviewed annually.

Mr. McNiel's base salary for 2010 was based on the terms set forth in an offer letter. His compensation for 2011, 2012 and 2013 is based on the terms of his employment agreement as more fully described under the heading "Narrative Discussion to Summary Compensation Table," below. Base salaries for NEOs, other than the CEO, whose base salary is contractual, may be adjusted for performance-based compensation if the ratio between base and performance-based compensation changes significantly. For example, if the value of long-term performance-based incentive grants was to substantially decline due to market conditions, the Compensation Committee might consider increasing base salary in order to retain the NEOs. In May, 2012, when Mr. Petrucelly was named Acting Chief Financial Officer, his salary was set at \$185,000. In August, 2012, when Mr. Petrucelly was named Chief Financial Officer, his salary was increased to \$225,000. In March, 2012, Mr. Horowitz's base salary was increased to \$280,000.

Non-Equity Incentive Plan Compensation

From the inception of the Company through 2011, non-equity incentive compensation for the Named Executive Officers was awarded on an ad hoc basis upon recommendation from the Company's Chief Executive Officer to reward the performance of the executive officers and in accordance with the Company's performance.

In March, 2012, we adopted the 2012 Management Incentive Bonus Plan (the “2012 Plan”). The 2012 Plan is designed to reward performance against key corporate goals and covers both the Named Executive Officers and other members of our Company’s management team. The non-equity incentive plan compensation targets were approved after considering targets for comparable positions at the benchmark companies discussed below; the scope of and accountability associated with each Named Executive Officer’s position; and the performance and experience of each Named Executive Officer. The performance metrics against which our Named Executive Officers are measured are clearly communicated, consistently applied and are focused on corporate objectives. The 2012 Plan incentive targets were designed to motivate management to achieve specific goals related to certain revenue and profitability objectives. These metrics were selected because we believed that, at this stage of our development, they were most closely correlated to increasing stockholder value. In addition to the metrics, there is a component of judgment in the actual bonuses to be granted to Messrs. Horowitz, Petrucelly and Wu.

For our Named Executive Officers, the components of the potential bonus are as follows:

Named Executive Officer	Total Revenue	Total Profit	Discretion
CEO	50%	50%	--
CFO	30%	60%	10%
General Counsel	30%	60%	10%
VP, Business Development	70%	20%	10%

Payments based on revenue achievement began at 80% of the target and went up to 125% of the target. Payments were equal to achievement up to 100% of target and were accelerated above 100% of target to a maximum payout of 150% at 125% achievement.

Payments based on profit achievement begin at 80% of the target and went up to 150% of the target. Payments were equal to achievement up to 100% of target and were accelerated above 100% of target to a maximum of 200% at 150% achievement.

At 100% of plan, Mr. McNiel would have received a payment equal to 100% of their base salaries and Messrs. Horowitz, Petrucelly and Wu would have each received a payment equal to 40% of their base salaries.

We achieved 82% of our revenue target. We were not profitable for the year. Accordingly, Mr. McNiel received \$163,940 under the 2012 Plan.

Messrs. Horowitz and Petrucelly were each awarded the full amount of discretionary bonus, \$38,742 and \$31,132, respectively. Mr. Horowitz was granted the full amount due to, among other things, his efforts in resolving the U.S. Attorney and SEC investigations of the Company, his assumption of additional managerial responsibilities upon the departure of the Company’s Chief Financial Officer, his work on evaluating strategic initiatives, and his handling of certain other non-routine matters. Mr. Petrucelly was granted the full amount due to, among other things, his assumption of new duties and his enablement of a smooth transition following the departure of the Company’s Chief Financial Officer, his work on evaluating strategic initiatives, and his handling of certain other non-routine matters.

Due to size of the payment to Mr. Wu under the 2012 Plan (\$57,379), it was determined that no discretionary payment was appropriate.

We are currently considering the parameters of a management incentive plan for 2013.

Long-Term Equity Incentive Awards

We currently provide long-term equity incentive compensation to further align the interests of our Named Executive Officers with our stockholders.

The Compensation Committee is responsible for determining the individuals who will be granted options and/or restricted shares, the number of options and/or restricted shares each individual will receive, and the terms of the options or restricted shares, including the exercise period of each option, and the vesting period of each option and/or restricted share. The number of stock options and/or restricted shares granted to each Named Executive Officer is determined by the Compensation Committee based upon several factors, including the executive officer's salary grade, performance and the value of the stock options and/or restricted shares at the time of grant. We grant options at the fair market value of the underlying stock on the date of grant. Discretionary long-term incentive awards granted to the Named Executive Officers are discussed under the heading "Narrative Discussion to Summary Compensation Table," below.

Other benefits

Our Named Executive Officers participate in benefit programs that are substantially the same as all other eligible employees of our company.

Consultants and Benchmarking

We have not retained a compensation consultant to review our policies and procedures with respect to executive compensation, although the Compensation Committee may elect to retain such a consultant in the future if it determines that so doing would be helpful in developing, implementing or maintaining compensation plans.

The Compensation Committee typically conducts an annual review of the aggregate level of our executive compensation, as well as the mix of elements used to compensate our Named Executive Officers. In addition, the Compensation Committee takes into account input from other independent members of our board of directors. The Compensation Committee reviews and considers tally sheets provided by Company management in order to make sure that it receives the full picture of the NEOs compensation. The Compensation Committee uses the tally sheets to have a picture of both annual cash compensation and equity compensation. Using this information, the Compensation Committee determines whether a particular executive's compensation is appropriate given the executive's role, experience and performance.

From time to time, the Compensation Committee also considers, to the extent available, publicly available data relating to the compensation practices and policies of other companies within and outside our industry. The Compensation Committee compares our executive compensation against the compensation paid by these peer companies. While such comparisons may not always be appropriate as a stand-alone tool for setting compensation due to the aspects of our business and objectives that may be unique to us, we generally believe that gathering this information is another tool that can be used as part of our compensation-related decision-making process. In establishing the 2012 Plan, we used some comparative data from CommVault Systems, Inc., Compellent Technologies, Inc., Double-Take Software, Inc., and Isilon Systems, LLC, technology companies that are competitors and/or located in the same geographic region as the Company and/or with similar sales and market capitalization to

the Company.

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Although generally we believe that executive base salaries should be targeted taking into consideration the median of the range of salaries for executives in similar positions at comparable companies, we recognize that, to attract, retain and motivate key individuals, such as the Named Executive Officers, the Compensation Committee may determine that it is in our best interests to negotiate total compensation packages with our Named Executive Officers that may deviate from the general principle of targeting total compensation at the median level for the peer group. Actual pay for each Named Executive Officer is determined around this structure, driven by the performance of the Named Executive Officer over time, as well as our annual performance.

Employment Agreements

We have an employment agreement with our Chief Executive Officer. We do not have employment agreements with any other Named Executive Officers.

The employment agreement with Mr. McNiel is used by the Company to establish key elements of the agreement between the Company and Mr. McNiel, including the proposed minimum period of employment and the fundamental elements of compensation. The agreement also facilitates the creation of covenants, such as those regarding competition during after the employment period or limitations on the reasons for which Mr. McNiel may be terminated, that would not otherwise be part of the employment relationship. The terms of the agreement with Mr. McNiel are set out below in the section “Summary Compensation Table.”

Severance and Change in Control Agreements

The Named Executive Officers are each participants in the 2005 Key Executive Severance Protection Plan, as amended (the “2005 Plan”). The terms of the 2005 Plan that provide the terms of our severance and change in control agreements are set out below in the section “Potential Payments Upon Severance or Change in Control.”

We created the 2005 Plan because we wanted to insure the continuity of management if there was an actual or potential change in control event. The 2005 Plan provides peace of mind for the Named Executive Officers that their livelihoods will not be affected by the actual or potential change in control. This means that they will not be distracted by concerns for their own benefit during such an event. In addition, the 2005 Plan helps to attract and to retain the Name Executive Officers.

Mr. McNiel’s employment agreement with the Company also contains certain severance provisions. These provisions are discussed below in the section “Potential Payments Upon Severance or Change in Control.”

Risk Assessment of the Company’s Compensation Policies

The Compensation Committee reviews the compensation and benefit plans generally for all employees in addition to its review for the NEOs. The Compensation Committee has determined that because of the mix of long term and short terms incentives in the Company’s compensation and benefit plans, it is not reasonably likely that the Company’s compensation and benefit plans would have a material adverse effect on the Company.

“Say on Pay”

In 2011, the Company’s stockholders approved the compensation of the Named Executive Officers. The Compensation Committee views this approval as validation of the Company’s compensation philosophy and mechanics.

In 2011, the Company’s stockholders also voted to hold “say on pay” votes every three years.

2012 Compensation Committee Report

The Compensation Committee has reviewed and discussed with management the foregoing Compensation Discussion and Analysis section of the Company's 2013 Proxy Statement. Based on its review and discussions with management, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in the Company's 2013 Proxy Statement.

Compensation Committee:

Alan W. Kaufman
 Irwin Lieber (Chair)
 Eli Oxenhorn

B. Summary Compensation Table

Name	Year	Salary	Bonus	Stock Awards	Option Awards	All Other Compensation	Total
James P. McNiel President and Chief Executive Officer (Principal Executive Officer)	2012	\$ 400,000	\$ 163,940 (3)	\$ -	\$ -	\$ 39,494 (11)	\$ 603,434
	2011	\$ 400,000	\$ -	\$ 289,900 (4)	\$ 3,483,800 (6)	\$ 29,257 (11)	\$ 4,202,957
	2010	\$ 200,000	\$ -	\$ 211,324 (5)	\$ -	\$ -	\$ 411,324
Louis Petrucelly Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer) (1)	2012	\$ 192,125	\$ 31,132 (3)	\$ -	\$ 65,500 (7)	\$ -	\$ 288,757
Bernard Wu Vice President - Business Development	2012	\$ 250,000	\$ 57,379 (3)	\$ -	\$ -	\$ -	\$ 307,379
	2011	\$ 250,000	\$ -	\$ -	\$ 109,500 (8)	\$ -	\$ 359,500
	2010	\$ 250,000	\$ -	\$ -	\$ -	\$ -	\$ 250,000
Seth Horowitz Vice President - General Counsel and Secretary	2012	\$ 275,000	\$ 38,742 (3)	\$ -	\$ 97,800 (9)	\$ -	\$ 411,542
	2011	\$ 250,000	\$ -	\$ -	\$ 109,500 (8)	\$ -	\$ 359,500
	2010	\$ 250,000	\$ -	\$ -	\$ -	\$ -	\$ 250,000
Bryan Urquhart	2012	\$ 115,644	\$ -	\$ -	\$ -	\$ 23,750 (12)	\$ 139,394
	2011	\$ 45,490	\$ -	\$ -	\$ 495,000 (10)	\$ -	\$ 540,490

Former Vice
President and
Chief Financial
Officer (2)

- (1) Mr. Petrucelly was appointed Acting Chief Financial Officer, Vice President of Finance and Treasurer of the Company on May 25, 2012. On August 7, 2012, the Company appointed Mr. Petrucelly Chief Financial Officer, Vice President and Treasurer of the Company.
- (2) Mr. Urquhart ceased to be an Executive Officer of the Company on May 25, 2012.
- (3) Pursuant to the Company's 2012 Management Incentive Bonus Plan, the Company's Executive Officers received bonus payments on March 15, 2013.
- (4) The Company granted 90,000 restricted stock awards on January 11, 2011 to Mr. McNiel. The dollar amounts in the table represent the total grant date fair value of the awards in accordance with the authoritative guidance issued by the FASB on stock compensation. The awards were granted in accordance with Mr. McNiel's employment agreement and subject to a two-year vesting period. Please refer to footnote 8 of the Company's 2012 annual report filed on Form 10-K (which is included in the materials mailed with this Proxy Statement) for further information relating to all share-based awards.
- (5) The Company granted 13,661, 16,178, 16,587, and 17,483 restricted stock awards on March 2, 2010, July 2, 2010, September 2, 2010 and December 20, 2010, respectively, to Mr. McNiel. The dollar amounts in the table represent the total grant date fair value of the awards in accordance with the authoritative guidance issued by the FASB on stock compensation. Each of the awards was granted in accordance with Mr. McNiel's original employment arrangement and was immediately vested upon grant. Please refer to footnote 8 of the Company's 2012 annual report filed on Form 10-K (which is included in the materials mailed with this Proxy Statement) for further information relating to all share-based awards.
- (6) The Company granted 1,520,000 stock options on January 11, 2011 to Mr. McNiel. Of this amount, 1,220,000 stock options were approved by the Company's stockholders' at the annual meeting of stockholders on May 9, 2011. The dollar amounts in the table represent the total grant date fair value of the awards in accordance with the authoritative guidance issued by the FASB on stock compensation. The awards were granted in accordance with Mr. McNiel's employment agreement and subject to a three-year vesting period. Please refer to footnote 8 of the Company's 2012 annual report filed on Form 10-K (which is included in the materials mailed with this Proxy Statement) for further information relating to all share-based awards.

- (7) The Company granted 50,000 stock options on June 5, 2012 to Mr. Petrucelly. The dollar amounts in the table represent the total grant date fair value of the awards in accordance with the authoritative guidance issued by the FASB on stock compensation. The awards were granted on a discretionary basis and subject to a three-year vesting period. Please refer to footnote 8 of the Company's 2012 annual report filed on Form 10-K (which is included in the materials mailed with this Proxy Statement) for further information relating to all share-based awards.
- (8) The Company granted 50,000 stock options on May 9, 2011 to each of Messrs. Wu and Horowitz. The dollar amounts in the table represent the total grant date fair value of the awards in accordance with the authoritative guidance issued by the FASB on stock compensation. The awards were granted on a discretionary basis and are subject to a three-year vesting period. Please refer to footnote 8 of the Company's 2012 annual report filed on Form 10-K (which is included in the materials mailed with this Proxy Statement) for further information relating to all share-based awards.
- (9) The Company granted 60,000 stock options on March 12, 2012 to Mr. Horowitz. The dollar amounts in the table represent the total grant date fair value of the awards in accordance with the authoritative guidance issued by the FASB on stock compensation. The awards were granted on a discretionary basis and subject to a three-year vesting period. Please refer to footnote 8 of the Company's 2012 annual report filed on Form 10-K (which is included in the materials mailed with this Proxy Statement) for further information relating to all share-based awards.
- (10) The Company granted 300,000 stock options on November 7, 2011 to Mr. Urquhart. The dollar amounts in the table represent the total grant date fair value of the awards in accordance with the authoritative guidance issued by the FASB on stock compensation. The awards were granted in accordance with Mr. Urquhart's arrangement and subject to a three-year vesting period. Please refer to footnote 8 of the Company's 2012 annual report filed on Form 10-K (which is included in the materials mailed with this Proxy Statement) for further information relating to all share-based awards.
- (11) In 2012 and 2011, the Company paid \$39,494 and \$29,257, respectively, in transportation costs for Mr. McNiel. The 2011 Employment Agreement provides that, in light of the Company's location and a disability that prevents Mr. McNiel from driving a car, the Company will provide transportation so that Mr. McNiel may commute to and from the Company's offices and to travel to other locations where business is being conducted. In lieu of providing the transportation, on prior notice to Mr. McNiel, the Company may elect to reimburse Mr. McNiel for up to \$35,000 of expenses incurred by him annually commuting to the Company's offices and traveling to other locations where business is being conducted.
- (12) The Company agreed to pay Mr. Urquhart severance pay in the amount of \$23,750 for the period beginning on May 28, 2012 and ending June 26, 2012.

Narrative Discussion to Summary Compensation Table

Jim McNiel

In 2010, Mr. McNiel was employed pursuant to an arrangement that paid him a base salary of \$200,000 per annum, plus the issuance to Mr. McNiel of \$50,000 of the Company's common stock per quarter, which shares were deemed vested as of the date they were issued. While Mr. McNiel was considered to be an at will employee, the terms of this arrangement were set forth in an offer letter from the Company to Mr. McNiel. The offer letter further provided that the Company would recommend to the Company's Compensation Committee that Mr. McNiel be granted options to purchase shares of the Company's common stock. The offer letter also provided that if Mr. McNiel's employment was terminated without cause, the vesting of the options granted to him would accelerate based on how long he had been employed by the Company at the time of termination.

On January 11, 2011, Mr. McNiel and the Company entered into an agreement for his employ (the “2011 Employment Agreement”). Pursuant to the 2011 Employment Agreement, Mr. McNiel receives a base salary of \$400,000 per annum. Under the 2011 Employment Agreement, Mr. McNiel is also entitled to participate in all benefit programs generally available to Company employees.

The 2011 Employment Agreement further provides that Mr. McNiel would receive an option to purchase 300,000 shares of the Company’s common stock, pursuant to the FalconStor Software Inc. 2006 Incentive Stock Plan (the “2006 Plan”), and (B) an option to purchase 1,220,000 shares of the Company’s common stock, pursuant to a Stand-Alone Stock Option Agreement, subject to stockholder approval of the Option Agreement (collectively, the “Stock Options”). The Stock Options will have an exercise price per share equal to the closing price of the Company’s common stock on the NASDAQ Global Market on the date of grant, which was \$3.22 per share. The Stock Options vested and become exercisable in accordance with the following schedule: thirty three percent (33%) vested on the first anniversary of the date of this Agreement; thirty three percent (33%) vested on the second anniversary of the date of this Agreement; and thirty-four percent (34%) will vest on January 1 of the third year following the date of this Agreement; provided, however, with respect to the options granted pursuant to the Option Agreement, if stockholder approval of the Option Agreement had not been obtained on or prior to January 11, 2012, the Option Agreement and the grant made thereunder would have been deemed void ab initio. The Option Agreement was approved by a vote of stockholders at the annual meeting of stockholders on May 9, 2011.

The 2011 Employment Agreement further provides that in the event stockholder approval of the Option Agreement had not been obtained on or prior to January 11, 2012, the Company would have to grant to Mr. McNiel, at the first meeting of the Compensation Committee following that date, such number of restricted shares of the Company’s common stock having a value equivalent to that of the option to purchase 1,220,000 shares granted pursuant to the Option Agreement as of the date of the original option grant, as reasonably determined by the Compensation Committee.

The 2011 Employment Agreement further provides that the Company would grant Employee 90,000 restricted shares of the Company’s common stock (the “Restricted Shares”), pursuant to the 2006 Plan. These Restricted Shares were granted on January 11, 2011 and have vested.

The 2011 Employment Agreement further provides that, in light of the Company’s location and a disability that prevents Mr. McNiel from driving a car, the Company will provide transportation so that Mr. McNiel may commute to and from the Company’s offices and to travel to other locations where business is being conducted. In lieu of providing the transportation, on prior notice to the Mr. McNiel, the Company may elect to reimburse Mr. McNiel for up to \$35,000 of expenses incurred by him annually commuting to the Company’s offices and traveling to other locations where business is being conducted.

Other Named Executive Officers

Each of the other Named Executive Officers is an employee at will.

The salaries for the NEOs are set by the Compensation Committee using the criteria set forth above in the “Compensation Discussion and Analysis” section. Mr. Wu’s salary was \$250,000 for each of 2010, 2011 and 2012. Mr. Horowitz’s salary was \$250,000 for 2010, 2011 and the beginning of 2012. Effective March 15, 2012, Mr. Horowitz’s salary was increased to \$280,000. Mr. Petrucelly became an NEO on May 25, 2012 when he was named Acting Chief Financial Officer, at which time his salary was \$185,000. On August 7, 2012, when Mr. Petrucelly was named Chief Financial Officer, his salary was increased to \$225,000. Mr. Urquhart’s salary for 2011 and 2012 was \$285,000. Mr. Urquhart’s employment with the Company terminated on May 25, 2012.

In May, 2011, Messrs. Horowitz and Wu each received grants of options to purchase up to 50,000 shares of Company stock. In March, 2012, Mr. Horowitz received a grant of options to purchase up to 60,000 shares of Company stock. In June, 2012, Mr. Petrucelly received a grant of options to purchase up to 50,000 shares of Company stock. In November, 2011, Mr. Urquhart received a grant of options to purchase up to 300,000 shares of Company stock. The grants to Messrs. Horowitz, Petrucelly and Wu were made to align the interests of the NEOs with stockholders and as a retention incentive to the NEOs. The grant to Mr. Urquhart was made as part of the compensation package negotiated to attract Mr. Urquhart to the Company. All options granted vest as to 33% of the award on each of the first two anniversaries of the grant and 34% on the third anniversary of the grant.

In addition to their cash compensation, the Named Executive Officers also receive, from time to time, grants of equity compensation in accordance with the compensation philosophy discussed above.

C. Grants of Plan-Based Awards For 2012

The following table provides information related to plan-based awards granted to the Company's Named Executive Officers. The Company currently does not have any plans providing for the grant of stock appreciation rights.

Name	Grant Date	All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards (\$/Share)	Grant Date Fair Value of Stock and Option Awards (\$)
James P. McNeil President and Chief Executive Officer (Principal Executive Officer)	-	-	-	\$ -	\$ -
Louis Petrucelly Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer) (1)	6/5/2012	-	50,000(3)	\$ 2.46	\$ 65,500
Bernard Wu Vice President - Business Development	-	-	-	\$ -	\$ -
Seth Horowitz Vice President - General Counsel and Secretary	3/12/2012	-	60,000(3)	\$ 3.05	\$ 97,800
Bryan Urquhart Former Vice President and Chief Financial Officer (2)	-	-	-	\$ -	\$ -

(1) Mr. Petrucelly was appointed Acting Chief Financial Officer, Vice President of Finance and Treasurer of the Company on May 25, 2012. On August 7, 2012, the Company appointed Mr. Petrucelly Chief Financial Officer, Vice President and Treasurer of the Company.

(2) Mr. Urquhart ceased to be an Executive Officer of the Company on May 25, 2012.

(3) Reflects non-qualified stock option awards granted from the Company's 2006 Incentive Stock Plan. The awards vests 33%, 33% and 34% per year on each anniversary of the date of grant.

(4) The dollar amounts in the table represent the total grant date fair value of the awards in accordance with the authoritative guidance issued by the FASB on stock compensation.

D. Outstanding Equity Awards at Fiscal Year End 2012

The following table provides information related to the aggregate outstanding equity awards which were granted to the Company's Named Executive Officers as of December 31, 2012. The table does not include restricted stock awards to certain of the Named Executive Officers that were forfeited, as described above.

Name	Option Awards		Stock Awards			
	Number of Securities Underlying Unexercised Options (#) Exerciseable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)
James P. McNiel President and Chief Executive Officer (Principal Executive Officer)	300,000 (2)	-	\$ 3.96	12/02/19	45,000 (19)	\$ 104,850 (21)
	99,000 (3)	201,000 (3)	\$ 3.22	01/11/21	-	-
	402,600 (4)	817,400 (4)	\$ 3.22	01/11/21	-	-
Louis Petrucelly Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer)	10,000 (5)	-	\$ 10.84	04/03/17	2,250 (20)	\$ 5,243 (21)
	10,000 (6)	-	\$ 7.14	03/10/18	-	-
	15,000 (7)	-	\$ 2.63	11/06/18	-	-
(1)	15,000 (8)	-	\$ 2.25	03/09/19	-	-
	12,000 (9)	-	\$ 5.12	08/06/19	-	-
	6,600 (10)	3,400 (10)	\$ 3.93	03/11/20	-	-
	9,900 (11)	5,100 (11)	\$ 3.31	12/20/20	-	-
	8,250 (12)	16,750 (12)	\$ 4.12	05/09/21	-	-
	-	50,000 (13)	\$ 2.46	06/05/22	-	-
Bernard Wu Vice President - Business Development	75,000 (14)	-	\$ 6.80	11/07/15	-	-
	160,000 (15)	-	\$ 2.25	03/09/19	-	-
	16,500 (16)	33,500 (16)	\$ 4.12	05/09/21	-	-
	-	-				
Seth Horowitz Vice President - General Counsel and Secretary	50,000 (17)	-	\$ 2.25	03/09/19	-	-
	16,500 (16)	33,500 (16)	\$ 4.12	05/09/21	-	-
	-	60,000 (18)	\$ 3.05	03/12/22	-	-

(1) Mr. Petrucelly was appointed Acting Chief Financial Officer, Vice President of Finance and Treasurer of the Company on May 25, 2012. On August 7, 2012, the Company appointed Mr. Petrucelly Chief Financial Officer, Vice President and Treasurer of the Company.

(2) Award fully vested on December 2, 2012.

(3) Mr. McNiel was awarded 300,000 stock options on January 11, 2011, which vest 33%, 33% and 34% on each anniversary over a three-year period.

(4) Mr. McNiel was awarded 1,220,000 stock options on January 11, 2011, which vest 33%, 33% and 34% on each anniversary over a three-year period. The award was approved by the Company stockholders' at the Annual Meeting of Stockholders' on May 9, 2011.

(5) Award fully vested on April 3, 2010.

(6) Award fully vested on March 10, 2011.

(7) Award fully vested on November 6, 2011.

(8) Award fully vested on March 9, 2012.

(9) Award fully vested on August 6, 2012.

(10) Mr. Petrucelly was awarded 10,000 stock options on March 11, 2010, which vest 33%, 33% and 34% on each anniversary over a three-year period.

(11) Mr. Petrucelly was awarded 15,000 stock options on December 20, 2010, which vest 33%, 33% and 34% on each anniversary over a three-year period.

(12) Mr. Petrucelly was awarded 25,000 stock options on May 9, 2011, which vest 33%, 33% and 34% on each anniversary over a three-year period.

(13) Mr. Petrucelly was awarded 50,000 stock options on June 5, 2012, which vest 33%, 33% and 34% on each anniversary over a three-year period.

(14) Award fully vested on November 7, 2008.

(15) Award fully vested on March 9, 2012.

(16) Messrs. Wu and Horowitz were each awarded 50,000 stock options on May 9, 2011, which vest 33%, 33% and 34% on each anniversary over a three-year period.

(17) Award fully vested on March 9, 2012.

(18) Mr. Horowitz was awarded 60,000 stock options on March 12, 2012, which vest 33%, 33% and 34% on each anniversary over a three-year period.

(19) Mr. McNiel was awarded 90,000 shares of restricted stock on January 11, 2011, which vest 50% and 50% on each anniversary over a two-year period.

(20) Mr. Petrucelly was awarded 7,500 shares of restricted stock on August 5, 2010, which vest 33%, 33% and 34% on each anniversary over a three-year period, of which, 4,950 restricted stock awards have vested.

(21) The Closing Price of the Company's stock price on December 31, 2012 was \$2.33 per share.

E. Option Exercises and Stock Vested for 2012

The following table provides information related to the vesting of restricted stock for the Company's Named Executive Officers during the year ended December 31, 2012. No options were exercised by the Company's Named Executive Officers during the fiscal year ended December 31, 2012.

Name	Stock Awards	
	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$)
James P. McNiel President and Chief Executive Officer (Principal Executive Officer)	45,000	\$ 108,900 (3)
Louis Petrucelly Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer) (1)	4,175	\$ 7,711 (4)(5)
Bernard Wu Vice President - Business Development	30,600	\$ 93,789 (6)
Seth Horowitz	17,000	\$ 52,105 (7)

Vice President -
General Counsel and Secretary

Bryan Urquhart	-	\$ -
Former Vice President and Chief Financial Officer (2)		

(1) Mr. Petrucelly was appointed Acting Chief Financial Officer, Vice President of Finance and Treasurer of the Company on May 25, 2012. On August 7, 2012, the Company appointed Mr. Petrucelly Chief Financial Officer, Vice President and Treasurer of the Company.

(2) Mr. Urquhart ceased to be an Executive Officer of the Company on May 25, 2012.

(3) Reflects 33% vesting of 45,000 shares of restricted stock awarded to Mr. McNiel on January 11, 2011. The average market price of the Company's stock at the vesting date was \$2.42 per share.

(4) Reflects 34% vesting of 1,700 shares of restricted stock awarded to Mr. Petrucelly on August 6, 2009. The average market price of the Company's stock at the vesting date was \$1.85 per share.

(5) Reflects 33% vesting of 2,475 shares of restricted stock awarded to Mr. Petrucelly on August 5, 2010. The average market price of the Company's stock at the vesting date was \$1.85 per share.

(6) Reflects 34% vesting of 30,600 shares of restricted stock awarded to Mr. Wu on March 9, 2009. The average market price of the Company's stock at the vesting date was \$3.07 per share.

(7) Reflects 34% vesting of 17,000 shares of restricted stock awarded to Mr. Horowitz on March 9, 2009. The average market price of the Company's stock at the vesting date was \$3.07 per share.

F. Potential Payments Upon Severance or Change in Control

Severance Agreements

The 2011 Employment Agreement with Mr. McNiel provides for certain payments upon severance or a change in control.

If Mr. McNiel's employment is terminated by the Company without Cause (as defined in the 2011 Employment Agreement), or by Mr. McNeil for Good Reason (as defined in the 2011 Employment Agreement), Mr. McNiel is entitled to the following:

(i) his fully earned but unpaid base salary, when due, through the termination date at the rate then in effect, plus all other amounts which Mr. McNiel earned and accrued under any compensation plan of the Company at the time of termination;

(ii) a lump sum cash payment equal to twelve (12) months of the his annual base salary, including both cash salary and the cash equivalent of shares of the Company's common stock payable under the 2011 Employment Agreement, as in effect immediately prior to termination date; and

(iii) the right to COBRA benefits, at Employee's cost.

If the 2011 Employment Agreement expires and the parties do not enter into a subsequent agreement extending Mr. McNiel's employment as President and Chief Executive Officer, Mr. McNiel is entitled to the following:

(i) his fully earned but unpaid base salary, when due, through the termination date at the rate then in effect, plus all other amounts which he earned and accrued under any compensation plan of the Company at the time of termination;

(ii) a lump sum cash payment equal to six (6) months of his annual base salary, including both cash salary and the cash equivalent of shares of the Company's common stock payable under the 2011 Employment agreement, as in effect immediately prior to the termination date; and

(iii) the right to COBRA benefits, at his cost;

provided, however, that Mr. McNiel is not entitled to receive any payments or benefits under for failure to renew if,

- (x) the Company declines to enter into a renewal agreement with Mr. McNiel because Mr. McNiel breached certain sections of the 2011 Employment Agreement; or
- (y) Mr. McNiel was terminated for Cause, as defined in the 2011 Employment Agreement; or
- (z) Mr. McNiel received a change of control payment from the Company under any other plan, program or agreement that provides change of control benefits that are at least equal to the amount that would be received by Mr. McNiel pursuant to the severance terms of the 2011 Employment Agreement.

If Mr. McNiel's employment is terminated as a result of death, the Company will provide his estate with:

- (i) his fully earned but unpaid base salary, when due, through the termination date at the rate then in effect, plus all other amounts which Mr. McNiel earned and accrued under any compensation plan of the Company at the termination date; and
- (ii) A death benefit equivalent to one (1) times Mr. McNiel's annual base salary, including both cash salary and the cash equivalent of shares of the Company's common stock payable under the 2011 Employment Agreement, at the rate then in effect payable as may be determined by the Company, but not less often than six (6) equal monthly installments, payable on the last day of each month, commencing in the month subsequent to the month in which the death occurs.

Change in Control Agreements

The Company's 2005 Plan provides for payments to certain officers and employees of the Company, including all of the Named Executive Officers, in the event that there is a change in control of the Company and the individual's employment is terminated within twenty-four months of the change in control. These agreements were entered into to ensure the continued service of the Named Executive Officers in the event of a change in control.

For purposes of the 2005 Plan, a "Change in Control" is deemed to have occurred if:

- more than fifty percent of the Company's voting securities, or the power to vote more than fifty percent of the Company's voting securities, is acquired;
- the members of the Company's board of directors cease to be a majority of the board of directors following a merger;
- a merger, consolidation or reorganization (a) with or into the Company, or (b) in which securities of the Company are issued;
 - a complete liquidation or dissolution of the Company; or
 - the sale or other disposition of all or substantially all of the assets of the Company.

In the event a Change in Control occurs, and a Named Executive Officer is terminated, or the Named Executive Officer ends his employment for Good Reason, within two years of the Change in Control, the Named Executive Officer is entitled to certain severance benefits ("Severance Benefits"). The Named Executive Officer is not entitled to severance benefits if the Named Executive Officer is terminated: (a) for cause; (b) by reason of permanent disability;

(c) voluntarily by the Named Executive Officer other than for certain defined reasons; or (d) by death. “Good Reason” for leaving employment includes: (i) a diminution in the NEO’s title, offices or responsibilities; (ii) a reduction in base salary; (iii) a material increase in commuting distance or business travel requirements; (iv) a diminution in compensation or benefits; (v) a breach of the 2005 Plan; or (vi) a purported termination for cause which does not comply with the terms of the 2005 Plan.

The Severance Benefits to which each of the Named Executive Officers would be entitled are:

- a. a payment equal to three times the Named Executive Officer's base salary, on an annualized basis, at the time of the Change in Control or, if greater, at any time after the Change in Control;
- b. a payment equal to three times the highest annual bonus paid or payable to the Named Executive Officer during the three years preceding the Change in Control;
- c. the continuation for three years for the Named Executive Officer and his dependents and beneficiaries of basic life insurance, flexible spending account, medical and dental benefits which were being provided immediately prior to the Change in Control (or, if greater, at any time thereafter); and
- d1. replacement of all stock options granted by the Company, whether or not vested, with an equal number of fully vested options to purchase shares of the Company's common stock; or
- d2. if the Company's board of directors approves at the time, the surrender of all options, whether vested or not, in return for a cash payment equal to the difference between the full exercise price of each option surrendered and the greater of: (1) the average price per share paid in connection with the acquisition of control of the Company; (2) the price per share paid in connection with any tender offer leading to control of the Company; and (3) the mean between the high and the low selling price of Company common stock on the relevant market on the date on which the Named Executive Officer became entitled to receive Severance Benefits.

In addition, each of the Named Executive Officers is entitled to: (1) at the time any such tax is due, a lump sum payment equal to the amount of any income tax payable by the Named Executive Officer and attributable to the benefits set forth in (c); and (2) in the event that any of the Severance Benefits is subject to an excise tax, a payment in an amount grossed up so that the net payment, after taxes, is equal to the excise tax.

The following table sets forth the value of the severance benefits each Named Executive Officer would be entitled to receive under the 2005 Plan assuming that a Change in Control and the entitlement to receive Severance Benefits occurred on December 31, 2012:

Severance Benefit Component	James McNeil	Louis Petrucelly	Bernard Wu	Seth Horowitz
3 x Base Salary	\$1,200,000	\$675,000	\$750,000	\$840,000
3 x Bonus	\$491,820	\$93,396	\$172,137	\$116,226
3 x Value of Benefits (1), (2)	\$48,921	\$47,634	\$47,817	\$48,039
Benefits Income Tax Gross-Up (2), (3)	\$46,007	\$44,797	\$50,111	\$45,178
Excise Tax Gross-Up (2), (4), (5)	\$879,003	\$453,636	\$-	\$-
Reduction to avoid excise tax (4)	\$-	\$-	\$-	\$(33,939)
Equity Awards - Vested and Unvested Accelerated (6)	\$104,850	\$7,142	\$12,800	\$4,000
Total	\$2,770,601	\$1,321,605	\$1,032,865	\$1,019,504

(1) Benefits include medical benefits, dental benefits, long-term disability and group-term life insurance.

(2) Assumes that the Named Executive Officer receives three full years of benefits.

(3) Assumes (i) an effective federal income tax rate of 37.30% for Messrs. McNeil, Petrucelly and Horowitz and an effective federal income tax rate of 35.5% for Mr. Wu, (ii) an effective 8.82% New York state tax rate for Messrs. McNeil, Petrucelly and Horowitz and (iii) an effective 13.3% California state tax rate for Mr. Wu.

(4) The payments to Messrs. McNeil, Petrucelly and Horowitz would be subject to excise tax under Internal Revenue Code 4999 ("IRC 4999"). The 2005 Plan provides that if any participant is subject to excise tax under IRC 4999, the participant would be entitled to receive an additional payment ("Gross-Up Payment") such that the net amount retained by the participant from the Gross-Up Payment, after reduction for any federal, state and local income taxes, employment taxes and the excise tax on the Gross-Up Payment (and any interest, penalties or additions to tax payable by the participant with respect thereto), is equal to the excise tax imposed on his or her payments. Messrs. McNeil and Petrucelly would be entitled to Gross-Up Payments of \$879,003 and \$453,636, respectively. The 2005 Plan also provides that in the event that a reduction to the payments in respect of a participant of 10% or less would cause no excise tax to be payable, then the participant is not entitled to a Gross-Up Payment and the payments will be reduced (but not below zero) to the extent necessary so that the payments shall not be subject to the excise tax. Mr. Horowitz is not entitled to a Gross-Up Payment and the payment set forth in the table for Mr. Horowitz is reduced by \$33,939.

(5) Mr. Wu is not subject to the excise tax provisions of the IRC 4999.

(6) The value of (i) vested and unvested accelerated stock options and (ii) unvested restricted stock awards is the difference between the exercise price of each option and \$2.33, the closing price the Company's common stock on the Nasdaq Global Market on December 31, 2012.

Report on Repricing of Options. None of the stock options granted under any of the Company's plans was repriced in the fiscal year ended December 31, 2012.

Compensation Committee Interlock and Insider Participation. Messrs. Alan W. Kaufman, Irwin Lieber and Eli Oxenhorn served as members of the Compensation Committee of the Board of Directors during the fiscal year ended December 31, 2012. Except as disclosed under "Certain Relationships and Related Transactions – Related Party Transactions Reviewed During 2012", there were no relationships that require disclosure under Item 407(e)(4) of Regulation S-K.

Equity Compensation Plan Information

The Company currently does not have any equity compensation plans not approved by security holders.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (1) (a)	Weighted-average exercise price of outstanding options, warrants and rights (1) (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (1) (c)
Equity compensation plans approved by security holders	11,532,032	\$4.59	2,526,036
	(1)	As of December 31, 2012	

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The Company's Board of Directors has recognized that related party transactions present a heightened risk of conflicts of interest and/or improper valuation (or the perception thereof). The Board therefore adopted a policy to be followed in connection with all related party transactions involving the Company.

A. Identification of Related Transactions

Under the policy, any "Related Party Transaction" shall be consummated or shall continue only if:

1. the Audit Committee approves or ratifies such transaction in accordance with the guidelines set forth in the policy and if the transaction is on terms comparable to those that could be obtained in arm's length dealings with an unrelated third party; or
2. the transaction is approved by the disinterested members of the Board of Directors; or
3. the transaction involves compensation approved by the Company's Compensation and Management Development Committee.

For purposes of the policy, a "Related Party" is:

1. a senior officer (which includes at a minimum each executive officer) or director of the Company; or
2. a shareholder owning in excess of five percent of the Company (or its controlled affiliates); or
3. a person who is an immediate family member of a senior officer or director; or

4. an entity which is owned or controlled by someone listed in 1, 2 or 3 above, or an entity in which someone listed in 1, 2 or 3 above has a substantial ownership interest or control of such entity.

For purposes of the policy, a "Related Party Transaction" is a transaction between the Company and any Related Party (including any transactions requiring disclosure under Item 404 of Regulation S-K under the Securities Exchange Act of 1934), other than:

1. transactions available to all employees generally
2. transactions involving less than \$5,000 when aggregated with all similar transactions.

B. Audit Committee Approval

The Board of Directors determined that the Audit Committee of the Board is best suited to review and approve Related Party Transactions. Accordingly, at each calendar year's first regularly scheduled Audit Committee meeting, management recommends Related Party Transactions to be entered into by the Company for that calendar year, including the proposed aggregate value of such transactions if applicable. After review, the Committee approves or disapproves such transactions and at each subsequently scheduled meeting, management updates the Committee as to any material change to those proposed transactions.

In the event management recommends any further Related Party Transactions subsequent to the first calendar year meeting, such transactions may be presented to the Committee for approval or preliminarily entered into by management subject to ratification by the Committee; provided that if ratification is not forthcoming, management shall make all reasonable efforts to cancel or annul such transaction.

C. Corporate Opportunity

The Board recognizes that situations may exist where a significant opportunity may be presented to management or a member of the Board of Directors that may equally be available to the Company, either directly or via referral. Before such opportunity may be consummated by a Related Party (other than an otherwise unaffiliated 5% shareholder), such opportunity shall be presented to the Board of Directors of the Company for consideration.

D. Disclosure

All Related Party Transactions are to be disclosed in the Company's applicable filings as required by the Securities Act of 1933 and the Securities Exchange Act of 1934 and related rules. Furthermore, all Related Party Transactions shall be disclosed to the Audit Committee of the Board and any material Related Party Transaction shall be disclosed to the full Board of Directors.

E. Other Agreements

Management assures that all Related Party Transactions are approved in accordance with any requirements of the Company's financing agreements.

Related Party Transactions Reviewed During 2012

Seth Oxenhorn, the son of Eli Oxenhorn, the Chairman of our Board of Directors, is a Director of Business Development for the Company. This is a non-executive role and Seth Oxenhorn is not an executive officer of the Company. During 2012, Seth Oxenhorn received total compensation of \$323,338, of which \$130,000 was salary,

\$183,138 was commission, and \$10,200 was the value of a grant of stock options. All of such compensation earned by Seth Oxenhorn is in accordance with the Company's compensation plan for all personnel in similar positions.

PROPOSAL NO. 2

FALCONSTOR SOFTWARE, INC., 2013

OUTSIDE DIRECTORS EQUITY COMPENSATION PLAN

The Board of Directors proposes that the FalconStor Software, Inc., 2013 Outside Directors Equity Compensation Plan (the “2013 Plan”) be approved.

The 2013 Plan is intended to assist the Company in securing and retaining qualified outside directors (the “Directors”) by allowing them to participate in the ownership and growth of the Company through the grant of shares of restricted stock and nonqualified stock options. The granting of such restricted stock or options serves as partial consideration for, and gives the Directors an additional inducement to remain in, the service of the Company and its subsidiaries and provides them with an increased incentive to work towards the Company’s success. Shares of Common Stock may be issued under the 2013 Plan to Directors with such restrictions as determined by the Company or upon the exercise of nonqualified stock options.

The Board of Directors believes it is in the Company's and its stockholders' best interests to approve the 2013 Plan because it would allow the Company to continue to grant nonqualified options and restricted shares which facilitates the benefits of the additional incentive inherent in the ownership of Common Stock by the Directors and helps the Company retain the services of these Directors.

The proposed 2013 Plan is attached as Exhibit A to this Proxy Statement.

SUMMARY OF THE 2013 Plan

The following summary of the 2013 Plan, assuming stockholder approval of the 2013 Plan, is qualified in its entirety by the specific language of the 2013 Plan.

General. The 2013 Plan provides for the grant of restricted stock or nonqualified stock options to outside directors of the Company.

Shares Subject to Plan. A maximum of 400,000 of the authorized but unissued or treasury shares of the common stock of the Company may be issued upon the grant of restricted shares or upon the exercise of options granted under the 2013 Plan. Upon any stock dividend, stock split, reverse stock split, recapitalization, combination, reclassification, or similar change in the capital structure of the Company, appropriate adjustments will be made to the shares subject to the 2013 Plan and to outstanding restricted shares and options. To the extent that (i) any outstanding restricted share or under the 2013 Plan expires or terminates prior to the termination of the restrictions on restricted stock, (ii) any options expires prior to the exercise in full, or (iii) shares issued upon the exercise of an option are repurchased by the Company, the shares of Common Stock for which such option is not exercised or the repurchased shares shall be returned to the 2013 Plan and again become available for grant.

Administration. The 2013 Plan will be administered by the Board of Directors. The Board will approve option and restricted share grants to Directors and will determine the terms of any restrictions on restricted shares, subject to the provisions of the 2013 Plan. The Board will also make any other determinations necessary or advisable for the administration of the 2013 Plan. The determinations by the Board will be final and conclusive.

Eligibility. Current outside directors of the Company, and individuals who served as outside directors for the Company in the twelve months prior to the date of any equity grant under the 2013 Plan, are eligible to participate in the 2013 Plan.

Terms and Conditions of Options. Each option granted under the 2013 Plan is evidenced by a written agreement between the Company and the optionee specifying the number of shares subject to the option and the other terms and conditions of the option, consistent with the requirements of the 2013 Plan. The purchase price of each share of Common Stock purchasable under a nonqualified option shall not be less than 100% of the fair market value of such share of Common Stock on the date the option is granted. Generally, the fair market value of the Common Stock will be the closing price per share on the date of grant as reported on The Nasdaq Global Market. The exercise price may be paid in cash, by check, or in cash equivalent, by tender of shares of the Company's Common Stock owned by the optionee having a fair market value not less than the exercise price, by the assignment of the proceeds of a sale of some or all of the shares of Common Stock being acquired upon the exercise of the option, or by any combination of these. Notwithstanding the foregoing, an optionee may not take any actions which are prohibited by the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated by the Securities and Exchange Commission or any other agency thereunder.

Options granted under the 2013 Plan become exercisable at such time or times and subject to such terms and conditions are set forth in Section 5(b) of the 2013 Plan. The term of each option shall be 10 years after the date of grant, subject to earlier termination in the event the optionee's service with the Company ceases.

In general, during the lifetime of the optionee, the option may be exercised only by the optionee and may not be transferred or assigned, except by will or the laws of descent and distribution. However, the 2013 Plan provides that, with the consent of the Committee, an optionee may transfer a nonqualified option to: (i) an Immediate Family Member (as described in the 2013 Plan); (ii) a trust for the exclusive benefit of the Director and/or one or more Immediate Family Members; (iii) a partnership in which the Director and/or one or more Immediate Family Members are the only partners; or (iv) such other person or entity as the Board of Directors may permit.

Upon a Change of Control of the Company, the Company will replace all unexercised stock options with an equal number of unrestricted and fully vested stock options to purchase shares of the Company's Common Stock. Alternatively, upon a Change of Control, and subject to Board approval at the time, the Company may require an optionee to surrender any unexercised options and to receive in return from the Company a cash payment equal to the difference between the exercise price of each option surrendered and the greater of (i) the average price per share paid in connection with the acquisition of the Company, (ii) the price per share paid in connection with any tender offer for shares of the Company's common stock leading to control, and (iii) the mean between the high and the low selling prices of such stock on the Nasdaq Global Market or other market on which the Company's common stock is then traded on the date of the Change of Control.

Simultaneously with the granting of an option the Committee may also grant dividend equivalent rights equal to the number of shares of common stock underlying the option multiplied by the per-share cash dividend or per-share market value of a non-cash dividend. This provision shall only apply to special dividends of the Company.

Terms and Conditions of Restricted Stock. A grantee of restricted stock has no right to an award of restricted stock until the grantee accepts the award within the timeframe prescribed by the Committee and, if the Committee requires, makes payment to the Company in cash, or by check or other acceptable instrument. Certificate(s) are issued in the grantee's name after acceptance of the award by the grantee, but are not delivered to the Grantee until the shares are free of any restrictions specified by the Committee at the time grant. After acceptance and the issuance of a stock certificate, the participant shall have all the rights of a stockholder with respect to the restricted stock.

Shares of restricted stock are forfeitable until the terms of the restricted stock grant have been satisfied. Shares of restricted stock are not transferable until the date on which the Committee has specified such restrictions have lapsed. The shares of restricted stock shall vest in accordance with Section 5(b) of the 2013 Plan. Unless otherwise provided by the Committee at or after grant, distributions in the form of dividends or otherwise of additional shares or property in respect of shares of restricted stock shall be subject to the same restrictions as such shares of restricted stock.

Upon the occurrence of a change in control of the Company, the Committee may accelerate the vesting of outstanding restricted stock, in whole or in part, as determined by the Committee, in its sole discretion.

Unless otherwise determined by the Committee at or after grant, in the event the grantee ceases to be an employee or otherwise associated with the Company for any other reason, all shares of restricted stock previously awarded to him which are still subject to restrictions will be forfeited and the Company will have the right to complete a blank stock power. The Committee may provide (on or after grant) that restrictions or forfeiture conditions relating to shares of restricted stock will be waived in whole or in part in the event of termination resulting from specified causes, and the Committee may in other cases waive in whole or in part restrictions or forfeiture conditions relating to restricted stock.

Termination or Amendment. Unless earlier terminated by the Board, the 2013 Plan will terminate on March 9, 2023. The 2013 Plan provides that it may be terminated or amended by the Board at any time, subject to stockholder approval only if such amendment would increase the total number of shares of Common Stock reserved for issuance thereunder.

SUMMARY OF UNITED STATES FEDERAL INCOME TAX CONSEQUENCES

Non-Qualified Stock Options. No taxable income will be recognized by an option holder upon receipt of a nonqualified stock option, and the Company will not be entitled to a tax deduction for such grant.

Upon the exercise of a nonqualified stock option, the option holder will generally include in taxable income, for federal income tax purposes, the excess in value on the date of exercise of the shares acquired pursuant to the nonqualified stock option over the exercise price. Upon a subsequent sale of the shares, the option holder will derive short-term or long-term gain or loss, depending upon the option holder's holding period for the shares, commencing upon the exercise of the option, and upon the subsequent appreciation or depreciation in the value of the shares.

The Company generally will be entitled to a corresponding deduction at the time that the participant is required to include the value of the shares in his income.

Restricted Shares. A participant will not have taxable income upon grant, but will have ordinary income at the time of vesting. The amount of income will equal the fair market value on the vesting date of the shares of restricted stock received minus the amount, if any, paid by the recipient. A participant may instead, however, elect to be taxed at the time of grant.

The Company generally will be entitled to a corresponding deduction at the time that the participant is required to include the value of the restricted shares in his income.

The Company shall issue in the participant's name a certificate for the shares of Common Stock associated with the award of restricted stock; however, unless otherwise provided, the certificate shall not be delivered to the participant until such shares are free of any restrictions specified by the Committee at the time of grant. Shares of restricted stock are forfeitable until the terms of the restricted stock grant have been satisfied, and shares of restricted stock may not be transferred until all restrictions have lapsed. Upon a Change of Control, the Committee may accelerate the vesting of

outstanding restricted stock, in its sole discretion.

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The Board believes it is in the Company's best interests to approve the 2013 Plan, which would allow the Company to continue to grant options, and to grant restricted stock, to secure for the Company the benefits of the additional incentive inherent in the ownership of shares of the Company's Common Stock by outside directors and to help the Company secure and retain the services of outside directors.

Recommendation of the Board of Directors

THE BOARD OF DIRECTORS RECOMMENDS A VOTE TO APPROVE THE FALCONSTOR SOFTWARE, INC., 2013 OUTSIDE DIRECTORS EQUITY COMPENSATION PLAN

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

PROPOSAL NO. 3

The accounting firm of KPMG LLP has been selected as the independent registered public accounting firm to audit the Company's consolidated financial statements for the fiscal year ending December 31, 2013. Although the selection of accountants does not require ratification, the Audit Committee of the Board of Directors has directed that the appointment of KPMG LLP be submitted to stockholders for ratification due to the significance of their appointment by the Company. If stockholders do not ratify the appointment of KPMG LLP, the Audit Committee will consider the appointment of another independent registered public accounting firm. A representative of KPMG LLP, which served as the Company's independent registered public accounting firm for the fiscal year ended December 31, 2012, is expected to be present at the Meeting and, if he so desires, will have the opportunity to make a statement, and in any event will be available to respond to appropriate questions.

Principal Accountant Fees and Services

Fees for services rendered by KPMG LLP for the years 2012 and 2011 fell into the following categories:

Audit Fees: Fees billed for professional services rendered by KPMG LLP for the audits of the Company's consolidated financial statements as of and for the fiscal years ended December 31, 2012 and 2011, and the reviews of the interim condensed consolidated financial statements included in the Company's Form 10-Qs during such fiscal years. These fees also include (i) statutory audits of certain Company subsidiaries, and (ii) audits of internal control over financial reporting, required under Section 404 of the Sarbanes-Oxley Act of 2002. The 2011 audit fees include \$16,000 for additional audit fees related to 2011, but billed and paid during 2012.

Audit Relate Fees: Fees billed for professional services rendered by KPMG LLP for (i) agreed-upon procedures relating to the XBRL-tagged data of the Company's Quarterly Reports on Form 10-Q and Annual Report on Form 10-K in 2012 and 2011, (ii) registration statement on Form S-8 in 2011, and (iii) Securities and Exchange Commission comment letter in 2011.

Tax Fees: Fees billed for tax-related services rendered by KPMG LLP to the Company.

All Other Fees: Fees billed for on-line resource tools provided by KPMG LLP for the years 2012 and 2011.

The approximate fees for each category were as follows:

Description	Years Ended December 31,	
	2012	2011
Audit Fees	\$ 645,993	\$ 625,487
Audit Related Fees	\$ 78,500	\$ 124,000
Tax Fees	\$ 3,391	\$ 3,417
All Other Fees	\$ 1,792	\$ 1,792

The Audit Committee has considered whether the provision by KPMG LLP of the services covered by the fees other than the audit fees is compatible with maintaining KPMG LLP's independence and believes that it is compatible.

Recommendation of the Board of Directors

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE SELECTION OF THE INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM.

Audit Committee Pre-Approval Procedures. The Audit Committee has adopted the following guidelines regarding the engagement of the Company's independent registered public accounting firm to perform services for the Company:

For audit services (including statutory audit engagements as required under local country laws), the independent registered public accounting firm will provide the Audit Committee with an engagement letter during the first quarter of each year outlining the scope of the audit services proposed to be performed during the fiscal year. If agreed to by the Audit Committee, this engagement letter will be formally accepted by the Audit Committee at a meeting of the Audit Committee.

The independent registered public accounting firm will submit to the Audit Committee for approval an audit services fee proposal after acceptance of the engagement letter.

For non-audit services, Company management will submit to the Audit Committee for approval (during the second quarter of each fiscal year) the list of non-audit services that it recommends the Audit Committee engage the independent registered public accounting firm to provide for the fiscal year. Company management and the independent registered public accounting firm will each confirm to the Audit Committee that each non-audit service on the list is permissible under all applicable legal requirements. In addition to the list of planned non-audit services, a budget estimating non-audit service spending for the fiscal year will be provided. The Audit Committee will approve both the list of permissible non-audit services and the budget for such services. The Audit Committee will be informed routinely as to the non-audit services actually provided by the independent registered public accounting firm pursuant to this pre-approval process.

To ensure prompt handling of unexpected matters, the Audit Committee delegates to the Chair the authority to amend or modify the list of approved permissible non-audit services and fees. The Chair will report action taken to the Audit Committee at the next Audit Committee meeting.

The independent registered public accounting firm must ensure that all audit and non-audit services provided to the Company have been approved by the Audit Committee. The Company Controller will be responsible for tracking all independent registered public accounting firm fees against the budget for such services and report at least annually to the Audit Committee.

Audit Committee Report

The Board of Directors appoints an Audit Committee each year to review the Company's financial matters. Please see the Audit Committee discussion in the Board of Directors section, above, for a discussion of the Audit Committee.

The Audit Committee meets with KPMG LLP (the Company's independent registered public accounting firm) and reviews the scope of their audit, report and recommendations. The Audit Committee members reviewed and discussed the audited consolidated financial statements as of and for the fiscal year ended December 31, 2012 with management. The Audit Committee also discussed all matters required to be discussed by Statement of Auditing Standards No. 61, Communication with Audit Committees, as currently in effect, with KPMG LLP. The Audit Committee received the written disclosures and the letter from KPMG LLP as required by Independence Standards Board Standard No. 1 Independence Discussions with Audit Committees, as currently in effect, and has discussed the independence of KPMG LLP with representatives of such firm.

Based on their review and the discussions described above, the Audit Committee recommended to the Board of Directors that the Company's audited consolidated financial statements be included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, to be filed with the SEC.

Audit Committee
Steven Fischer (Chair)
Irwin Lieber
Barry Rubenstein

SOLICITATION STATEMENT

The Company will bear all expenses in connection with the solicitation of proxies. In addition to the use of the mail, solicitations may be made by the Company's regular employees, by telephone, telegraph or personal contact, without additional compensation. The Company will, upon their request, reimburse brokerage houses and persons holding shares of Common Stock in the names of the Company's nominees for their reasonable expenses in sending solicited material to their principals.

STOCKHOLDER PROPOSALS

In order to be considered for inclusion in the proxy materials to be distributed in connection with the next annual meeting of stockholders of the Company, stockholder proposals for such meeting must be submitted to the Company no later than November 30, 2013.

On May 21, 1998 the SEC adopted an amendment to Rule 14a-4, as promulgated under the Securities and Exchange Act of 1934, as amended. The amendment to Rule 14a-4(c)(1) governs the Company's use of its discretionary proxy voting authority with respect to a stockholder proposal, which is not addressed in the Company's proxy statement. The amendment provides that if the Company does not receive notice of the proposal at least 45 days prior to the first anniversary of the date of mailing of the prior year's proxy statement, then the Company will be permitted to use its discretionary voting authority when the proposal is raised at the annual meeting, without any discussion of the matter in the proxy statement.

With respect to the Company's 2014 Annual Meeting of Stockholders, if the Company is not provided notice of a stockholder proposal, which has not been timely submitted, for inclusion in the Company's proxy statement by February 13, 2014, the Company will be permitted to use its discretionary voting authority as outlined above.

OTHER MATTERS

So far as now known, there is no business other than that described above to be presented for action by the stockholders at the Annual Meeting, but it is intended that the proxies will be voted upon any other matters and proposals that may legally come before the Annual Meeting or any adjournment thereof, in accordance with the discretion of the persons named therein.

ANNUAL REPORT

The Company has sent, or is concurrently sending, to all of its stockholders of record as of March 15, 2013 information on how those stockholders may access a copy of the Company's Annual Report for the fiscal year ended December 31, 2012. Such report contains the Company's audited consolidated financial statements for the fiscal year ended December 31, 2012.

By Order of the Board of Directors,

Seth R. Horowitz
Secretary

Dated: Melville, New York
March 29, 2013

The Company will furnish a free copy of its Annual Report on Form 10-K for the fiscal year ended December 31, 2012 (without exhibits) to all of its stockholders of record as of March 15, 2013 who will make a written request to Mr. Louis J. Petrucelly, Chief Financial Officer, FalconStor Software, Inc., 2 Huntington Quadrangle, Suite 2S01, Melville, New York 11747.

EXHIBIT A

FalconStor Software, Inc.

2013 Outside Directors Equity Compensation Plan

- (1) Purpose. The FalconStor Software, Inc. 2013 Outside Directors Equity Compensation Plan (the “Plan”) is established effective as of the 15th day of March, 2013, (the “Effective Date”) to create additional incentive for the non employee directors of FalconStor Software, Inc., a Delaware corporation, and any successor corporation thereto (collectively referred to as the “Company”) to promote the financial success and progress of the Company and any present or future parent and/or subsidiary corporations of the Company. For purposes of the Plan, a parent corporation and a subsidiary corporation shall be as defined in sections 424(e) and 424(f) of the Internal Revenue Code of 1986, as amended (the “Code”).
- (2) Administration. The Plan shall be administered by the Board of Directors of the Company (the “Board”) and/or by a duly appointed committee of the Board having such powers as shall be specified by the Board. Any subsequent references herein to the Board shall also mean the committee if such committee has been appointed and, unless the powers of the committee have been specifically limited, the committee shall have all of the powers of the Board granted herein, including, without limitation, the power to terminate or amend the Plan at any time subject to the terms of the Plan and any applicable limitations imposed by law. The Board shall have no authority, discretion or power to select the non-employee directors of the Company who will receive options or be granted shares of restricted stock under the Plan, to set the exercise price of the options granted under the Plan, to determine the number of shares of common stock to be granted under option or the time at which such options are to be granted, to establish the duration of option grants, to determine the number of shares of restricted stock to be granted or the time at which such shares of restricted stock are to be granted or to alter other terms or conditions specified in the Plan, except in the sense of administering the Plan subject to the provisions of the Plan. All questions of interpretation of the Plan, of any options granted under the Plan (an “Option”) or of any restricted stock granted under the plan (“Restricted Stock” and together with the Options, an “Award”) shall be determined by the Board, and such determinations shall be final and binding upon all persons having an interest in the Plan and/or any Award. Any officer of the Company shall have the authority to act on behalf of the Company with respect to any matter, right, obligation, or election which is the responsibility of or which is allocated to the Company herein, provided the officer has apparent authority with respect to such matter, right, obligation, or election.
- (3) Eligibility and Type of Awards. Awards may be granted only to directors of the Company who, at the time of such grant, are not employees of the Company or of any parent or subsidiary corporation of the Company (“Outside Directors”) or who had served as an Outside Director within 12 months of the date of grant and who are serving as a consultant to the Company as of the date of the grant. Options granted to Outside Directors shall be nonqualified stock options; that is, options that are not treated as having been granted under section 422(b) of the Code. A person granted an Option is hereinafter referred to as an “Optionee”. A person granted Restricted Stock is hereinafter referred to as a “Grantee” (and together with the Optionees, the “Participants”). Notwithstanding anything contained herein, no Participant may take any action that is prohibited by the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated by the Securities and Exchange Commission or any other agency thereunder.

- (4) Shares Subject to Awards. Options shall be for the purchase of shares of authorized but unissued common stock or treasury shares of common stock of the Company (the “Stock”), subject to adjustment as provided in paragraph 8 below. The maximum number of shares of Stock which may be issued or granted under the Plan shall be Four Hundred Thousand (400,000) shares. Should any Option or share of Restricted Stock expire or be canceled prior to its exercise or vesting in full or should the number of shares of Stock to be delivered upon the exercise or vesting in full of an Option or share of Restricted Stock be reduced for any reason, the shares of Stock theretofore subject to such Option or share of Restricted Stock may be subject to future Options or shares of Restricted Stock under the Plan.
- (5) Terms, Conditions and Form of Options. Options granted pursuant to the Plan shall be evidenced by written agreements specifying the number of shares of Stock covered thereby, in substantially the form attached hereto as Exhibit A (the “Option Agreement”), which written agreement may incorporate all or any of the terms of the Plan by reference and shall comply with and be subject to the following terms and conditions:
- a. Option Exercise Price. The exercise price per share of Stock subject to an Option shall be the fair market value of a share of the Stock on the close of business on the date of the granting of the Option as reported on the Nasdaq Global Market. To the extent that the Stock of the Company is not listed on the Nasdaq Global Market but is listed on a securities exchange other than the Nasdaq Global Market, the fair market value per share of Stock shall be the closing price on such exchange on the date of granting of the Option. If the Stock of the Company is not listed on the Nasdaq Global Market or another exchange, fair market value shall be the mean between the closing bid and asked prices of publicly traded shares of Stock in the over the counter market, or, if such bid and asked prices shall not be available, as reported by any nationally recognized quotation service selected by the Company, or as determined by the Board of Directors in a manner consistent with the provisions of the Code. If the date of the granting of an Option does not fall on a day on which the Stock of the Company is trading on the Nasdaq Global Market, other securities exchange or the over the counter market, the date on which the Option exercise price shall be established shall be the last day on which the Stock of the Company was so traded prior to the date of the granting Option.
- b. Exercise Period and Exercisability of Options. An Option granted pursuant to the Plan shall be exercisable for a term of ten years. Options granted pursuant to the Plan shall first become exercisable on the day (the “Initial Vesting Date”) which is one year from the date on which the Option was granted. The Option shall first be exercisable on and after the Initial Vesting Date and prior to termination of the Option in an amount equal to the number of Option Shares multiplied by the Vested Ratio (as hereinafter defined) as set forth below, less the number of shares previously acquired upon exercise of any portion of the Option.

The “Vested Ratio” shall mean, on any relevant date, except as otherwise provided herein, the ratio determined as follows:

	Vested Ratio
(i) Prior to Initial Vesting Date:	0
On Initial Vesting Date, provided the Optionee’s Service has not terminated prior to such date:	1/3
Plus	
(ii) For each Year of the Optionee’s continuous Service from the Initial Vesting Date until the Vested Ratio equals 1/1, an additional:	1/3

For purposes of the Plan, “Service” shall mean the Optionee’s service with the Company or a parent or subsidiary corporation of the Company, whether in the capacity of an employee, a director or a consultant. The Optionee’s Service shall not be deemed to have terminated merely because of a change in the capacity in which the Optionee renders Service to the Company or a parent or subsidiary corporation of the Company, provided that there is no interruption or termination of the Optionee’s Service. For purposes of the Plan, “Year” means the lesser of (i) the time period between regular annual meetings of stockholders of the Company, provided such meetings are held more than three hundred (300) days apart, and (ii) three hundred and sixty five (365) days.

c. Termination of Optionee. In the event of an Optionee’s termination of Service for any reason other than as a result of death or disability of the Optionee, in which case all Options that have become vested will remain exercisable for the earlier of 36 months or the expiration date of the Options, all Options that have not become vested and exercisable as of the date of such cessation of Service shall be forfeited and to the extent that such Options have become vested and exercisable as of such date, such Options must be exercised, if at all, within ninety (90) days after the Optionee’s termination of Service, after which time such Options shall automatically terminate; provided, however, in the event an Optionee ceases being a director because the Optionee’s Service was terminated for cause, all Options granted hereunder (whether vested or unvested) shall terminate immediately.

- d. Payment of Option Exercise. Payment of the exercise price for the number of shares of Stock being purchased pursuant to any Option shall be made (i) in cash, by check, or cash equivalent, (ii) by the assignment of the proceeds of a sale of some or all of the shares being acquired upon the exercise of an Option (including, without limitation, through an exercise complying with the provisions of Regulation T as promulgated from time to time by the Board of Governors of the Federal Reserve System), (iii) by the delivery to the Company of shares of Stock which have been owned by the holder of the Option for more than six months and which have an aggregate value equal to such exercise price, or (iv) by any combination thereof. The Company reserves, at any and all times, the right, in the Company's sole and absolute discretion, to establish, decline to approve and/or terminate any program and/or procedure for the exercise of Options by means of an assignment of the proceeds of a sale of some or all the shares of Stock to be acquired upon such exercise or the delivery of previously owned shares of Stock.
- e. Transfer of Control. Notwithstanding any provision in this Plan, in the event there is a Change in Control (as defined below), all unvested Options shall immediately vest. The Company may, in its sole discretion also determine that, upon the occurrence of a Change in Control, each outstanding Option (whether vested or unvested) shall terminate within a specified number of days after notice to the Participant, and each such Participant shall receive, with respect to each such Option, an amount in cash per Option (whether vested or unvested) then held, which is the difference between the full exercise price of each such Option and the greatest of (i) the average price per share paid in connection with the Change in Control if such control was acquired by the payment of cash or the then fair market value of the consideration paid for such shares if such control was acquired for consideration other than cash, (ii) the price per share paid in connection with any tender offer for shares of the Company's Common Stock leading to a Change in Control, or (iii) the mean between the high and low selling price of such stock on the Nasdaq Global Market or other market on which the Company's Common Stock is then traded on the date of the Change in Control.

For purposes of the Plan, a Change in Control shall be deemed to have occurred if:

- i. An acquisition (other than directly from the Company) of any voting securities of the Company (the “Voting Securities”) by any “Person” (as the term “person” is used for purposes of Section 13(d) or 14(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), immediately after which such Person has “Beneficial Ownership” (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of more than fifty percent (50%) of (1) the then-outstanding shares of common stock of the Company (or any other securities into which such shares of common stock are changed or for which such shares of common stock are exchanged) (the “Shares”) or (2) the combined voting power of the Company’s then-outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred pursuant to this paragraph (i), the acquisition of Shares or Voting Securities in a “Non-Control Acquisition” (as hereinafter defined) shall not constitute a Change in Control. A “Non-Control Acquisition” shall mean an acquisition by (a) an employee benefit plan (or a trust forming a part thereof) maintained by (A) the Company or (B) any corporation or other Person the majority of the voting power, voting equity securities or equity interest of which is owned, directly or indirectly, by the Company (for purposes of this definition, a “Related Entity”), (b) the Company or any Related Entity, or (c) any Person in connection with a “Non-Control Transaction” (as hereinafter defined);
- ii. The individuals who, as of the Effective Date, are members of the board of directors of the Company (the “Incumbent Board”), cease for any reason to constitute at least a majority of the members of the board of directors of the Company or, following a Merger (as hereinafter defined), the board of directors of (x) the corporation resulting from such Merger (the “Surviving Corporation”), if fifty percent (50%) or more of the combined voting power of the then-outstanding voting securities of the Surviving Corporation is not Beneficially Owned, directly or indirectly, by another Person (a “Parent Corporation”) or (y) if there is one or more than one Parent Corporation, the ultimate Parent Corporation; provided, however, that, if the election, or nomination for election by the Company’s common stockholders, of any new director was approved by a vote of at least two-thirds of the Incumbent Board, such new director shall, for purposes of the Plan, be considered a member of the Incumbent Board; and provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of an actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the board of directors of the Company (a “Proxy Contest”), including by reason of any agreement intended to avoid or settle any Proxy Contest; or

iii.

The consummation of:

1. A merger, consolidation or reorganization (1) with or into the Company or (2) in which securities of the Company are issued (a “Merger”), unless such Merger is a “Non-Control Transaction.” A “Non-Control Transaction” shall mean a Merger in which:
 - a. the stockholders of the Company immediately before such Merger own directly or indirectly immediately following such Merger at least fifty percent (50%) of the combined voting power of the outstanding voting securities of (x) the Surviving Corporation, if there is no Parent Corporation or (y) if there is one or more than one Parent Corporation, the ultimate Parent Corporation;
 - b. the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such Merger constitute at least a majority of the members of the board of directors of (x) the Surviving Corporation, if there is no Parent Corporation, or (y) if there is one or more than one Parent Corporation, the ultimate Parent Corporation; and
 - c. (no Person other than (1) the Company, (2) any Related Entity, or (3) any employee benefit plan (or any trust forming a part thereof) that, immediately prior to the Merger, was maintained by the Company or any Related Entity, or (4) any Person who, immediately prior to the Merger had Beneficial Ownership of twenty percent (20%) or more of the then outstanding Shares or Voting Securities, has Beneficial Ownership, directly or indirectly, of twenty percent (20%) or more of the combined voting power of the outstanding voting securities or common stock of (x) the Surviving Corporation, if fifty percent (50%) or more of the combined voting power of the then outstanding voting securities of the Surviving Corporation is not Beneficially Owned, directly or indirectly by a Parent Corporation, or (y) if there is one or more than one Parent Corporation, the ultimate Parent Corporation;
2. A complete liquidation or dissolution of the Company; or
3. The sale or other disposition of all or substantially all of the assets of the Company and its subsidiaries taken as a whole to any Person (other than (x) a transfer to a Related Entity, (y) a transfer under conditions that would constitute a Non-Control Transaction, with the disposition of assets being regarded as a Merger for this purpose or (z) the distribution to the Company’s stockholders of the stock of a Related Entity or any other assets).

Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the “Subject Person”) acquired Beneficial Ownership of more than the permitted amount of the then outstanding Shares or Voting Securities as a result of the acquisition of Shares or Voting Securities by the Company which, by reducing the number of Shares or Voting Securities then outstanding, increases the proportional number of shares Beneficially Owned by the Subject Persons; provided, that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Shares or Voting Securities by the Company and, after such share acquisition by the Company, the Subject Person becomes the Beneficial Owner of any additional Shares or Voting Securities and such Beneficial Ownership increases the percentage of the then outstanding Shares or Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

f. Stockholder Approval. No Option may be granted pursuant to the Plan prior to obtaining stockholder approval of the Plan.

g. Transferability of Options.

i. Except as provided in paragraph 5(g)(ii), an Option may be exercised during the lifetime of the Optionee only by the Optionee or the Optionee’s guardian or legal representative and may not be assigned or transferred in any manner except by will or by the laws of descent and distribution or as otherwise required by law.

ii. Notwithstanding the foregoing, with the consent of the Board, in its sole discretion, an Optionee may transfer all or a portion of the Option to: (i) an Immediate Family Member (as defined below), (ii) a trust for the exclusive benefit of the Optionee and/or one or more Immediate Family Members, (iii) a partnership in which the Optionee and/or one or more Immediate Family Members are the only partners, or (iv) such other person or entity as the Board may permit (individually, a “Permitted Transferee”). For purposes of this paragraph 5(g)(ii) “Immediate Family Members” shall mean the Optionee’s spouse, former spouse, children or grandchildren, whether natural or adopted. As a condition to such transfer, each Permitted Transferee to whom the Option or any interest therein is transferred shall agree in writing (in a form satisfactory to the Company) to be bound by all of the terms and conditions of the Option Agreement evidencing such Option and any additional restrictions or conditions as the Company may require. Following the transfer of an Option, the term “Optionee” shall refer to the Permitted Transferee, except that, with respect to any requirements of continued Service or provision for the Company’s tax withholding obligations, such term shall refer to the original Optionee. The Company shall have no obligation to notify a Permitted Transferee of any termination of the transferred Option, including an early termination resulting from the termination of Service of the Original Optionee. A Permitted Transferee shall be prohibited from making a subsequent transfer of a transferred Option except to the original Optionee or to another permitted Transferee or as provided in paragraph 5(g)(i).

- h. Re-Pricing of Options / Replacement Options. The Company shall not re-price any Options or issue any replacement Options unless the Option re-pricing or Option replacement shall have been approved by the holders of a majority of the outstanding shares of the Company.
- i. Time for Granting Options. All Options shall be granted, if at all, within three years from the Effective Date.
- (6) Terms and Conditions of Restricted Stock: Restricted Stock awarded pursuant to the Plan shall be evidenced by written agreements specifying the number of shares of Restricted Stock covered thereby, in substantially the form attached hereto in Exhibit B (the "Restricted Stock Agreement"). Grants of Restricted Stock shall be subject to the following conditions and shall contain such additional terms and conditions (including provisions relating to the acceleration of vesting of Restricted Stock upon a Change in Control), not inconsistent with the terms of the Plan, as the Board shall deem desirable:
- a. Grant and Vesting. The Restricted Stock shall be granted at such time as is determined by the Board. Such Restricted Stock shall have the same Vested Ratio as is provided under Section 5(b) hereto.
- b. Grantee Rights. A Grantee shall have no rights to an award of Restricted Stock unless and until Grantee accepts the award within the period prescribed by the Board. After acceptance and issuance of a certificate or certificates, as provided for below, the Grantee shall have the rights of a stockholder with respect to Restricted Stock subject to the non-transferability and forfeiture restrictions described in Section 6(e) below.
- c. Issuance of Certificates. The Company shall issue, in the Grantee's name, a certificate or certificates for the shares of Restricted Stock associated with the award promptly after the Grantee accepts such award.
- d. Delivery of Certificates. Unless otherwise provided, any certificate or certificates issued evidencing shares of Restricted Stock shall not be delivered to the Grantee until such shares are free of any restrictions specified by the Board at the time of grant.
- e. Forfeitability, Non-Transferability of Restricted Stock. Shares of Restricted Stock are forfeitable until the terms of the Restricted Stock grant have been satisfied. Shares of Restricted Stock are not transferable until the date on which the Board has specified such restrictions have lapsed. Unless otherwise provided by the Board at or after grant, distributions in the form of dividends or otherwise of additional shares or property in respect of shares of Restricted Stock shall be subject to the same restrictions as such shares of Restricted Stock.

- f. Transfer of Control. Upon the occurrence of a Change in Control as defined in Section 5(e), all outstanding shares of Restricted Stock shall immediately vest.
- g. Termination of Grantee. In the event the Grantee ceases to be an Outside Director or otherwise associated with the Company for any other reason, all shares of Restricted Stock theretofore awarded to him which are still subject to restrictions shall be forfeited and the Company shall have the right to complete a blank stock power. The Board may provide (on or after grant) that restrictions or forfeiture conditions relating to shares of Restricted Stock will be waived in whole or in part in the event of termination resulting from specified causes, and the Board may in other cases waive in whole or in part restrictions or forfeiture conditions relating to Restricted Stock.
- (7) Authority to Vary Terms. The Board shall have the authority from time to time to vary the terms of the Option and Restricted Stock Agreements either in connection with the grant of an individual Option or Restricted Stock or in connection with the authorization of a new standard form or forms of Awards; provided, however, that the terms and conditions of such revised or amended standard form or forms of stock option agreement shall be in accordance with the terms of the Plan. Such authority shall include, but not be limited to, the authority to grant Options which are immediately exercisable subject to the Company's right to repurchase any unvested shares of Stock acquired by the Participant on exercise of an Option in the event such Participant's service as director of the Company is terminated for any reason.
- (8) Effect of Change in Stock Subject to Plan. Appropriate adjustments shall be made in the number and class of shares of Stock subject to the Plan, the number of shares to be granted under the Plan and to any outstanding Options or shares of Restricted Stock and in the Option exercise price of any outstanding Options in the event of a stock dividend, stock split, recapitalization, reverse stock split, combination, reclassification, or like change in the capital structure of the Company.
- (9) Termination or Amendment of Plan. The Board, including any duly appointed committee of the Board, may terminate or amend the Plan at any time; provided, however, that without the approval of the stockholders of the Company, there shall be no increase in the total number of shares of Stock covered by the Plan (except by operation of the provisions of paragraph 8 above). In any event, no amendment may adversely affect any then outstanding Option, or any unexercised portion thereof, without the consent of the Participant. It is the intention of the Board that the Plan comply strictly with the provisions of Section 409A of the Code and Treasury Regulations and other Internal Revenue Service guidance promulgated thereunder (the "Section 409A Rules") and the Board shall exercise its discretion in granting awards hereunder (and the terms of such awards), accordingly. The Plan and any grant of an award hereunder may be amended from time to time (without, in the case of an award, the consent of the Participant) as may be necessary or appropriate to comply with the Section 409A Rules.

(10) Taxes.

- a. The Company may make such provisions as it may deem appropriate, consistent with applicable law, in connection with any Options or Restricted Stock granted under the Plan with respect to the withholding of any taxes (including income or employment taxes) or any other tax matters.
- b. If any Grantee, in connection with the acquisition of Restricted Stock, makes the election permitted under Section 83(b) of the Code (that is, an election to include in gross income in the year of transfer the amounts specified in Section 83(b)), such Grantee shall notify the Company of the election with the Internal Revenue Service pursuant to regulations issued under the authority of Code Section 83(b).

(11) Government Regulations. The Plan, and the grant and exercise of Options or Restricted Stock hereunder, and the obligation of the Company to sell and deliver shares under such Options and Restricted Stock shall be subject to all applicable laws, rules and regulations, and to such approvals by any governmental agencies, national securities exchanges and interdealer quotation systems as may be required.

(12) General Provisions.

- a. Certificates. All certificates for shares of Stock delivered under the Plan shall be subject to such stop transfer orders and other restrictions as the Board may deem advisable under the rules, regulations and other requirements of the Securities and Exchange Commission, or other securities commission having jurisdiction, any applicable Federal or state securities law, any stock exchange or interdealer quotation system upon which the Stock is then listed or traded and the Board may cause a legend or legends to be placed on any such certificates to make appropriate reference to such restrictions.
- b. Employment Matters. Neither the adoption of the Plan nor any grant or award under the Plan shall confer upon any Participant who is a director, continued service as a director, with the Company or a Subsidiary, as the case may be, nor shall it interfere in any way with the right of the Company or any Subsidiary to terminate the service of any of its directors at any time.
- c. Limitation of Liability. No member of the Board, or any officer or employee of the Company acting on behalf of the Board, shall be personally liable for any action, determination or interpretation taken or made in good faith with respect to the Plan, and all members of the Board and each and any officer or employee of the Company acting on their behalf shall, to the extent permitted by law, be fully indemnified and protected by the Company in respect of any such action, determination or interpretation.
- d. Registration of Stock. Notwithstanding any other provision in the Plan, no Option may be exercised unless and until the Stock to be issued upon the exercise thereof has been registered under the Securities Act of 1933, as amended, and applicable state securities laws, or are, in the opinion of counsel to the Company, exempt from such registration in the United States. The Company shall not be under any obligation to register under applicable federal or state securities laws any Stock to be issued upon the exercise of an Option granted hereunder in order to permit the exercise of an Option and the issuance and sale of the Stock subject to such Option, although the Company may in its sole discretion register such Stock at such time as the Company shall determine. If the Company chooses to comply with such an exemption from registration, the Stock issued under the Plan may, at the direction of the Committee, bear an appropriate restrictive legend restricting the transfer or pledge of the Stock represented thereby, and the Board may also give appropriate stop transfer instructions with respect to such Stock to the Company's transfer agent.

(13)

Governing Law. The validity, construction, and effect of the Plan and any rules and regulations relating to the Plan shall be determined in accordance with the internal laws of the State of Delaware, without giving effect to principles of conflicts of laws, and applicable federal law.

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